

Let's Talk About Commissions

By Kareen Kinzli Larsen

Realtor at RE/MAX Alliance

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Real estate commissions made national news recently when a jury in Kansas City, Missouri awarded the plaintiffs, Sitzer/Burnett, \$1.78 billion in damages against the National Association of Realtors and co-defendants including Home Services of America and Keller Williams. RE/MAX and Anywhere Real Estate were named in the suit but settled prior to the trial. As a result, many copycat lawsuits are popping up across the country. The plaintiffs claimed that the defendants conspired to keep real estate commissions high and that commissions paid to the buyer's broker are not clearly known by the buyers. While we will not know the true outcome and ramifications of this case for several years, as the defendants plan to appeal, it is important to understand how commissions are paid and learn how our local Northern Colorado MLS is well ahead of the curve as many of the complaints in this lawsuit have already been addressed locally.

How are commissions paid?

Generally speaking, if a seller lists a property with a licensed real estate professional, the seller agrees upon the amount of commissions that will be paid to the listing company and what services will be offered in exchange for those commissions. Additionally, the seller agrees upon an amount for the listing company to pay a buyer's broker. Technically, the seller pays the listing company, and the listing company pays the buyer's broker. This buyer's broker commission is advertised by the listing company in the Multiple Listing Service (MLS).

At the heart of the lawsuit is a National Association of Realtors rule that requires a buyer's broker commission be offered to list the property in the MLS system. Most MLS systems nationwide are owned by local Realtor organizations, and therefore, governed by the National Association of Realtors and this rule. It is important to note, there has never been a rule on the amount of the cooperating broker commission. Real estate commissions have always been and will always be negotiable. In fact, our local MLS allows \$0.00 to be offered to the buyer's broker when a property is listed for sale.

What is the history behind sellers paying real estate commissions?

To understand the current system, we must understand how buyer's brokers evolved. While I can't speak to individual states rules or the exact specifics of the Sitzer/Burnett case, I can tell the history for home buyers in Colorado. Prior to 1994, the Colorado Real Estate Commission only allowed real estate brokers to be agents for the sellers. The buyer's broker was considered a sub-agent of the seller and owed all fiduciary responsibility to the seller alone. Since both the listing broker and the buyer's broker were representing the seller, the seller paid the commissions. In 1994, after acknowledging that buyers required representation, the Colorado Real Estate Commission created Buyer Agency. This allowed for a buyer's broker to represent the interest of a buyer, even though the commissions were paid by the seller, thus creating the system we have today.

Why do the sellers pay the buyer's broker commissions?

Most buyers feel it is imperative to enlist the help of a qualified real estate broker to help them through the home buying process. For most people, this is the most expensive and impactful purchase they will ever make, and they want assistance to avoid costly mistakes. Real estate brokers bring tremendous value to buyers. They are experts in the area knowing zoning issues, local and state ordinances affecting real estate, common condition problems and requirements for the sale of real estate. They help buyers understand and comply with the real estate contract. Real estate brokers counsel, negotiate, and research on behalf of the buyer. They assist with lending, inspections, appraisals, and closing details, and countless unexpected issues that arise during a transaction.

Sellers realize that most buyers will be working with a licensed real estate professional. Sellers understand that for a buyer to purchase a property the buyer must have a down payment, funds for inspections, additional funds for closing costs, and may even need funds to repair or improve the property after purchase. Most buyers, especially first-time home buyers, do not have excess funds to pay their buyer's broker. If a seller doesn't offer to pay a buyer's broker commission, the buyer would have to pay their broker directly, and many just simply don't have the funds or the ability to do this. However, buyers want representation by a qualified broker.

Real estate commissions cannot be financed as part of a buyer's loan, and in fact, VA (veteran) buyers are prohibited from paying any commissions as part of a real estate transaction if they are obtaining a VA loan. If a Seller offers to pay the buyer's broker commissions out of the total proceeds at closing, their property becomes more attractive to buyers working with a broker because it reduces the amount of money the buyer needs upfront to purchase the home.

Are the Buyer and Seller aware of the commissions being paid?

Commissions, to both listing broker and buyer's broker, are very apparent to the sellers because they are discussed and agreed upon in the initial listing agreement and they are clearly stated on the seller's settlement statement at closing. Most brokers discuss commissions with their buyers upfront, however, if commissions are not discussed, it is a little harder for buyers to know the numbers. The seller paid buyer's broker commissions are not listed on the buyer's settlement statement. Our local MLS system in Northern Colorado publishes the amount offered to buyer's brokers on their public interfacing website www.coloproperty.com, however, this practice is not consistent throughout the country. Although our local MLS system openly feeds commissions to real estate websites who pull the data, it is up to that individual website if they publish publicly the commissions offered to the buyer's broker.

Changes in the future

Although we will not know the outcome of the appeals of the Sitzler/Burnett case for some time, the real estate industry is discussing several potential changes in the future.

The National Association of Realtors may not be allowed to require an offer of compensation to the buyer's broker to list a property within a Realtor Association owned MLS. In truth, this is no different than what our local MLS is already allowing.

We may see a change to the listing agreement which changes the structure of how commissions are paid. Rather than a seller paying the listing company the full commissions and the listing company paying the buyer's broker, the sellers will pay the listing company and buyer's broker separately at closing if the seller chooses to offer a buyer's broker commission.

Currently our local MLS is publicly disclosing offers of compensation to the buyer's broker, but all MLS systems across the country, including public real estate listing sites, may be required to publish buyer broker commissions in the future. The industry may also see mandatory disclosure of buyer's broker commissions to the buyer at or before closing.

Colorado buyers may expect to see an increased insistence upon Buyer Agency Agreements from real estate brokers. This agreement defines the relationship and compensation between the buyer and the broker. Commissions are clearly agreed upon upfront, including who will pay the buyer's broker in the event the seller is not offering a buyer's broker commission.

