

Paragraph 12 and Broker Compensation Agreements

Broker compensation can be structured in various ways. Different forms may be needed depending on whether compensation is being paid by the buyer, seller, or listing broker. Paragraph 12 in the sales contract may need to be completed, and/or a separate broker compensation agreement may be required.

Paragraph 12, Settlement and Other Expenses

TREC and Texas REALTORS® recently made changes to Paragraph 12 in several sales contracts*. Paragraph 12A(1) (Seller's Expenses) and 12A(2) (Buyer's Expenses) of the sales contracts were amended to clarify that at closing each party must pay the brokerage fees they have agreed to pay. In other words, each party must pay the broker's fee that party agreed to pay in their respective listing agreement and buyer representation agreement. And Paragraph 12A(1)(b) now allows the parties to include a specific amount for sellers to pay the buyer's broker's fees directly.

*The following sales contracts were amended: One to Four Family Residential Contract (Resale) (TXR 1601); New Home Contract (Incomplete Construction) (TXR 1603); New Home Contract (Completed Construction) (TXR 1604); Residential Condominium Contract (TXR 1605); New Residential Condominium Contract (Complete Construction) (TXR 1608); New Residential Condominium Contract (Incomplete Construction) (TXR 1609); Farm and Ranch Contract (TXR 1701).

12. SETTLEMENT AND OTHER EXPENSES:

A. The following expenses must be paid at or prior to closing:

(1) Seller shall pay the following expenses (Seller's Expenses):

(a) releases of existing liens, including prepayment penalties and recording fees; release of Seller's loan liability; tax statements or certificates; preparation of deed; one-half of escrow fee; brokerage fees that Seller has agreed to pay; and other expenses payable by Seller under this contract;

(b) the following amount to be applied to brokerage fees that Buyer has agreed to pay: \$ _____ or _____ % of the Sales Price (check one box only); and

(c) an amount not to exceed \$ _____ to be applied to other Buyer's Expenses.

(2) Buyer shall pay the following expenses (Buyer's Expenses): Appraisal fees; loan application fees; origination charges; credit reports; preparation of loan documents; interest on the notes from date of disbursement to one month prior to dates of first monthly payments; recording fees; copies of easements and restrictions; loan title policy with endorsements required by lender; loan-related inspection fees; photos; amortization schedules; one-half of escrow fee; all prepaid items, including required premiums for flood and hazard insurance, reserve deposits for insurance, ad valorem taxes and special governmental assessments; final compliance inspection; courier fee; repair inspection; underwriting fee; wire transfer fee; expenses incident to any loan; Private Mortgage Insurance Premium (PMI), VA Loan Funding Fee, or FHA Mortgage Insurance Premium (MIP) as required by the lender; brokerage fees that Buyer has agreed to pay; and other expenses payable by Buyer under this contract.

Listing Broker's Compensation

Sellers will typically be responsible for paying their listing broker's compensation under the terms of the listing agreement. The listing broker should provide the title company with a Commission Disbursement Authorization form (CDA) (*supplied by the brokerage firm*) to disclose the amount of compensation being paid by the sellers.

Buyer's Broker's Compensation

Who's Paying the Buyer's Broker? Knowing the answer to this question is the key to understanding which forms are needed and how to properly complete them. Depending on how a transaction is structured, the buyer's broker may be paid directly by the buyer, directly by the seller, by the listing broker, or by any combination.

Buyer Pays the Buyer's Broker (Use a Commission Disbursement Agreement (CDA))

Buyers agree to pay their broker in the buyer's representation agreement. Under the Texas REALTORS® *Buyer/Tenant Representation Agreement* (Long Form, TXR 1501; Short Form, TXR 1507), the buyer's broker will attempt to obtain payment of their fee from the seller or listing broker. If the seller or listing broker doesn't pay the buyer's broker's fee, the buyer is still obligated to pay (*see below*).

Paragraph 7B, Residential Buyer/Tenant Representation Agreement (TXR 1501)

B. Source of Compensation: Broker will seek to obtain payment of the fees specified in Paragraph 7A first from the seller, landlord, or their agents. **If such persons refuse or fail to pay Broker the amount specified, Client will pay Broker the amount specified less any amounts Broker receives from such persons.**

The amount the buyers are paying towards their broker's fee is *not* written in the sales contract. The buyer's broker should provide the title company with a CDA to disclose the amount of compensation being paid by the buyers.

Listing Broker Pays the Buyer's Broker (Use the *Compensation Agreement Between Brokers*)

Under Paragraph 5A of the Texas REALTORS® *Residential Real Estate Listing Agreement, Exclusive Right to Sell* (TXR 1101), sellers can agree to pay the listing broker a fee that includes an amount that the listing broker will then pay the buyer's broker. Since the listing broker is paying the buyer's broker, the brokers will need to execute a broker-to-broker compensation agreement, such as the *Compensation Agreement Between Brokers* (TXR 2402). The commission Disclosure Paragraph on page 10 of the TREC sales contracts (*see below*) should also be completed with the agreed-upon compensation. The amount the listing broker is paying should *not* be included in Paragraph 12A(1)(b) in this situation. Paragraph 12A(1)(b) only includes amounts the *seller* is paying directly.

Disclosure: Pursuant to a previous, separate agreement, Listing Broker has agreed to pay Other Broker a fee (\$ _____ or _____ % of the Sales Price). This disclosure is for informational purposes and does not change the previous agreement between brokers to pay or share a commission.

Seller Pays the Buyer's Broker Directly (Use Paragraph 12A(1)(b) in the sales contract)

Under Paragraph 5B of the Texas REALTORS® *Residential Real Estate Listing Agreement, Exclusive Right to Sell* (TXR 1101), sellers have only agreed to pay their listing broker's fee. Sellers can negotiate payment of the buyer's broker's fee on a case-by-case basis in the sales contract. If the sellers agree to compensate the buyer's broker directly, Paragraph 12A(1)(b) (*see below*) should be completed with the appropriate amount. The brokers do *not* need a broker-to-broker compensation agreement because the seller is paying the buyer's broker directly through the sales contract. Likewise, the commission Disclosure Paragraph on page 10 should *not* be completed with the amount the sellers are paying. A broker-to-broker compensation agreement and the commission Disclosure Paragraph on page 10 should only be used for amounts the *listing broker* has agreed to pay.

12. SETTLEMENT AND OTHER EXPENSES:

A. The following expenses must be paid at or prior to closing:

(1) Seller shall pay the following expenses (Seller's Expenses):

(a) releases of existing liens, including prepayment penalties and recording fees; release of Seller's loan liability; tax statements or certificates; preparation of deed; one-half of escrow fee; brokerage fees that Seller has agreed to pay; and other expenses payable by Seller under this contract;

(b) the following amount to be applied to brokerage fees that Buyer has agreed to pay:
 \$ _____ or _____ % of the Sales Price (check one box only); and

(c) an amount not to exceed \$ _____ to be applied to other Buyer's Expenses.

Note: The *Compensation Agreement Between Broker and Owner* (TXR 2401) is *not* needed if 12A(1)(b) is used. Using TXR 2401 and completing 12A(1)(b) in the sales contract creates a duplicate obligation for sellers to pay those fees. TXR 2401 creates a separate contractual obligation between sellers and the buyer's broker outside of the sales contract. Use of TXR 2401 would be more appropriate in for-sale-by-owner transactions or other scenarios where compensation is agreed to outside of the sales contract.

Buyer's Broker Compensation Examples

Scenario #1. Paragraph 5A was used in the listing agreement. Therefore, the sellers agreed to pay the listing broker a fee, and the listing broker agreed to pay a portion of that fee to the buyer's broker. The amount being paid by the listing broker is not enough to cover the buyer's broker fee in the buyer's representation agreement. *The buyer is responsible for the difference.* Forms needed:

- *Compensation Agreement Between Brokers* (TXR 2402) for the amount the listing broker is paying.
- Buyer's broker should submit a CDA indicating the amount being paid directly by the buyer.

Scenario #2. Paragraph 5A was used in the listing agreement. Sellers agreed to pay the listing broker a fee, and the listing broker agreed to pay a portion of that fee to the buyer's broker. The amount being paid by the listing broker is not enough to cover the buyer's broker fee in the buyer's representation agreement. *Sellers agree to pay the difference.* Forms needed:

- *Compensation Agreement Between Brokers* (TXR 2402) for the amount the *listing broker* is paying.
- Complete Paragraph 12A(1)(b) for the amount the *sellers* are paying to the buyer's broker.

Scenario #3. Same facts as Scenario #2 but the amount the listing broker agrees to pay *and* the amount the sellers agree to pay is still not enough to cover the entire buyer's broker's fee. Forms needed:

- *Compensation Agreement Between Brokers* (TXR 2402) for the amount the *listing broker* is paying.
- Complete Paragraph 12A(1)(b) for the portion the *sellers* are paying directly to the buyer's broker.
- Buyer's broker should submit a CDA indicating the remaining amount being paid by the buyer.

Compensation for Broker When Acting as an Intermediary

As an intermediary, the broker represents both the sellers and buyers in the transaction. Both parties have agreed to compensate the broker in the listing agreement and buyer representation agreement, respectively. The seller may agree to pay the intermediary broker an amount to cover the buyer-side broker fees. Intermediary broker compensation is handled differently depending on whether Paragraph 5A or 5B was used in the listing agreement.

Under Paragraph 5A in the Texas REALTORS® *Residential Real Estate Listing Agreement, Exclusive Right to Sell* (TXR 1101), the sellers have already agreed to pay an amount towards the buyer's broker's fee. Paragraph 5A(4) states that the intermediary broker will retain the entire compensation listed in Paragraph 5A, including the compensation intended for the buyer's broker in Paragraph 5A(2). If the amount in Paragraph 5A(2) is enough to cover the entire buyer-side broker's fee, no other agreement is required. The intermediary broker is being fully compensated for both sides of the transaction. Neither Paragraph 12A(1)(b) nor the commission Disclosure Paragraph on page 10 should be completed.

Note: If the amount the sellers agreed to pay the buyer-side broker's fee in the listing agreement, Paragraph 5A(2), is *not* enough to cover the broker's fee from the buyer representation agreement, the buyer can request the sellers pay an additional amount to the intermediary broker. Paragraph 12A(1)(b) in the sales contract should be completed with this additional amount.

Under Paragraph 5B in the Texas REALTORS® *Residential Real Estate Listing Agreement, Exclusive Right to Sell* (TXR 1101), the sellers only agreed to pay the intermediary broker the seller-side broker's fee. If the sellers agree to also pay the intermediary broker for the buyer-side broker's fee, the parties should complete 12A(1)(b) of the sales contract.