

The Earnest Money Deposit

Most offers to buy a house are accompanied by a check or promissory note redeemable on the clearing of the buyer's contingencies or upon the acceptance of the buyer's offer. This check or promissory note is generally referred to as the "earnest money deposit." The basic reason for the deposit is to impress the seller that the buyer "earnestly" intends to purchase the property.

It's a good faith deposit but not to be confused with a down payment. When buyers execute a purchase contract, the contract specifies how much money the buyer is initially putting up to secure the contract, to show "good faith," and how much money all together will be deposited as a down payment. The balance is generally financed as a mortgage or a combination of mortgages.

The amount of the deposit varies from purchase to purchase, depending on a variety of factors. If a property generates a lot of interest, a buyer may make a larger deposit to convince the seller that their offer is stronger than the others. During "hot" markets, deposits are generally larger than during slow markets.

There are reasons to try and keep the deposit as small as possible, but not so small that the seller doesn't take it seriously. You see, once a buyer and seller agree to terms, the earnest money deposit is usually placed in an escrow account. At that point it is no longer the buyer's money -- it belongs jointly to the buyer and seller.

Almost all deals close and the earnest money funds are applied to the buyer's down payment and closing costs. As the saying goes, however -- there are exceptions to the rule.

Some sellers think that if the deal falls through, the earnest money deposit is automatically forfeit. Some buyers think that if the deal doesn't close, they automatically get the money back.

Neither one is true.

Even when the failure to close is the buyer's fault, the seller doesn't have a "right" to the deposit as a way to "punish" the buyer. Nor does the buyer automatically get the entire deposit back, even when they are not at fault.

First, there are normally a small amount of cancellation fees that must be paid. These fees are collected from the deposit. Second, since the deposit is held in trust, both the buyer and seller must agree on the disposition of the funds. This is a quirk of law in most states and the real estate agents and their companies have no control over the situation.

If something goes wrong very early in the deal, the seller normally understands and the deposit is usually returned to the buyer without a fuss. When things go awry later in the transaction, both parties usually exercise common sense and negotiate a fair solution. In a few rare occurrences, the buyer and seller find it difficult to agree.

The point is that it always makes sense to reach an agreement. Failure to agree ties the money up for awhile, could possibly lead to further legal action and inconvenience, and it just becomes a frustrating mess for both sides -- more so than you realize at the time.

Serious problems are the exception, not the rule. Most "challenges" are routine to a qualified professional real estate agent. The situation may be new to you, but the agent may have dealt with it many times in the past