**Attorney’s Corner-Legal Tip of the Month**

**Option Payment for Due Diligence Period**

**Many of us recall the old Georgia Association of Realtors (“GAR”) Purchase and Sale Agreement where the buyer only had a right to terminate if there were material defects with the property discovered and the seller was unwilling or unable to remedy/repair those by the date of closing.   As you can imagine, this lead to heated debates and litigation as to what constituted a material defect with the property giving the buyer the right to terminate.  Was a leaky toilet a material defect?  What about a small hairline crack in a step?  And the arguments ensued!**

**Because of this problem the GAR forms committee changed the Purchase and Sale Agreement to give the buyer a due diligence period for inspection where the buyer can terminate the contract for any reason (or no reason at all).  Essentially the buyer had the option to purchase and the Purchase and Sale Agreement referenced “$10 Option Money” to be paid by the purchaser for the granting of Due Diligence (although in practice this $10 was rarely ever actually paid). While this change eliminated the arguments related to material defects and the right to terminate, it unfortunately has lead to other problematic issues in the market.  Because buyers essentially have nothing to lose by placing a property under contract, we have buyers that are not serious about purchasing place properties under contract and buyers that place multiple properties under contract, when they intend to purchase only one property.  Sellers have become increasingly frustrated with the process as they have taken their properties off the market during the hot selling season (sometimes multiple times) and ended up with nothing.**

**In an effort to address some of these issues the 2015 GAR Purchase and Sale Agreement includes a section, whereby the seller can seek option money in excess of the $10 already referenced. This additional money is NOT applied to the purchase price by default and should be considered “sunk money” unless otherwise addressed in the contract. For example, if the buyer pays the seller $1,000 option money, and the buyer discovers a crack in the foundation during inspection, the $1,000 is the seller’s money to keep.  The option money is also paid directly to the seller either by check or wire transfer as indicated in the agreement.  The relevant paragraph provides:**

**The introduction of this new provision has lead to many questions:**

**Can the buyer have the option money applied to the purchase price if they actually close on the property?**

**Yes, by special stipulation as follows:**

***Buyer and Seller agree that the $\_\_\_\_ option money referenced herein and paid by Buyer shall be applied to the purchase price at closing. If the Buyer does not close on the property, Seller shall retain the $\_\_\_ option money.***

**If a lender is involved, how will they treat the option payment?**

**While we are uncertain until we see it in practice, lenders we’ve discussed the option payment provision with think it will be treated in one of two ways:**

**1)    If the option money is not applied to purchase price, the lender will consider the payment irrelevant and not count it towards any payment related to the transaction.**

**2)    If the option money is applied to the purchase price by special stipulation and the deal reaches closing, the lender will view the option money as additional earnest money applied to the purchase price.  For this reason, the lender will also need to source the funds so be sure to keep a copy of the check or wire to the seller, documenting that the option money was paid.**

**What if the seller is unable to convey good and marketable title to the property or otherwise defaults?**

**We believe this question could be a very tricky one as the option money has already been paid to the seller and therefore very difficult to recoup.  Often times the seller is unable to actually sell the property after going binding due to title issues, divorce, bankruptcy, short sale etc.  For this reason, we recommend including the following special stipulation if you do include the payment of option money:**

***In the event of Seller default, in addition to any other remedies provided for herein, Buyer shall be entitled to an immediate and full refund of any option money paid.***

**What’s to prevent a seller from collecting multiple option money checks from different buyers?**

**Like a Purchase and Sale Agreement, a seller can only accept one option money payment from the one contract they accept.  A seller cannot give more than one person the option to buy a property at the same time.**

**What is the right amount of money to include as option money?**

**This is the magical question.  On one hand if you are offering the option money to show that you are serious about buying the home and to make your offer look stronger, you would probably think of an amount in the thousands of dollars range.  On the other hand, without having had a home inspection where anything could come up and all of the option money could be a total sunk cost, some buyers may consider an amount in the hundreds of dollars range.  Ultimately the amount to include will depend on 1) the financial ability of the buyer to put up the money knowing that they may end up just walking away from it and 2) the need to show the seller the buyer’s commitment to the deal.  We expect in multiple offer situations for option money to appear in offers to demonstrate the commitment to the deal.**

**How should we advise our buyers about the risk of option money?**

**We foresee buyers who misunderstand option money being potentially very upset with their agents if they put down a large amount of option money and then have to walk away from the deal because of something wrong with the house during the inspection.  To protect yourself as an agent where option money is paid we recommend including following special stipulation:**

***Buyer acknowledges and understands that the option money paid in Section 9 (b)(2) of this agreement is non-refundable and paid in exchange for buyer’s option to purchase the home.  Should buyer terminate the transaction during due diligence or pursuant to another contingency in this agreement they will be entitled to a refund of earnest money but NOT option money paid.  The only exception where buyer would be entitled to refund of option money is the case of seller being unable to convey good and marketable title as provided for herein.***

**Is there an additional method or alternative method of demonstrating to the seller the buyer’s commitment to the transaction besides option money?**

**In addition to or in lieu of option money it is wise for buyers to consider making the affirmative representation to the seller that they are not under contract on another property and will not be making offers on other properties during the term of the transaction if appropriate. This provision was included in previous years GAR Purchase and Sale Agreements but removed in 2014.  Obviously including this statement would not make sense if the buyer was planning to possibly buy other properties or more than one property.  But, if the buyer was buying the home as their residence it would help to demonstrate commitment to the transaction by including the following:**

***Buyer warrants that buyer is currently NOT under contract to purchase other real property. Buyer warrants that during the Due Diligence Period, buyer shall NOT enter into any other such contracts. Buyer shall be in default of the agreement if buyer breaches buyer’s warranties in this special stipulation.***

**In this *hot real estate market*, we may see sellers require buyers to pay some amount of money to take a property off the market during due diligence. There is certainly value in having a property listed during May and June! Stay tuned for other helpful tips and insight as this new provision evolves in practice.**

**Authors: Will Keyes and Whit Wood**