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Home Sale Contingency – Buying and Selling Blues

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Buying the next home (when you still own another one) can be a dicey proposition. You have to know whether you must sell your current home before buying the new home or if you can buy without regard to selling. Is it a choice because your lender has assured you that you do not need the equity in the home to put towards the next and the current mortgage debt will not hinder your loan application or are you required to have your current home sold because you either need the equity and /or the do not have the income to support both mortgages? Equally important is where the new home seller will accept a contract contingent on a sale.

When you need to sell the current home, a home sale contingency rider is a document that should be attached to a contract that benefits and protects the buyer in these situations. We do not recommend using the mortgage contingency period as time to sell your home. Without agreement on that matter, the Seller can argue that unless you specifically had agreement that the home sale was part of the mortgage contingency and hold up the return of the earnest money if things do not pan out on your sale. Note that some forms of contract specifically state that Contract is not contingent on the sale of the current home.

If you are considering making an offer with a home sale contingency then there are a few questions you need to consider. The first question is what specifically does a home sales contingency involve? The terms of that rider are normally simple. The rider typically states that you own an existing property and if you do not sell and /or close on that property by a certain date, usually the date you want to buy your new property, then you may notify the Seller and the contract is cancelled and earnest money returned. You will be required to list your property within a very short period of time, as mutually agreed by both the buyer and the seller if you have not already done so. While this seems like all upside for the buyer, the contingency usually contains a provision that permits the Seller to continue marketing the property for sale. If the Seller receives an offer during that period, then the buyer usually has the right to waive the home sale contingency and all other contingencies (usually within 48 hours of the notice) and proceed with the purchase of the home.

Even if the lender will allow you to carry two properties, you must ask yourself whether making loan payments on two homes for an unknown period of time is a burden that you can handle. Also, you cannot assume you can handle both mortgages because you will have a tenant on the first home to pick up the payment burden. Lenders look at debt to income ratios and make determinations on loan approvals, in part, based on those ratios. When the ratios do not work in the buyer's favor, buyers sometimes try to rent out their existing residence thinking that the income from the existing residence will offset any problems with debt ratios. In other words the income they receive from renting the property will reduce the amount the mortgage is counted against their debt load. Unfortunately, it is not that simple. The buyer will have to provide documentation, including a history of receiving rental income, current leases, and security deposit and rent check clearance. Also, certain lending guidelines only allow lenders to attribute 75% of the rental income against their principal, interest, taxes and insurance payments for their existing home and that is only if there is at least 25%-30% equity in the home and it has been used as rental for the prior two years on the tax return. For example, if you have a monthly mortgage payment in which you also pay taxes and insurance in the amount of \$2,000 and you receive \$2,000 in rental income, those figures will not necessarily offset one another. The lender may only attribute \$1,500, or 75%, of the rental income against your monthly debt ratio, depending on current guidelines. Some lenders require a certain amount of equity in the first home as well.

If you cannot afford to own two properties at the same time and/or your lender will not approve your loan without first selling your existing property then the home sales contingency will allow you to negotiate a contract without putting your earnest money at risk if the sale of your first home does not occur.

The final question to be answered remains whether the Seller will permit a home sale rider to the contract. That question can only be answered during your initial contract negotiations with the potential Seller.