EARNEST MONEY: A PRIMER FOR BUYERS

Real estate agents are expected to understand and explain earnest money deposits to their clients, including why they're necessary and how they affect the home buying process. A deposit like this shows the seller that a buyer is serious—in other words, "earnest" in their intention to purchase the house.

Knowing how earnest money works is essential knowledge for both the buyer's and the seller's agents. The point of the earnest deposit is to stop would-be buyers from making offers on multiple houses they're interested in, which would result in all those properties temporarily taken off the market until the buyer commits to one of them. For this reason, it's unusual for a seller to entertain an offer on their house without it being backed up by a deposit that a buyer could lose.

If the sale proceeds successfully, the earnest money can be used for the down payment or the closing costs of the sale. It can be looked at by buyers as putting aside some funds to cover part of these later costs.

Since it is a deposit, it does mean that there are many situations that allow buyers to reclaim these funds when things don't go according to plan. A well-trained buyer's agent realizes that earnest money needs to be protected from loss.

How Much Should a Buyer Offer in Earnest Money?

Typically, the deposit required by a buyer will be between 1% and 5% of the purchase price. There are a few factors that can affect this, however, including the state of the real estate market and what the seller requests as a deposit.

A higher deposit can be required if there is a lot of demand in the local market, but on the other hand, a low deposit might be accepted if there isn't much demand. Also, the customs around earnest money vary from state to state, which makes it essential for real estate agents to educate their clients.

Some real estate agents might recommend that their clients put down a higher deposit if they think it will lead to an offer being accepted. Higher deposits could also lead to the seller being more flexible on other terms in the offer.

Agents should explain to their clients that although it is a deposit, a buyer will not see their money again for perhaps a few months. Smart real estate agents will check with their clients to make sure holding the earnest money will not put undue pressure on the buyer's finances.

What Happens to the Earnest Money Deposit?

New real estate agents should understand that when an offer has been accepted, a purchase agreement for the house will be executed. This agreement should state who is going to be holding the deposit. This will normally be the title company or seller's real estate agency, who will keep it in their escrow account. The earnest money will be accounted for at the time of the closing.

If you've been a real estate agent for a while, you know that you shouldn't hand over earnest money to the seller of the house. If things don't go as planned, it could be very difficult to recover that money.

How Do Earnest Money and a Down Payment Differ?

Quite often, buyers get confused about the difference between earnest money and a down payment. It is important for real estate agents to explain the two. While they both contribute to the purchase price of the house, the earnest money is security for the seller, while a down payment is money a buyer must put towards the purchase price. The balance of a buyer's funds for purchasing a house will come from the procurement of a mortgage.

Is It Possible to Get an Earnest Money Deposit Back?

There are many situations that will allow purchasers to get their earnest money deposits back. When things go wrong, and the deal falls through, buyers should be able to get their money back most of the time.

Buyer's agents and their clients should review the terms given in the purchase agreement contract to find out exactly how refunds are dealt with. It's imperative for buyer's agents to educate their clients in these matters. There should be contingencies in the contract to allow for situations where the buyer can walk away with their deposit returned to them. Common contingencies would include finding problems with the house when it is inspected or the buyer failing to secure financing for the purchase price.

If problems are found during the home inspection, the buyer can choose to cancel the offer, renegotiate the price, or have the seller rectify the problem before they proceed. If the buyer is not able to proceed with the sale because they cannot get the financing, they also would be able to get their earnest money returned.

Real estate agents should educate and inform their clients what contingencies are in place in the contract, so that they are fully aware of what protections they have during the sales process.

Can You Lose Your Earnest Money Deposit?

A buyer's agent should always inform their clients they absolutely can lose their earnest money deposit—otherwise, what would be the point of having one? Real estate agents should remind their buyer clients they can forfeit their earnest money when they don't pay attention to the terms of the contract.

Here are the most common ways buyers can lose their deposit:

- They don't respond in writing to the extensions they have in the contract, such as a home inspection or financing.
- They get cold feet and just walk away from the sale.
- They find another property they like better and don't proceed.
- They decided to put up a nonrefundable deposit to make their offer more attractive to the seller.

Some buyers have no idea their earnest money deposit is at risk if they violate the terms of the contract. A significant role of any buyer's agent is to explain the earnest money process. An agent should also do their utmost to protect the buyer from losing their finds. This includes reminders on any essential deadlines that must be met.

Can earnest money be deposited digitally?

Yes, and as many real estate transactions move toward digitization, electronic earnest money deposits (EMDs) are of particular interest for brokerages and agents. Earnnest, for instance, is a digital platform that allows for the secure deposits of funds from buyer directly to escrow holder. The app provides a fully digital, closed network for earnest money transactions—no physical checks required. It's also connected to more than 12,000 banks nationwide with banking-level security and encryption.

Real estate agents must always remember the fiduciary interests of their clients. In fact, it's a significant reason why dual agency is looked at unfavorably, as you don't have a fiduciary in this arrangement.

Final Thoughts on Earnest Money Deposits

Real estate agents should explain to their clients that there are situations where earnest money could be more significant. For example, a builder will usually require a buyer to put down a larger earnest money deposit. It is not uncommon for a builder to want to have 10% of the purchase price. At times, they also require the ability to use the funds and not have them held in an escrow account.

Giving funds to a builder can be somewhat risky if they are not financially sound. A buyer's agents should always advise their clients to consult with an attorney before agreeing to release earnest money to a construction company.

New agents and seasoned agents alike should always look at earnest money as the glue in a successful real estate transaction.

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