Earnest Money (Sale Contract) Deposit

Earnest money, also known as a Good Faith Money, is a deposit made to a seller showing the buyer's good faith in a transaction. Often used in real estate transactions, earnest money is essentially a financial promise from the Buyer, show intent to purchase, but allow the buyer additional time for conducting property inspections and securing financing. It is also typically the penalty (liquidated damages) that the Buyer would forfeit, if they were to invalidate, void, or terminate the contract. Earnest money is typically held jointly by the seller and buyer in a trust or escrow account.

When a buyer decides to purchase a home from a seller, both parties enter into a contract stipulating the financial terms and timelines of the pending transaction. In most real estate contracts, there are Buyer protection clauses to allow the home to be inspected and appraised to ensure Buyer is educated, aware, and comfortable with the condition and potential uses of the property to be purchased. This timeframe can take a week, or up to 6 weeks or more if financing is involved.

To prove to the seller that the buyer's offer to purchase a property is earnest and in good faith, the buyer will be required to make an appropriate (Earnest Money) deposit into escrow.

In exchange, the seller will take the house off the market while the Buyer orchestrates the inspections and the house is professionally appraised.

Liquidated Damages

Liquidated damages are the sum a party agrees to pay if the party breaches a contract. Liquidated damages must be a good faith estimate of the actual damages anticipated by a breach. They must be reasonable in light of the anticipated or actual harm caused by the breach

Earnest Money Terms

The earnest money is usually stipulated to be collected funds (Money Order, Cashier's Check, Wired funds), and is typically due in escrow within 3 business days of acceptance of the purchase offer.

The amount of earnest money to be deposited will vary from contract to contract. As a reference however, the offered amount is often in the range of $1,000, up to 3-5% of the purchase price.

As the earnest money is one of the terms of the contract, it can be negotiated between Buyer & Seller prior to contract acceptance.

Buyers will typically consider an amount that will show their good faith, but they will also want to consider an amount that will limit their ultimate financial risk in the transaction (Liquidated Damages).

Sellers, on the other hand, will prefer a higher amount to ensure the Buyer's good faith in purchase, and to offset financial damages in case the transaction fails, due to the Buyer not performing per the contract terms.

Therefore, a Buyer should consider the financial risk, but also offer a high enough amount to get the offer accepted.

Earnest Money Deposit

The earnest money deposit is ultimately put toward the Buyer's down payment at closing. The transaction is usually finalized when all Buyer contingencies have been met and the Buyer has deposited the remainder of the required funds into escrow, or has secured funds from a mortgage for financing.

If the Sale Fails

If the deal falls through, the buyer may or may not be able to reclaim their earnest money, depending on whether the Buyer has performed to the stipulations and contingencies spelled out in the contract.

Earnest Money Refunds

The earnest money will be refunded to the Buyer if the transaction fails to complete based on various contingency clauses stipulated in a typical real estate purchase contract.

Seller Property Disclosure (An annulment?)

CC&Rs

Clear Title

Professional Inspection

Appraisal

Seller Termination

Earnest Money Forfeiture

If the transaction has failed, and the Buyer has not performed per the terms of the contract, the earnest money is subject to forfeiture to the Seller.

Earnest Money Release

In a failed transaction, escrow will typically require Buyer & Seller signed instructions stipulating who, the earnest money held in escrow, will be released to. These instructions may direct escrow to release 100% to the Buyer, 100% to the Seller, or the earnest money release could be shared between the parties.

Earnest Money Dispute

In a failed transaction, if the parties cannot agree upon who the earnest money should be released to, escrow will hold the funds in a trust account, and will typically require court order instructions to release the funds.