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Real Estate Contract Escalation Clauses

*An Additional Tool to Assist the Qualified Real Estate Agent
In Today's Multi-Offer Real Estate Situations*

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Currently, there is an unprecedented demand in the Florida real estate marketplace, with Seller's seizing the opportunity to sell at a time when demand is high. In fact, our law firm, along with our affiliated Title Company, Title Masters, LLC, is handling hundreds of closings this year.

For years Florida has been an area where people have purchased their retirement dream homes but, given the political climate of today, there are additional reasons people are purchasing in Florida. Numerous "blue states" are witnessing residents fleeing their states for a variety of reasons: high taxes, crime, and such "blue states" being governed in a direction that many of its citizens feel is far too progressive or socialistic.

The reality is that age-old adage, "*people vote with their feet.*" Therefore, people are flocking to Florida based upon our economy, the way our Governor, Ron DeSantis, has handled the COVID-19 crisis by protecting our most vulnerable while allowing for reasonable conduct of business, along with all of the other positive features that have people even more interested in moving to this state.

Because of this, Florida is experiencing unprecedented real estate closings. Real estate investors and real estate professionals frequently report that many properties now are being put under contract before the property has even been listed. Once listed, multiple offers are received. The result of multiple bidding situations on the same residential property (and in certain cases, commercial property), has caused agents to become more creative and aggressive in order to secure the winning contract that is accepted by the Buyer.

It is currently a reality that Florida has extremely low inventories of single-family units in the real estate marketplace, and that vacuum has to be filled by new construction. In the short term and until construction catches up with demand, most active real estate brokers and agents in the

state of Florida have recognized the challenges of getting a proposed real estate contract accepted by a Seller.

As such, our law firm and title company have received numerous inquiries from real estate brokers and agents regarding tools they can use on behalf of the Sellers and Buyers when they are faced with multiple offer situations.

A frequent request is for us to provide them with the standard “Escalation Clause” that can be utilized within their contracts. This article will address the use of the “Escalation Clause” and some of the pitfalls that can be encountered by both Seller, Buyer, and, as importantly, exposure to liability for the agents using Escalation Clauses in real estate contracts.

1. Fundamentals: What is a Real Estate Contract Escalation Clause?

A real estate Escalation Clause is a clause written into the Buyer’s offer that indicates that, under certain circumstances, the offer can be increased so as to enable the Buyer to be able to control the narrative and the Contract. Specifically, an Escalation Clause, formatted properly, indicates that the Buyer is making an offer for a sum certain and that the Buyer has a written agreement in place with the Seller in which the Seller will accept the Buyer’s offer, subject to other competing offers received during a specified time period, say 48 hours. The key to the proposal is to provide that the Buyer and Seller agree that:

- a. The sales price offered by the Buyer is acceptable subject to other offers being accepted.
- b. The Seller allows the Buyer to increase its offer by incremental sums, say \$2,000.00 increments.
- c. The Seller acknowledges that the Buyer has a ‘cap’ on its offer, as an example, \$10,000.00 over the original contract price.

2. Format for Making an Offer with an Escalation Clause and Sample Escalation Clause

Let’s use a \$400,000.00 purchase price of a single-family home as an example and assume that it involves a multi-party bidding situation.

- a. The Buyer utilizes a FARBAR As-Is Contract.
- b. In Section (20) or in a separate Addendum, the Buyer indicates the following:
“The purchase price of \$400,000.00 is the total purchase price the Buyer makes toward the purchase of the subject property. However, Seller and Buyer acknowledge and agree that if the Seller receives a bona fide, legitimate, third party arm’s length offer for an amount higher than \$400,000.00 within forty-eight (48) hours of the Buyer’s offer, then in such event Seller and Buyer agree that Buyer’s offer will automatically increase (escalate) and Buyer will increase its offer by

\$2,000.00 over the highest, bona fide, third party arm's length offer received by the Seller up to a maximum of \$10,000.00 over the best offer received by Seller within such 48 hours period."

- c. This allows for the Seller, in a multiple offer situation, to notify the Buyer that it has received a bona fide, arms-length competing offer and provides the initial Buyer to have an automatic increase of \$2,000.00 over the initial offer (using the above example). The increased amount can actually be any increment suited to the situation and that amount is subject to the willingness of the Seller and Buyer to accept the terms and conditions.

3. Pitfalls or Land Mines in Using Escalation Clauses

Escalation Clauses appear to be a simple and pragmatic approach to solving the problem. However, there are a number of pitfalls and realities involved with use of the Escalation Clause.

Initially, there has to be a cap on the Escalation Clause. Using the example above, when a Buyer has submitted an offer of \$400,000.00 and is thereafter advised by the Seller that there is a competing offer(s), the Buyer might be willing to draft an Escalation Clause in the Addendum to enhance the Buyer's offer. The offering price can escalate at a monetary increment over the highest offer at an agreed upon sum with a specified amount not to exceed as a cap. By way of example: \$2,000.00 over the best bona fide offer received by the Seller but not to exceed \$410,000.00 or a suitable maximum price the Buyer is willing to offer in the face of a multiple bidder situation.

This allows the Buyer to protect itself by requesting:

- a. a bona fide and legitimate offer and,
- b. an identification that the maximum Buyer would pay is \$410,000.00, using the example above

Keep in mind some of the inherent problems (pitfalls or landmines) inherent in this process:

- a. It has to be determined that a Seller is willing to accept a Contract with an Escalation Clause.
- b. There has to be a very tight time frame for this offer to be accepted. In other words, if this offer is submitted on Day 1, the Buyer could indicate that the Seller only has a limited period of time (48 hours as an example) within which to accept the offer with the Escalation Clause. That protects the Buyer from having a long-term period between the Buyer's offer and the Seller's acceptance of other offers.
- c. There has to be some verification process of the other offer. Keep in mind the established confidentiality of offers and the duties of agents not to disclose amounts, as well as the competing thought that the Buyer needs to know if the other offer is a bona fide and legitimate offer. One way to establish and maintain confidentiality is to have the Seller indicate and provide to the Buyer, a copy of

the Contract (redacting the information of the competing Buyer and real estate agent) demonstrating that the attached Contract is a valid offer submitted to them. By redacting the competing Buyer's information as part of the process within which the Seller notifies the initial Buyer, than under an Escalation Clause, that gives the initial Buyer the opportunity to increase its offer by the agreed upon amount over the last best offer received by Seller.

Further, keep in mind that these Contracts have to be properly and correctly drafted for each situation. Keep in mind the liability a real estate agent undertakes when drafting complicated contractual clauses. Each real estate broker and real estate agent in Florida is obligated to comply with the minimum provisions of Florida Statute §475.278 which states,

“(2) TRANSACTION BROKER RELATIONSHIP.—A transaction broker provides a limited form of representation to a buyer, a seller, or both in a real estate transaction but does not represent either in a fiduciary capacity or as a single agent. The duties of the real estate licensee in this limited form of representation include the following:

- (a) Dealing honestly and fairly;
- (b) Accounting for all funds;
- (c) **Using skill, care, and diligence in the transaction;**
- (d) Disclosing all known facts that materially affect the value of residential real property and are not readily observable to the buyer;
- (e) Presenting all offers and counteroffers in a timely manner, unless a party has previously directed the licensee otherwise in writing;
- (f) Limited confidentiality, unless waived in writing by a party. This limited confidentiality will prevent disclosure that the seller will accept a price less than the asking or listed price, that the buyer will pay a price greater than the price submitted in a written offer, of the motivation of any party for selling or buying property, that a seller or buyer will agree to financing terms other than those offered, or of any other information requested by a party to remain confidential; and
- (g) Any additional duties that are mutually agreed to with a party.” (emphasis supplied)

The question real estate brokers and agents should ask themselves is whether it is appropriate for them to draft complicated real estate contract and Escalation Clauses without the assistance of a qualified real estate attorney, and, if in doing so, what is the standard of skill, care and diligence in the transaction?

My opinion is that no matter how competent the real estate agent is, the drafting of contractual obligation exceeds the rights, duties, and obligations of a real estate agent and falls in the purview of a real estate agent practicing law and drafting contracts. This goes for real estate brokers as well, although there are some excellent real estate brokers in

Southwest Florida, many of whom, in my opinion, have the knowledge and experience to be able to draft such clauses.

A real estate broker and agent are entitled to fill in the blanks on the FARBAR forms and addendums and riders, but once the real estate agent begins drafting contractual provisions affecting the client's rights, then in such event that real estate agent should seek the advice of a qualified real estate attorney. Otherwise, that real estate agent is liable for anything that affects the client (Seller/Buyer) by the legal draftsmanship of that particular agent.

Clearly, the Escalation Clause is a clause that requires knowledge of real estate transactions along with the skill to draft an Escalation Clause that protects the clients and is clear and unambiguous when read by a third party, i.e. the Trier of Fact, in the event of any dispute.

The issues of real estate agent liability are also referenced in an article that I previously wrote on behalf of real estate agents to caution them against liability. The link of is below, and the article identifies all of the various potential causes of action against the real estate agent.

<https://www.jmlawfl.com/wp-content/uploads/sites/2868/2017/08/What-real-estate-agents-need-to-know-about-professional-liabilty-9.28.16.pdf>

This article should be referenced by agents who draft Escalation Clauses on their own without the assistance of a qualified attorney.

4. Overarching Theme

The overarching theme is that each transaction is unique and the Escalation Clause is another tool in the toolbelt for the advanced real estate agent to address the unprecedented real estate market that we are seeing in 2021. Many believe that this real estate market will extend out for quite some time based upon current market demand over supply.

As to the pitfalls of using Escalation Clauses: keep in mind that even a cursory review of the internet will demonstrate that many state realtor associations and real estate industry experts discourage the use of Escalation Clauses because of their complexity and the necessity that each transaction is contract-specific for each situation.

One of the issues brought to light by real estate experts is that an exact sale price must be agreed upon at some point to have a valid and enforceable contract. Most parties believe that to have a valid and enforceable contract in Florida, you have to use the FARBAR, the FARBAR As-Is, or some other form printed real estate contract with hundreds and hundreds of lines of contractual obligations. In fact, that is not correct. Our office has litigated cases and have actually obtained judgment for specific performance on

documents that were far less detailed than a FARBAR contract. The following key elements are essentials for the enforcement of a real estate contract:

- a. The name of both Seller and Buyer;
- b. An appropriate identification of the property;
- c. An identification of the purchase price; and
- d. A Closing date.

Other items such as who pays documentary stamps, title insurance, and the proration of taxes, etc. are simply add-ons.

The key point is that the essential elements set forth above are what make an enforceable contract. Conversely, as those key points relate to this contract, we definitely have to have an identifiable and objectively verifiable agreed upon contract amount. An Escalation Clause in a real estate contract must not be ambiguous or unclear in order to be enforceable. Remember, it needs to be objectively clear to the ultimate Trier of Fact.

Closing

As such, real estate investors and real estate professionals are warned that the use of an Escalation Clause, unless done properly, may result in an unenforceable contract and may lead to litigation, which is not consistent with the goals of Seller or Buyer, both of whom want to enter into the best contract that meets their respective needs.

- Kevin F. Jursinski, B.C.S