Real Estate Brokerage Agreements

Standard or Negotiable?

For a variety of different reasons, many people will look to real estate brokers to handle the sale of a home. Brokers can offer significantly larger reach, but sellers need to consider certain factors that can lead to unnecessary costs.

Negotiating the Brokerage Agreement

Many brokers characterize their exclusive right-to-sell listing agreement as "standard," and often the local or state Realtors association prepares a standard form. While the agreement may indeed be the *broker's* standard form, it may not be standard for the *industry*. In fact, the first rule in real estate is that everything is negotiable. A seller's leverage is dictated by their financial situation and the current state of the market — not the pre-written brokerage agreement.

The "standard form" will feature set language, typically, with blanks for such things as price, term of the listing, and commission rate. This makes some people conclude that only the items to be filled in are open for discussion or negotiation, and the remainder of the agreement must be accepted as is. This is a potentially costly mistake. Certain clauses in many brokerage agreements are not only unfair to the seller, but also do not reflect the proper role and responsibility of a real estate broker who acts as a listing agent.

Setting Criteria for the Commission

One important item to consider is the language that establishes when the commission is deemed to be earned. Often, agreements will establish a difference between the time a commission is earned and when it is payable. Technically they are two different concepts, but practically they are not. Most agreements state that the commission is payable at the closing, for an obvious reason: there is a ready source of funds available to pay it. But some agreements state that the commission is due once the broker procures "a buyer who is ready, willing, and able to purchase the property." In addition, there is often language stating that a "closing is not a prerequisite for the broker's fee being earned." These vague and unverifiable statements create a disconnect between the broker's obligation — which is to sell the property — and the broker's pay.

The Definition of "Ready, Willing, and Able." How does someone prove that a buyer is "ready, willing, and able"? Some brokers argue that a buyer meets these criteria if they sign a contract of sale. The problem is that often buyers sign contracts that depend on their ability to secure financing, pass inspections, or meet other types of contingencies — and sometimes buyers don't meet them. Ultimately, the only reliable means of definitively determining whether a buyer is ready, willing, and able is if the sale closes. We contend that the broker has not earned the commission until the following three conditions have all been met:

1. A contract of sale has been signed;
2. A closing takes place and title passes or transfers; and
3. The full purchase price is paid pursuant to the contract of sale.

The Ultimate Sale Price. Between the signing date and the closing date, certain factors can change the amount ultimately paid for the property. Many sellers offer the buyer credits off the purchase price if there are problems discovered during the inspection. These credits effectively reduce the sale price of the property — and the broker's commission should be reduced accordingly. Not all of the credits should be counted against the broker's commission, but sellers should determine whether it is justifiable to reduce the commission for certain items.

The Contract Deposit. Many brokerage agreements state that the broker is entitled to as much as 50% of the contract deposit retained by the seller in the event the buyer defaults. Retention of a contract deposit compensates the seller for damages, such as lower market value or other costs. In many instances, especially during a period of declining market values, the loss in property value from the time the contract was signed to the time of default can exceed the deposit. We believe a broker should not be entitled to any compensation when a buyer defaults because they have not fulfilled their stated function of finding a ready, willing, and able buyer.

Termination or Expiration of the Contract. Typically a broker can claim a commission if the property is sold within a reasonable time period after the agreement is terminated or expires. While this can be reasonable, it is important to stipulate all of the requirements the broker must meet in order to justify the payment. Some of those requirements should be the following:

- The broker introduced and showed the property to the buyer during the term of the agreement;
- The price and terms of sale were substantially negotiated during the term of the agreement; and
- The broker was the effective procuring cause of the sale.

A broker's continuing right to a commission after a listing has expired can hinder future marketing efforts of any new real estate brokers. To mitigate this exposure and provide sufficient incentive to the next broker, contracts should indicate that the outgoing broker can only earn a commission if the seller/owner has not employed another exclusive agent. This allows an owner to hire a different broker after expiration of the previous listing agreement without the need to list in the new brokerage agreement the potential buyers who had seen the property beforehand.

Summary

A broker's commission should be the result of their ability to:

- market,
- advertise,
- expose the property to the marketplace,
- secure an offer to buy the property,
- enter into and coordinate negotiations to sell the property,
- assist the seller in arriving at an agreement and signed contract,
- ensure the buyer fulfills their obligations, and
- bring about the transfer of title, with the seller receiving the purchase price pursuant to the contract.

These are only a few of the many issues sellers must navigate when undertaking the sale of real property. Although some states leave attorneys out of the entire process of selling real estate and instead utilize escrow companies to consummate transactions, we recommend sellers engage, or at least seek the advice of, counsel when signing any legally binding contract such as a brokerage agreement or contract of sale. Because the sale or purchase of real property may be the single largest asset transaction in your life, the advice of a knowledgeable professional may provide peace of mind — and potentially some cost savings.

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