



**Why buyers and sellers
each paying for their own
representation is the
most significant reform
that can be made today
in residential real estate**

By Greg Swann, Broker, BloodhoundRealty.com

Introduction

Here are three interesting real estate questions, two that came to me directly and one that was commended to me by [Rudy Bachraty of Trulia.com](#).

Question #1: “Potential buyers for our home (\$800K - California) have a realtor but he did not find our home for them. The buyers did and have visited both times without him. He has played no role whatever in bringing us these buyers. If we accept their offer why on earth should we give him 3% (\$24K) of our home’s equity for contributing nothing whatsoever?”

Question #2: “When looking at homes on our own and calling the listing agents ourselves to set up appointments, does that obligate us to go with the listing agent if we decide to place an offer on the property?”

Question #3: “Since the amount of work involved doesn’t really differ according to the value of the house, financially, it seems like the percentage commission would make higher prices more favorable from a buyer’s agent’s perspective. If this is the case, why would the buyer’s agent be motivated to help negotiate the price down?”

Now, there are nice, long, complicated answers for each of those questions, and nice, long, complicated answers are the very essence of a certain type of salesmanship. It’s called Tap-Dancing, and it works — at least if you’re easily confused. But here are much shorter, much more truthful answers to those three questions:

Answer #1: If you want to hang onto the buyers, you’re probably stuck paying the do-nothing agent. Grin and bear it.

Answer #2: You are not obliged to have the listing agent represent you, but he will almost certainly not agree either to compensate a buyer’s agent for you, nor to waive the buyer’s agent’s commission.

Answer #3: Ethical buyer’s agents and whores-with-hearts-of-gold do exist, but paying a buyer’s agent a percentage of the sales price is a misalignment of incentives: The buyers would rather pay less, but the buyers’ agent earns more when the buyers pay more.

Even better, here is a very short answer to all three of these dilemmas, plus dozens of others: Divorce the commissions.

Each one of these problems is caused by the insane way we compensate buyer’s agents in the residential real estate market. From the beginnings of real estate brokerage, sellers have set the amount of compensation for the listing agent, and the listing agent has set the amount of compensation for the buyer’s agent. The buyer’s agent’s incentives are misaligned with the

buyer's interests because the seller, historically, was paying the buyer's agent to get top dollar for the seller — a complete betrayal of the buyer.

Things are still done this way because nobody ever thought to change them, but the entire Rube Goldberg contraption is absurd: Sellers pay the listing agent to pay the buyer's agent to betray the seller's interest. Buyers believe they are getting real estate representation “for free,” when in fact “their” agent is being paid by the seller and the listing agent in the hope that the buyer's agent will betray the buyer — often with secret bonus payments to the buyer's agent to sweeten the pot. All of this is a massive conspiracy devised by real estate brokers to enrich themselves by defrauding consumers.

Over the course of the last two or three years, we've had a wonderful information explosion in the real estate industry. Venture capital-funded internet start-ups — I call them Realty.bots — have sprung up, providing scads of information to consumers — information that was previously more difficult to obtain. But the owners of the Realty.bots are much like consumers themselves: They understand real estate at the surface level of transactions, but they really don't know very much about what's going on at the level of real estate brokerage.

This is not a criticism. No one understands sex like a gynecologist, but when an OB/GYN's fancy lightly turns to thoughts of love, you might wince and change the subject. So while a great deal of previously undisclosed information is suddenly being shared with consumers, the most important issues in residential real estate representation are still concealed.

What are these issues? [The real estate licensing laws do not exist to provide you with consumer protection](#). They exist to “protect” you from cheaper competition. [The IRS “safe harbor” income-reporting exclusion for real estate brokers virtually assures that 90% or more of all new agents will fail within their first two years in business](#) — but not before they've had the chance to wreck the financial lives of innocent consumers with their “state-licensed” inexperience and ineptitude.

There's more, but by far the most significant “secret” issue in residential real estate is the way that buyer's agents are compensated. The current system virtually assures the betrayal of both the buyer's and the seller's interests, with this fate being avoided only by accident. Moreover, it occasions as a secondary consequence the citadel of secrets and lies known as the MLS system.

The residential real estate industry is not a true business in its present form. By means of legislative fiat and its own internal structures built on secrecy and deceit, it is a cartel — a vast conspiracy against the consumer. But of all the reforms I could name to correct this atrocious situation, the one that would make the most immediate, most consequential difference would be to divorce the real estate commissions — to restructure the way we account for funds at the closing table so that the seller pays only the listing agent and the buyer pays only the buyer's agent.

How hard would it be to effect this change? It could happen just like that — just by a change of policy by loan underwriters.

How likely is this to happen? Hide and watch.

But this is a vitally important *consumer* issue. There are a few Realtors who understand why this is so important, even if it might result in our earning less per transaction. There are similarly enlightened lenders and title reps. But for the most part, the entire real estate industry is opposed to this idea — and they're way ahead of consumers because they know the issue exists, and most consumers do not.

That's why I've put this little e-book together. It's based on a series of weblog posts I wrote in November of 2007. I've updated them here and there, but the main argument stands — and, to my knowledge, no one has been able to dispute it in even the smallest way. There is simply no way to argue that the present system of compensating Realtors is in the best interests of consumers. It serves — and is designed to serve — the real estate brokers and their agents *at the expense of the interests of consumers*.

What can be done? The best recent hope for divorcing the commissions was the Department of Justice/Federal Trade Commission lawsuit against the National Association of Realtors. Alas, that ended in an essentially-meaningless whitewash settlement. It seems plausible to me that, in due course, a judge in a real estate lawsuit will take notice that buyer's agency as it is currently practiced is in fact simply sub-agency — every agent works for the seller — in camouflage. And there's always a chance that both the NAR and the Mafia will wake up one day and forswear their criminal ways forevermore.

But don't hold your breath.

What we *can* do for now is arm ourselves with information. The sad fact is that most consumers don't even know this issue exists, and they blithely grope their way through real estate transactions, convinced to the core that their agents really are acting in their best interests. The good news is, this is often true. The bad news is, the commission structure we have right now rewards and sanctifies the persistent betrayal of Realtors' fiduciary duties to their clients.

So even though we may not be able to change anything right now, on our own, nothing will ever change until consumers learn that they must look out for their own interests in their real estate transactions.

So this is a matter of “consciousness raising.” If buyers and sellers understand how their agents are compensated, they can at least negotiate payment terms that aligns their agents' interests with their own. Simply raising the issue could provide important clues about the honesty and trustworthiness of particular agents.

If you would like to help pass this word along, you can use one of the buttons shown below to link back to this eBook. The more people who know about this issue, the greater our chances of achieving reform. To deploy one of these buttons, just copy the code you see below the button and paste it into the sidebar of your website or weblog.

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If you walked into court to defend yourself in a lawsuit, only to discover that “your” attorney was being compensated by your opponent in the dispute, you just might be able to smell a rat. As you will learn in this small book, residential real estate is a rat’s nest. With your help — and your completely justified outrage — we just might be able to clean it up.

Part I: How we got into this mess in the first place

Can we be straight with each other? I'm not a soft and subtle kind of guy, and my working assumption is that you are sick to death of being hustled — handled — lied to. We yammer all day about transparency, but if transparency is something other than old wine in a new bottle, it's time we told the truth, don't you think?

So let's start here: The National Association of Realtors, which celebrated its 100th birthday last year, is a vast and largely successful conspiracy against consumers by real estate brokers. By *brokers*, mind you, not agents, although agents are not without sin. The purpose of the National Association of Realtors is to limit — artificially, by fiat of law — the number of people to whom you might turn for help in effecting a real estate transaction. Before the NAR got real estate licensing laws passed, you could have worked with anyone: A friend, a relative, the local beautician or insurance agent. But because of real estate licensing laws, your choices are limited either to real estate brokers and their agents or attorneys. No one else can represent you in a real estate transaction, accepting compensation for their efforts, without breaking the law.

Why did the NAR do this? So that it might artificially raise the price you are obliged to pay for real estate representation. This is the conspiracy against the consumer, and it has been largely successful for the real estate brokers. The real estate licensing laws are written in such a way that the secondary victims of the NAR conspiracy are real estate agents — who fail in massive numbers — but they're on their own today. What we are talking about, in the broadest possible terms, is how the residential real estate industry can be reformed so that it is *not* a conspiracy against the consumer.

I would warn you against rebuttals that take the form of, “Yeah, but.” The “yeah” concedes the point, and the “but” seeks to muddy the waters. So brokers will read this and say, “Yeah, but licensing laws protect consumers.” This is false in its essence. The licensing laws enact a pantomime of consumer protection, but their purpose is to make sure that real estate brokers get paid whether or not consumers get what they want. [Clicking on this link](#) will take you to the Buyer Broker Agreement used in my home state of Arizona. If you take a close look at lines 10 through 27, you will see that the broker is going to get paid no matter what happens. If you get the house, the broker gets paid. But if you *don't* get the house, the broker *still* gets paid. The purpose of the real estate laws, written in their original form by the NAR and lobbied for by the NAR to this very day, is to protect the interests of real estate brokers, not consumers.

But there is still more to be learned from lines 10 through 27. What that language says is that “your” broker, as represented by “your” agent, will in fact be compensated for the work done in “your” behalf not by you but by the seller's broker. “Your” agent, who is allegedly working for you, putting your interests ahead of all others — including his or her own — will be paid for this effort by your opponent in your negotiations.

This is actually doubly insane. The person paying your agent to get you the lowest possible price for the home is the same person who is being paid by the seller to get the highest possible price for the home. You may start to think that *you* are getting screwed, having discovered that “your” agent is being compensated by the listing broker, but think about the poor seller: He is paying two brokers to pursue — at least in the abstract — antithetical goals. If you did a good job picking your agent, the seller will have paid the listing broker to pay your broker to pay your agent to *frustrate* the seller’s objective.

How could this *possibly* make sense?

The answer: It doesn’t make sense.

Not that long ago, “your” agent wasn’t your agent at all. Every agent worked as a sub-agent of the seller. The listing agent worked for the listing broker, and every agent of the listing broker worked to get the highest possible price for the seller. But every other broker in the MLS system *also* worked for the seller. And every agent of every cooperating broker worked for the seller, each one of them bound by a fiduciary duty to get the highest possible price for the seller.

From the seller’s point of view, at least, this made sense. The seller paid the listing broker to get the highest price, and the listing broker paid a portion of his commission to whomever brought in the buyer. He would have preferred it to be one of his own agents — this is called a dual agency — since his net profit on the transaction would be higher. But if another broker brought in the buyer, the listing broker would “split” his commission according to the terms provided for in the MLS. This split is called the cooperating broker’s commission or the co-broke. The essential data field of an MLS system is the co-broke.

From the buyer’s point of view, every agent working as the agent of the seller was a disaster. Luckily, buyers knew almost nothing about it. For one thing, buyers bonded with “their” agents, honestly believing that “their” agent was on their side, even though that agent was duty bound to work *only* in the seller’s interests. Still worse, many agents bonded with their buyers and actively worked in their interests, contrary to their fiduciary duty to the seller.

Can you guess what happened? Huge court battles. Buyers felt — with justice — that they had been sold a bill of goods. Sellers felt — with justice — that they had been betrayed by the people they had hired to protect them. The brokers took it in the shorts, because every sub-agent of every brokerage created an extended liability for the listing broker.

So what changed? Almost nothing. The brokers cooked up a new idea called buyer brokerage. Now, instead of representing the seller as a sub-agent of the listing broker, an agent working with buyers would represent those buyers as buyer’s agents. This was really, really good for the brokers: The extended liability for the actions of sub-agents working for other brokerages was severed. Now the broker was liable only for screw-ups by his own agents.

But isn’t buyer brokerage also good for buyers? It can be, but, practically speaking, the change was purely cosmetic. In the MLS system, the compensation for the buyer’s broker is now listed

as a buyer's broker's fee, rather than as a sub-agent's fee. The commission is still paid by the listing broker, who in turn is being paid by the seller. We went from a system that was a *de facto* con game to one that is merely insane. Is this an actual improvement? Not so much.

Consider this. When I take a listing, no matter how much I negotiate for my own compensation, I always set aside 3% for the buyer's broker. Why? Because, like most agents in my market, I don't trust buyer's agents to show my listings if I offer a lower co-broke. Even if I am taking nothing as the listing broker, which sometimes happens, I pay 3% to the buyer's broker. Even if the seller is "short" on what he owes the lender — that is, even if the seller will have to bring his own money to the closing table to get out of the loan — we're going to offer 3% as the co-broke.

This is twice wrong. First, I am determining what "your" employee is to be paid. And second, and far worse, I am betting with my own money that some substantial fraction of buyer's agents will consciously or subconsciously betray their fiduciary duty to you as the buyer over money. If I were to offer less than 3%, my listing might not sell, or might not sell as quickly, because some — certainly not all — buyer's agents would be pushing their clients into homes that paid the agent more money.

Want to go once worse? What is the purpose of a buyer's agent's bonus. The language will read like this, in a part of the MLS listing that isn't printed on the version you see: "\$1,500 bonus for successful Close of Escrow by December 15."

What does it mean? If "your" agent cajoles you into buying the seller's home and closing on time, "your" agent will get \$1,500 extra on top of the 3% commission that is already being offered. What your agent does about this is a matter of his or her own ethics, but what is the seller doing? Trying to buy "your" agent's loyalty, right?

Buyer brokerage allegedly did away with sub-agency. That's a white-wash, in my opinion. As long as the listing broker pays the buyer's broker, the buyer's broker works for the listing broker — and, hence, for the seller. But even allowing for the broker's "yeah, but" argument, the idea of the buyer's agent's bonus removes all doubt: Unless it is disclosed at the outset to the buyer and conceded in full to the buyer at Close of Escrow, a buyer's agent's bonus creates a *de facto* sub-agency. Both agents are presumed to be working to get what the seller wants, and neither agent is working to protect the buyer's interests.

What can be done about this? The answer is obvious, isn't it? In truth, it is and it isn't.

The obvious answer is for buyers to pay their own agents. If home-buyers were to pay for their own representation, they could assert much greater control over their agents. They could decide what work is to be done, when and in what quantity. And they could negotiate compensation, just like sellers do.

But the obvious answer turns out to be not so obvious after all. Buyers have never paid for their own representation before. Often, they do not have cash available to pay their real estate agent.

And the mechanisms we have used, until now, to settle up the funds in a real estate transaction do not provide for buyers to pay their own agents.

At this point the old time brokers will have advanced from “yeah, but” to thoughtful arguments like “impossible!” and “preposterous!” There are ways to solve the problems we have identified, and we’ll address them in due course.

But first we should think about the differences between buyers and sellers.

Part II: How buyers can finally take a seat at the grown-up's table

When a potential home-seller calls me to set up a listing appointment, very often the first question I will hear is, "How much do you charge?" A motivated seller is done with the house, and now all that matters is money. Sellers — usually — are practical, phlegmatic and open — if not at first then eventually — to logical persuasion.

Buyers, on the other hand, are giddy and emotional and mercurial and fun. They are on a safari to capture something big and exciting, and mere matters of finance are the farthest thing from their minds. This applies even to move-up buyers, people who are also selling their current home to buy the next one. On Friday evening, meeting about the house they are selling, they are coldly rational. On Saturday morning, shopping for the new house, they are swept away by their emotions.

Why do sellers pay the buyer's agent's commission, with or without sub-agency? Because it works. Buyers get to look at houses "for free." The agent will set up searches "for free," driving the buyers from house to house "for free." And when it comes time to write a contract, the more the buyers pay for the home, the more the buyer's agent will get paid. The seller is paying a percentage of the sales price, so the buyer's agent's pecuniary interest is aligned with that of the seller, not the buyers, his nominal clients. But — what the heck? — it's all being done "for free."

In the feast of residential real estate, buyers sit at the kiddie table and they don't even know it. If a buyer even thinks to ask who is paying for all these free gifts of information, transportation and advice, the buyer's agent will blow him off by saying, "Oh, the seller pays me." We like to think we are smart shoppers, suspicious if not outright cynical, but no one ever thinks to ask, "The seller pays you *for what?*"

There's more. Since the advent of buyer brokerage, the claim has been that listing agents and buyer's agents each represent their respective parties *as equals*. Sellers are not presumed to be better than buyers — more entitled to representation. Buyers and sellers are alleged to have equal places at the table.

If "your" agent set up an automated MLS search for you — or even just emailed listings to you — you might have thought you were seeing the complete listing. Certainly the information is much richer than the listings you will find on Realtor.com or sites like Zillow.com or Trulia.com. You might have thought to yourself, "Now, at last, I'm getting the straight dope."

Not quite. There are certain fields in an MLS listing that all MLS members are obliged to keep secret from the general public. Which fields? Rules vary from one MLS to another, but it's common for the buyer's broker's compensation to be omitted — so that you won't know how much "your" agent is getting paid. There will be a field for agents to talk to other agents that will be omitted from your listing. This is the space where a buyer's agent's bonus commission would

be offered. And the number of days the home has been on the market will not be disclosed in your version of the listing.

Whose interests are advanced by the omission of these fields from your version of the MLS listing? The seller's, to be sure, but also the listing agent's — and "your" agent's interests as they are distinguished from your own interests.

Whose interests are being betrayed by these omissions? Yours, as the buyer. MLS systems were created to market real estate for sellers, and almost nothing has changed in MLS rules to reflect the essentially specious idea of buyer brokerage. The MLS is the enduring embodiment of the idea of sub-agency, when every agent, even the one you thought of as "your" agent, represented the seller and *no one* represented the buyer. In reality, if you chose your agent well, he or she is giving you all the material facts you need to make an informed buying decision — but only by deliberately and willfully *violating* the rules of the MLS system.

You could argue that these MLS rules are just another way of infantilizing buyers, a position I would agree with. But much worse than that, these on-going rules of MLS systems are the enduring, vestigial engine of sub-agency in a real estate market where buyers are alleged to have full, fair and equal representation.

When I list a home for a seller, 90% of the work I will do for that seller will be done before the listing hits the MLS system. When I represent a buyer, the most important work I will do, if not the greatest in quantity of effort or clock-time, will be done after we have put a home under contract. In this respect, sellers have a built-in natural advantage in a real estate transaction: They have received 90% of the benefits of representation before the buyer has received any benefits to speak of. In a dual agency — one broker representing both parties — this is so much worse. The supposed equal treatment each party is to receive can never be equal. The seller is *always* ahead in this race.

But that natural advantage is nothing compared to the default advantage buyers give to sellers by not being prudent, rational, phlegmatic and logical. It is a delightful thing to buy a home, six weeks of euphoria, like being newly in love. But when the euphoria fades, too many buyers discover that they gave away far more than they had to in order to latch onto the home of their dreams.

Will the necessity of negotiating their buyer's agent's compensation make buyers more practical? Perhaps not. But if buyers have sense enough to bargain for compensation arrangements that align their agent's interests with their own objectives, rather than with the seller's, then the agent can steer them back toward reason when their minds become clouded by emotion.

This is important. Divorcing the commissions — the buyer pays the buyer's agent, the seller pays the listing agent — is potentially the most significant reform that can be made today in residential real estate. But if buyers persist in acting like goofy teenagers on a carnival midway,

they will continue to be — and they will *deserve* to be — nothing but sucker-bait for well-prepared sellers.

But even in the presence of coolly rational buyers, can the commissions actually be divorced?

Part III: The who-pays-whom of real estate is not as simple as you might have thought...

All right, let's go buy a house. I want to talk about the flow of money in a real estate transaction, and there is no better way of understanding that flow than wading right out into the middle of it all.

So let's buy a house for \$100,000. Where I live, in Phoenix, a hundred grand will get you a grungy dump. Where I grew up, in downstate Illinois, a hundred-thousand dollar house will put you among the diamond-crusted elite. Either way, it doesn't matter. We're not buying this house to live in it, but just so we can see who gets paid and how.

I want for us to buy this house with 100% financing — nothing down! — even though that kind of loan isn't as easy to get as it used to be. Even better, I want you to take 3% of the purchase price as a concession from the seller to defray your closing costs. You're going to have to put down an earnest deposit to show that you're serious, but I like \$500 for a house this cheap. Not only that, but, since there is going to be money left over from the closing costs concession, you're actually going to get your \$500 back at Close of Escrow.

Isn't that cool? You just took possession of a \$100,000 asset for not one red cent out-of-pocket. You bought a house for *nothing*. This is not a fantasy. I've done this for dozens of clients. But before you get on the phone to all your friends, telling them about your amazing financial skills, stop and think for a minute.

Did you just buy a house for nothing, or did you buy it by promising to make monthly payments for up to thirty — or forty — or fifty — years for principle, interest, taxes, insurance, HOA fees and private mortgage insurance?

Your lender pushed \$100,000 onto the closing table, but he did it on the strength of your promise to pay all that money back and then some. In essence, *you* pushed a hundred grand onto the table, just as much as if you had paid cash-out-of-pocket for the home.

Who *else* brought money to the closing table? Unless it was a short sale — the seller was “short” the amount owed on his loan for the property — the only person who brought *any* money to the closing table was you. You even paid that 3% “contribution” from the seller, borrowing 3% extra so you could give it to the seller so the seller could give it back to you. Everyone sitting at the closing table — including you! — is going to get paid, but every single dollar of those payments will have come from your money.

Consider just that 3% contribution for closing costs. It's a nice solution for buyers who have no cash, but it can also be a painless way to extract an extra 3% in discounted price from a seller who refuses to go any lower on the nominal purchase price. The buyers end up borrowing more, but the incremental interest costs on a loan they may hold for less than five years can be marginal

compared to the utility of having 3% of the purchase price available as cash at the time they are moving. Everything is a trade-off, and a clever buyer's agent can structure an offer in such a way that you get the best overall value in your current financial circumstances.

But suppose you were going to pay your own closing costs out of pocket. Would you have paid the same price for the house? The seller's "contribution" nets out to a 3% discount on the house — actually a little less than 3% allowing for other costs. If you weren't going to take this "contribution," you would certainly offer less for the home. So if you *had* taken the "contribution," who — *in reality* — would have paid your closing costs?

This little pantomime — you borrow more to give more to the seller so that the seller can give it back to you — is how we get this sleight of hand trick past your lender. If you are offering \$100,000 with a \$3,000 seller-funded discount, what is the *actual* value of the home? It's \$97,000, right? So why is the lender giving you \$100,000 in the form of a 100% loan? Because the lender is affecting to pretend to make-believe that your \$97,000 offer on the home is actually a \$100,000 offer. The actual flow of money — from lender to buyer to seller and back to buyer — has no physical reality. There is no actual cash changing hands. It's all bookkeeping notations. But by dancing precisely the right steps in a financial rain-dance, the lender pretends that 97% equals 100%.

But, guess what? We're not talking about seller "contributions" for closing costs. We're talking about the exact same pantomime when it is enacted to pay the listing agent's and buyer's agent's commissions.

Who brought every last dollar to the closing table? Who is paying everyone who walks away from that table with money in his or her pocket? Except in a short sale, the buyer pays for everything.

So who is paying the agents' commissions? The seller sets the gross amount of the commissions at the time the listing contract is signed. The listing agent and the seller set the amount of the buyer's agent's commission — including any bonus payments. But who actually *pays* those commissions?

I know of three different answers to that question.

The old-line brokers would argue that the seller is paying the commissions out of the accrued equity in the home. This is the accepted interpretation, and this is how lenders are able to justify the — to me absurd — pantomime of money-shuffling that is going on at the closing table. The buyer borrows \$100,000 and gives it all to the seller. The seller give \$3,000 back to the buyer's creditors in the form of closing costs. Then the seller gives \$7,000 to the listing broker, who in turn gives \$3,500 to the buyer's broker.

What's the problem?

Do you recall that the lender, in order to swallow that whopper about the seller's "contribution" to closing costs, had to make believe that 97% equals 100%? Try this on for size:

- The buyer believes the home is worth \$100,000
- The buyer's agent writes a contract reflecting a belief that the home is worth \$100,000
- The lender originates a loan predicated on the belief that the home is worth \$100,000
- The appraiser writes an opinion that that the home is worth \$100,000
- The loan underwriter approves a loan for \$100,000
- The title company prepares documents reflecting a purchase price of \$100,000

But: The seller accepts \$90,000 in trade for the home.

And: The lender is affecting to pretend to make-believe that the seller's 90% is equal to the buyer's 100%.

The "yeah, but" argument is that the seller has to pay marketing costs to sell the home. But clearly these are parasitic costs, just as the "contribution" for closing costs is parasitic. Fully ten per cent of the purchase price of the home reflects costs that do not add any value to the home. The buyer is borrowing ten per cent more than the home is actually worth in order to pay expenses that do not and cannot accrue as equity in the home. In my view, the lender is simply pretending that a home that is understood to have an actual value of \$90,000 is worth \$100,000 — all effected by sleight of hand bookkeeping.

At this point, objections will swarm around the idea of "market value." The claim is that you will be obliged to pay the prevailing market value for the home regardless of how other costs are calculated. But, as we have seen, you would certainly offer less for the home if you were not taking the seller's "contribution" for closing costs. And, if some benevolent charity were to offer to pay both agents' commissions outside of escrow, you would offer even less. The seller might try to insist that you pay the prevailing market value anyway — in which event we would go buy a different house from a seller who understands the difference between gross and net — and how to hang onto a bird in the hand.

In fact, "market value" is twice a fiction. The *only* financial value any marketable item can have is the price agreed upon by a buyer and a seller. What we call "market value" is simply an educated guess based on recent very similar transactions. There is nothing that prevents you from offering \$50,000 for our house, and nothing that prevents the seller from accepting your offer. The value of a home is what it sold for. Period.

Moreover, our idea of "market value" is clouded by the complicated lies the lender is telling itself. In other words, almost all recent sales will have been inflated from 5% to 10% by the imputation that real estate commissions and seller "contributions" to closing costs are expressions of the value of the home, when in fact they are parasitic costs tacked on by sleight-of-hand bookkeeping.

Note that I am *not* saying that real estate agents should not be paid for their efforts. Very much the contrary. If you've read this far, you understand that real estate is a complicated enterprise. Navigating a real estate transaction without representation is a poor idea. What I *am* saying is that the method we use now to document the flow of these funds is essentially a self-deception effected by the lender. The home isn't worth \$3,000 more because the seller is allegedly paying the buyer's closing costs, and it isn't worth \$7,000 more because the seller is allegedly paying the real estate brokers.

Another way of thinking of who pays whom in a real estate transaction is to argue that the seller pays the listing agent and the buyer pays the buyer's agent. This might be useful as a metaphor, but it is nothing but a pleasant fiction in our current circumstances. In the way the funds are accounted for by the lender and the title company, the seller is paying the brokerage commissions.

And, of course, from my point of view, the buyer is paying for everything. If the buyer is paying his own closing costs, he should offer less than if he were asking for a seller "contribution." But since real estate laws are written to protect real estate brokers, not consumers, an unrepresented buyer cannot expect to extract a similar discount, even though this would be entirely reasonable.

This is a knot that won't be untied, but the good news is, it doesn't need to be. If we divorce the real estate commissions, we can do the bookkeeping in such a way that the seller definitely *does* pay the listing agent, while the buyer definitely *does* pay the buyer's agent.

This is from [an essay I wrote on this topic in July of 2007](#):

To effect the divorced commission in the overwhelming majority of transactions, all that is necessary is for lenders to change their underwriting guidelines, making corresponding changes in the way they illustrate the flow of funds on the HUD-1 settlement statement.

Right now, many lenders will allow up to 7% in sales commissions, to be charged against the seller's side of the HUD-1, with up to 3% in closing costs, also charged against the seller's side of the HUD-1.

If lenders changed their guidelines, such that no more than 3.5% could be charged against the seller for the compensation of the listing agent, with no more than 3.5% charged against the buyer for the compensation of the buyer's agent, the commissions would be divorced.

So far, this is nothing more than a change in underwriting guidelines and HUD-1 accounting. Absolutely *nothing* has changed away from the paper-shuffling lender universe. The costs to the buyer and the proceeds to the seller are exactly the same.

Not to rock too many boats at once, but it would also be possible for lenders to make their internal procedures and the HUD-1 bookkeeping more honest, putting a little extra money in the pockets of both buyer and seller.

In the chart shown below, the first column illustrates the current procedure. The middle column shows how commissions can be divorced while retaining the psychotic style of accounting lenders currently deploy. The third column demonstrates how commissions can be divorced using accounting that is consonant with what is *really* going on.

Illustrating the Divorced Commission
Primary Purchase Loan with 100% financing

The way things are done now \$100,000 Full Purchase Price using psycho lender math	Divorced commissions \$100,000 Full Purchase Price using psycho lender math	Divorced commissions \$93,500 Full Purchase Price using honest math
3% Closing Costs (charged against Seller)	3% Closing Costs (charged against Seller)	3% Closing Costs (charged against Buyer)
Up to 7% Realtor Commissions (charged against Seller)	Up to 3.5% Buyer's Agent's Commission (charged against Buyer credited back from Seller)	Up to 3.5% Buyer's Agent's Commission (charged against Buyer)
	Up to 3.5% Listing Agent's Commission (charged against Seller)	Up to 3.5% Listing Agent's Commission (charged against Seller)
100% of funds – \$100,000 paid by Buyer's Lender Net to seller ~90% of Full Purchase Price – ~\$90,000	100% of funds – \$100,000 paid by Buyer's Lender Net to seller ~90% of Full Purchase Price – ~\$90,000	100% of funds – \$99,577.50 paid by Buyer's Lender Net to seller ~96.5% of Full Purchase Price – ~\$90,227.50

Two points to take away:

First, divorcing the commissions will impose no new financial burdens on buyers. To the contrary, taking control of their agent's compensation should empower them to pay less and/or get more overall value from their representation.

Second, in reality, divorcing the commissions can be effected simply and instantly, by the voluntary and unilateral action of mortgage loan underwriters. If they choose to insist on either column two or column three, as shown above, column one will be gone overnight.

And now it's time for the lenders to issue a "yeah, but."

“Yeah,” they will say, “but we will only loan against real property, not to pay the buyer’s agent or the buyer’s closing costs.” Which is to say the deliberately self-deceptive psycho lender math in column one is fine, but the exact same transaction expressed honestly — as a reflection of what is really and truly happening in real estate transactions all across America — is not acceptable.

This is absurd. The real estate commissions could be divorced tomorrow if lenders would insist on being told the truth instead of being willfully complicit in millions of new lies told every year.

The real estate commissions could be divorced tomorrow if the National Association of Realtors would impose a *real* code of ethics, one that forbade any member to participate in any real estate transaction where one party pays even one cent to the other party’s representative.

The real estate commissions could be divorced tomorrow if the Federal Department of Housing and Urban Development were to insist, via the RESPA guidelines, that the HUD-1 settlement statement reflect the actual flow of funds in a real estate transaction and not the inane lies the lenders insist on telling themselves.

In reality, the real estate commissions will be divorced when the Department of Justice, the Federal Trade Commission or a heavy-gaveled judge orders that they be divorced.

That’s a shame, because the rectitude of the matter is beyond all doubt. Some home sellers might want things to go on as they have, since sellers have such huge and unfair advantage in the present circumstance. Surely all home buyers, at least those who have read this eBook, want for the commissions to be divorced at once. But we are each of us sometimes sellers and sometimes buyers, and our best long-term interests are served by creating compensation systems for real estate representation that are equitable — and that align “our” agents’ interests with our own.

This is but one of many salutary benefits that can be achieved by divorcing the real estate commissions. We will take note of some of the others in Part IV.

Part IV: Divorcing the real estate commissions will result in benefits not just for buyers but also for their agents and for the real estate market as a whole

The National Association of Realtors was embroiled, until just lately, in a protracted anti-trust suit brought by the United States Department of Justice and the Federal Trade Commission. The case in a nutshell: The NAR had been attempting to use MLS rules to stifle lower-priced competition.

Recall that the NAR is a conspiracy against consumers. Its purpose is artificially to limit access to real estate representation, so that consumers will have to pay more than they might otherwise for real estate advice. The cause of action in the DOJ/FTC suit was a move by old-line brokers against young-turk brokers *within* the NAR. The trade organization stood accused of deliberately frustrating the objectives of *its own* members.

What is the essential data field in an MLS system — do you remember? It's the co-broke. Everything else is just details. Every true MLS system exists so that real estate brokers can communicate — in presumptive secrecy — how much they will pay when a co-operating broker procures a buyer for a particular listing.

Can you think of one simple thing the NAR could have done to have caused the DOJ/FTC anti-trust suit to evaporate in an instant?

How about... divorcing the real estate commissions...?

Do you think that might have worked?

Remember that the MLS system is a vestigial engine of sub-agency, designed from the outset to advance the home seller's interests — at the expense of the home buyer's interests.

If we were to divorce the real estate commissions, the co-broke field would go away and with it the entire edifice of the top-secret MLS system.

Does this mean homes would no longer be listed? Of course not. But home listing would become a free-market business — with no anti-consumer rules on what material facts can and cannot be disclosed to buyers.

Without doubt there will be a shake-out period, with conflicts among vendors, errors of judgement, etc. — just as in any competitive marketplace. This will occasion much lamentation — before, during and after — starting with “yeah, but” and proceeding from there to “if it ain't broke”, “the Tower of Babel” and on and endlessly on. In fact, we could not be undertaking this

change at a better time. Data-processing technology has advanced to the point that any problems of coordination among listings vendors will be resolved in short-order.

And *when* the listings marketplace shakes out, we will have the most comprehensive real estate listings databases ever devised. All of the represented listings will be cataloged, but so, too, will all of what formerly would have been *unrepresented* listings.

Except that there might not *be* any unrepresented listings. The low-cost, limited-service brokerages — another target of the NAR — face one nearly-insuperable objection right now: The co-broke. Do away with the co-broke and you may also do away with the For-Sale-By-Owner marketing plan.

Even if not, buyer's agents will no longer need to fear FSBO sellers. Their compensation will be paid by the buyer, no matter what the seller might be doing.

In the same respect, buyer's agents need not fear short sales. In a true short sale — the seller can't pay what he owes — the seller's lender will often try to limit the real estate commissions to be paid at close of escrow. The listing agent might still have to bite the bullet, but the buyer's agent's compensation will be totally unrelated to the seller's obligations to his lender.

The flip side of this is that listing agents will have nothing to gain from unrepresented buyers. The listing agent's compensation will be the same no matter how the buyer comes represented. There is still a peril of dual agency — a lister talking an unrepresented buyer into a dual representation. Divorcing the commissions will not by itself do away with dual agency, more's the pity, but I would consider it a true expression of ethics if the NAR were to forbid it in its Code of Ethics.

But even if buyers do enter into a dual agency, they will have acquired the right to negotiate compensation. As much as I might think dual representation is a poor idea, it may well be that a savvy buyer will negotiate a dual agency that advances his interests better than any other arrangement could.

And buyer's agents will no longer have to worry that their clients might wander off the reservation. More and more, buyers are taking matters into their own hands. Interesting looking structure? "I'll call the number on the sign." Open house? "Let's just take a quick peek." Model homes? "I want to see the kitchens." These are a buyer's agents nightmares, right now. The doctrine of procuring cause says that the real estate agent who was with your buyer when they decided to buy gets paid for procuring their patronage, even if that agent doesn't represent the buyer. If the true buyer's agent is scrupulous, he will now help his wayward clients complete their transaction for nothing.

What if the agent is not scrupulous? In our current circumstances, he will either abandon the client or try to sabotage the transaction, neither of which are in the buyer's interests. With luck, divorcing the commissions will drive most of the unscrupulous agents out of the real estate

business, but the way we do business now encourages and rewards unsavory behavior on the part of both buyer's agents and listing agents.

But how will buyers even know the difference? This is a common objection, one that is not without merit. As we discussed, buyers are often swept up by their emotions. They care about their future home, not mundane details. So how will they even know that the commissions have been divorced?

Because their agents will tell them, that's how. The way things are done now, a buyer's agent's pecuniary interests are best served by buyers being drunk on emotion. The buyer's agent wants to pick you up, show you some houses, get you to fall in love with one, and only *then* start talking about agency, representation, fiduciary duties — and compensation. Why then? Because you're not listening. You're in love with your new home, and you're waiting for all this "blah, blah, blah" to wind down so you can sign a big check and move in.

This is not in your best interest as a buyer, but divorcing the commissions will induce your agent to have that "blah, blah, blah" conversation before you ever see a house. Why? Because your buyer's agent will not have established *that* he is getting paid until he has worked out with you *how* he is to be paid. Will this cause buyers to be as serious as sellers already are about how much they are being charged? We can hope. But it is certain that it will cause buyer's agents to induce buyers to talk seriously about agency, representation, fiduciary duties — and compensation — before any other work is done.

It seems likely to me, in the long run, that as buyers become aware that they are paying for their own representation, they will become much better informed about what they are paying for. A skilled investor, for instance, may want an experienced agent to double-check his math and to supervise the inspections and repairs. Is that worth 3% of the purchase price? Not likely. Owner-occupants, on the other hand, may want — and will need to pay for — far more service. A party relocating from out-of-state may need and may be willing to pay for the kinds of concierge services most agents don't even offer right now.

In a truly free market — no secrets, no lies, no sleight-of-hand accounting tricks to dupe buyers into thinking that buyer representation is "free" — many variations of services and compensation plans will arise. This is already the case with seller representation — just as it is already the case in every other sort of business, for goodness' sake!

In due course, buyers and agents will learn to create compensation plans that align the agent's interests with the buyer's interests, providing incentives to the agent to deliver the best possible service to the buyer.

And, best of all, there will no longer be buyer's agent's bonuses paid by the seller in order to induce the buyer's agent to betray his fiduciary duty to his client.

Divorcing the real estate commissions will be a wrenching change. It's really nothing in bookkeeping terms, as we have seen. But people fear change, and this is a change that will

almost certainly result in a loss of income for real estate brokers. But, amazingly enough, it turns out that people don't buy and sell homes in order to enrich real estate brokers — or mortgage lenders or title companies. Divorcing the commissions is beyond all possible doubt the best thing that can be done for consumers, and that argument alone is sufficient reason to have done it already.

But nothing is that simple, alas. Socrates knew that chattel slavery was evil, a fact not one human being in all of history needed to be told. And yet it took us 2,500 years to eradicate most — not even all — human slavery. If the respondent in a lawsuit were paying for the plaintiff's attorney, I think each one of us might be able to sniff out the injustice. I don't think anyone can miss it in real estate, either, particularly not when I've gone through everything in so much detail, from so many different directions.

But, just to be sure, in Part V, we will take up some objections I have heard to divorcing the real estate commissions. And just to make things fun, we will talk about some positions I think opponents of divorced commissions would have to take in order to make their case.

Part V: Why arguments for the current method of compensating real estate agents and against divorcing the real estate commissions must fail

When first I wrote these essays, the National Association of Realtors was preparing for its annual convention, to be held in America's playground, Las Vegas, Nevada. Last year marked the 100th anniversary of the founding of the NAR, so that milestone was to be part of the festivities. Can you guess what *wasn't* on the program?

You guessed it. Not one session or event was devoted to an earnest discussion of divorcing the real estate commissions, reconfiguring the way we account for funds at Close of Escrow so that sellers pay only their own agents and buyers pay for their own representation. I think it would be accurate to say that the NAR likes things the way they are, but it would probably be still more accurate to say that divorcing the commissions is not even on the NAR's radar.

Why not? That's for you to decide, but the most common "yeah, but" objection you will hear to divorcing the commissions, among real estate professionals, is, "Yeah, but buyers don't even care who pays the commission."

I wrote this series of essays so you would know why it is important for the real estate commissions to be divorced. But assuming I have failed in this objective, let me endeavor now to help you understand why this matters:

In our current buyer's market, some sellers are offering 4%, 5%, even 6% buyer's agent's commissions. Some new home builders are offering 8%, 12%, 16%. The highest buyer's agent's commission I have heard so far is 20%.

You as the buyer bring or borrow every dollar that gets paid to anyone in a normal real estate transaction, so it is possible that you could end up writing a mortgage check every month with twenty cents of every dollar going to cover what you unwittingly paid for "your" agent. That's twenty cents of every dollar of principal payment, but also twenty cents of every dollar of *interest* — and taxes, and insurance and private mortgage insurance.

If buyer brokerage means anything, then it means that you employ "your" agent. But you do not employ anyone if you do not control that person's compensation. If "your" employee can skim 20% of the value of your home behind your back, then "your" employee is a con-man and *you* are his mark.

And maybe *that's* why the NAR doesn't want to talk about this issue...

Here's the way it really is: To defend that status quo — the seller allegedly paying the buyer's broker's commission as a split of the listing broker's commissions — you have to defend it at its

worst. *Why* would a builder offer a 20% buyer's agent's commission? To get that buyer's agent to betray his own client. There is no other reason. And there is no other reason for *any* buyer's agent's bonus proffered by the seller or the listing agent. And, therefore, there is no other reason for any co-broke — for *any* payment flowing from the seller to the buyer's representative. The seller is not paying to have his own objectives frustrated, and the listing agent knows all too well that paying a percentage of the purchase price as a buyer's agent's commission aligns the buyer's agent's interest with the seller's, not with his own client's interests. This doesn't mean that the buyer's agent necessarily *will* betray the buyer's interests, but the deck is surely stacked that way, and it has never in the 100-year history of the NAR ever been stacked any *other* way.

We have changed absolutely nothing from the bad old days of sub-agency *except* for the field in the MLS form we use to offer the buyer's agent's commission. From my point of view, to defend our current compensation scheme is to argue for sub-agency in its naked essence.

And thus the arguments that we hear in opposition to divorcing the real estate commissions tend to be consequentialist, often very self-servingly consequentialist.

As an example: Divorcing the commissions will cause buyers to use the listing agent for the home they want, rather than a buyer's agent. If we stipulate this, what's the problem? If the buyers got what they wanted in the way they wanted it, whose ox is gored? Oh, it's the would-have-been buyer's agent, operating on the presumption that people buy and sell homes so that he can get paid. In fact, buyers need representation in order to find the home they want, to qualify for a loan, to negotiate the purchase, to supervise inspections and repairs, to marshal the escrow process, etc. If *some* buyers are able to handle some or all of this work on their own, then those people are being substantively over-charged by the way we do things now.

Another argument is that buyers are so completely infantile that they cannot or will not consider paying for representation. Recall that the listing agent's compensation is almost always the *first* thing on a potential seller's mind. And yet buyers, alike unto sellers in every physiological and psychological respect, just can't catch on to the idea of paying for what they get. I think this is absurd, but, again, stipulate it. Where is the downside? People buy cars every day without representation. The salesperson works for the dealer, and no one is even *pretending* to be "your" representative. Could you get a better deal with professional advice? Would the value of that advice exceed its cost? That's a tough question, isn't it? Does a would-be professional advisor have a claim on a percentage of the price of your car whether you want his involvement or not?

There is one argument I have heard that is at least worth attending to. Harken back to this chart:

Illustrating the Divorced Commission

Primary Purchase Loan with 100% financing

The way things are done now \$100,000 Full Purchase Price using psycho lender math	Divorced commissions \$100,000 Full Purchase Price using psycho lender math	Divorced commissions \$93,500 Full Purchase Price using honest math
3% Closing Costs (charged against Seller)	3% Closing Costs (charged against Seller)	3% Closing Costs (charged against Buyer)
Up to 7% Realtor Commissions (charged against Seller)	Up to 3.5% Buyer's Agent's Commission (charged against Buyer credited back from Seller)	Up to 3.5% Buyer's Agent's Commission (charged against Buyer)
	Up to 3.5% Listing Agent's Commission (charged against Seller)	Up to 3.5% Listing Agent's Commission (charged against Seller)
100% of funds – \$100,000 paid by Buyer's Lender Net to seller ~90% of Full Purchase Price – ~\$90,000	100% of funds – \$100,000 paid by Buyer's Lender Net to seller ~90% of Full Purchase Price – ~\$90,000	100% of funds – \$99,577.50 paid by Buyer's Lender Net to seller ~96.5% of Full Purchase Price – ~\$90,227.50

The full purchase price of the home in column three is \$93,500, where the same home would be valued at \$100,000 in our current circumstances. In other words, in divorcing the real estate commissions, we could experience a one-time paper write-down in the evaluation of residential real estate of between 3% and 6.5% — a reflection of the buyer's side of the parasitic marketing costs now speciously considered to be part of the home's market value. This is a *paper* write-down, meaning it has no monetary consequence until a particular home is sold. Even then, the seller's net financial results will be the same or even slightly more, while the buyer's costs would be the same or slightly less. But even so, in order to stop telling lies at the closing table, there could be a one-time hit to the presumed paper value of American real estate.

Are the benefits to be realized from divorcing the real estate commissions worth the costs? I think so.

But what if you say otherwise? What *else* are you saying?

In Part I of this series of essays we discussed the reasons why the idea of buyer brokerage is in many respects simply a camouflage for on-going sub-agency. In order to endorse continuing to pay real estate commissions the way we are doing it now, I think you are endorsing the willful deception of home-buyers.

We talked in Part II about the many ways that the current method of compensating agents, and the systems built to support that method of compensation, infantilizes buyers, simultaneously deceiving them about who pays the buyer's agent's commission and deliberately withholding from them material facts about the biggest financial investment in their lives. Again, I think that to uphold this compensation scheme, you necessarily make yourself party to this systemic

conspiracy of deception and non-disclosure, with the only alternative being the willful violation of MLS rules.

In Part III we took up the financial sleight-of-hand undertaken by lenders to justify paying real estate commissions and buyer's closing costs *as if* they are represented in the value of the home, rather than being ancillary parasitic costs. We demonstrated how easy it would be to achieve the exact same outcomes without deception. In consequence, I think that to continue to advocate the present system of compensating agents, you would have to assert that it is in some way preferable or to the buyer's best interest to tell obvious lies on the HUD-1 Settlement Statement, rather than expressing the flow of funds truthfully.

Part IV of this argument detailed all of the many benefits that will accrue to buyers, particularly, to their agents, and to the real estate marketplace as a whole, as a result of divorcing the real estate commissions. Not only can we eliminate the anti-consumer secrecy policy of the MLS system, we can build much more comprehensive inventories of home listings. On top of all that, the hostility and fear that have governed the so-called "co-operative" relations among real estate brokers will be eliminated from real estate transactions. And again, in order to oppose divorcing the real estate commissions, I believe that you are obliged to argue that not only are these many benefits *not* beneficial to consumers, but also that the many stark defects we have identified with the present system of compensating agents are not only *not* defects but are in fact even *more* beneficial to consumers than the benefits we have named here.

Finally, here in Part V, we have demonstrated everything this is absurd about arguments in support of paying real estate commissions the way we do now and arguments against divorcing the real estate commissions.

In fact, the most likely case to be made is that nothing will change. So far, the *only* interested parties are the real estate brokers, and their self-identified interest is to limit access to representation and to frustrate real competition even *among* real estate brokers in order to sustain the highest attainable price for real estate representation. *Until* consumers come to understand that divorcing the commissions is the only way to align the interests of buyer's agents, especially, with their clients, the NAR will not reform itself from within. My expectation is that we will have to wait for either yet another DOJ/FTC anti-trust suit or some other court action to force a change. This is sad, since it means that the NAR will have assured its own irrelevance by failing to act for justice without being compelled.

Even so, by now we *all* know what is truly just in real estate representation. There are two or three other reforms I could name that would help to turn residential real estate into an honest business, instead of a half-camouflaged con-game constantly apologizing for itself. But the reform that will make the biggest difference, the most immediate difference and the most enduringly consequential difference is divorcing the real estate commissions, with the seller paying only the listing broker and the buyer paying only the buyer's broker. If we can champion and ultimately enact only one reform to the real estate business, divorcing the real estate commissions is the one that matters most.