LandThink #21
February 27, 2009

Seller contingencies? What's that about?

By Curtis Seltzer
Landthink contributor

(This is the sixteenth in a series of articles about issues that sellers and buyers face when negotiating a purchase-offer contract.)

Real-estate buyers and sellers are familiar with buyer-demanded contingencies, such as a home inspection or financing, which make the purchase depend on the buyer arranging or learning something to his satisfaction, or having the seller do something to make the deal work.

In working with land and other rural property, particularly larger tracts, I've occasionally encountered sellers inserting contingencies into the buyer's purchase contract. As long as the agreement reflects a meeting of the minds between buyer and seller, a seller contingency is no different than a buyer's—satisfactory results bring the parties to a sale and unsatisfactory results void the offer without penalty.

One seller contingency in larger deals I've found is the demand for proof that the buyer has the financial resources to make the purchase. I've seen sellers ask for net-worth statements, other financials and letters from lenders indicating a willingness to go forward with the buyer.

Some sellers ask for this information as a condition of showing the property to a buyer. When a broker or seller asks a buyer to provide proof of his ability to make the purchase, I advise against complying with the request. It has always felt to me that these requests are a ploy to scope the buyer's ability to pay full asking price rather than a genuine concern over capability. I don't object to a contingency of this sort, since the parties have agreed on a contract price and the ploy angle has disappeared..

I once ran into a seller of some 9,000 acres who insisted that the buyer agree to a contingency allowing the seller to commission an appraisal at his expense and choice of appraiser. If the appraisal came in at or below the contract price, the deal would go through. If, however, the appraisal number was five percent more than the contract price, the seller reserved the right to void the agreement without penalty or allow the buyer to pay the appraisal price. My opinion was that this was simply a ruse to get more money out of the buyer—and said so. I urged the buyer to walk away.

As might be expected, the appraisal came in above the five percent number, and the buyer paid the higher price—to his ultimate chagrin. The seller had owned the property for more than a decade and could have easily gotten an appraisal prior to signing a purchase contract with this buyer. Buyers, in my opinion, should not agree to this type of seller contingency.

Several sellers have used contingencies related to getting something to work out on their side of the deal. One wanted to make the buyer's purchase contingent on being able to arrange a 1031 exchange. Another wanted the buyer's contract to depend on being able to get a contract signed for another property at a specific price, or less.

It's fair for a seller of large acreage to ask for buyer financials, especially when an unknown buyer wants a long study-period contingency, say three months or more. Sellers don't want to be strung out by a buyer who's looking to put the seller in a jam and then get the property at a discount.

Sellers, like buyers, can also use unneeded contingencies as bargaining chips with the other side, though I think this is a high-risk bargaining strategy that is likely to blow up a contract.

A seller might also use a contingency for one or more of the following reasons:

1. To give himself time to clean up some problem that he does not want to pass along to the buyer, e.g., a fence line off the surveyed boundary line, or a prescriptive-use claim by a third party. Issues of this type can produce post-sale litigation that ensnares the seller.

2. To give both parties time to work out something between them that has some importance, but both sides recognize can be resolved once a contract is in place, e.g., the value of personal property the seller has agreed to convey.

3. To demand something of the buyer, such as an increase in deposit by the end of the fourteenth calendar day of escrow.

4. To demand that the buyer perform or complete a task by a certain date.

Sellers, like buyers, should not use contingencies willy-nilly, because they're red flags to the other side. I've always found that a letter explaining the purpose of my contingencies helps smooth the reception of a contract with contingencies included.