



Understanding Real Estate Escalation Clauses

With existing-home sales jumping 14.5%, we might see bidding wars again

The National Association of Realtors just reported that existing-home sales reversed a 12-month slide in February, registering the largest monthly percentage increase since July 2020. Remember how crazy real estate was back then?

Sure, sales are down from one-year ago, but total existing-home sales (that includes single-family homes, townhomes, condominiums and co-ops) leapt an astonishing 14.5% from January to February, at an annual rate of 4.58 million. Further, unsold inventory sits at a 2.6-month supply at the current sales pace, down 10.3% from January.

Escalation Clauses

In a competitive real estate market, buyers are often faced with the challenge of bidding against other interested parties to secure their dream home. In such scenarios, an escalation clause can provide a useful tool to help buyers stay ahead of the competition. But what exactly is an escalation clause, and when should you use one?

An escalation clause is a contractual provision that allows a buyer to increase their offer price automatically if another buyer submits a higher offer. The clause typically includes a predetermined amount that the buyer is willing to raise their bid by, up to a maximum limit. For example, a buyer may include an escalation clause that increases their offer by \$5,000 each time another buyer submits an offer higher than theirs, up to a maximum of \$550,000.

The purpose of an escalation clause is to give buyers a competitive edge in a bidding war without having to submit multiple offers manually. In a seller's market, where the demand for properties exceeds the supply, an escalation clause can help buyers stand out from the crowd and increase their chances of securing the home they want.

Things to Consider

However, there are some factors to consider before including an escalation clause in a real estate offer. First, it's essential to make sure the seller accepts escalation clauses, as not all sellers will agree to them. Additionally, the clause must be worded carefully to ensure that the buyer is not bound to pay more than the property is worth.

To determine whether an escalation clause is appropriate, buyers should consult with a real estate agent or attorney who can advise them on the local market conditions and the seller's preferences. In some cases, a buyer may opt to forego an escalation clause and instead submit their best offer upfront.

When considering an escalation clause, buyers should also be mindful of their financing options. If a buyer is relying on a mortgage to purchase the property, their lender will only approve a loan up to the appraised value of the property. Therefore, if the final sale price exceeds the appraised value, the buyer will need to come up with the difference in cash.

Location, Location, Location

An escalation clause can be a valuable tool for buyers in a competitive real estate market. However, it's essential to use them judiciously and with caution, ensuring that the clause is worded appropriately and that the buyer can afford to pay the increased amount.

By working with a trusted real estate professional, buyers can navigate the complexities of the bidding process and find the home of their dreams.