

The Weidenbaum & Harari, LLP Definition Series:

The Mortgage Contingency Clause

Sellers and Buyers alike often inquire as to the meaning of the “mortgage contingency clause,” one of the more significant clauses in New York real estate contracts. Simply put, a mortgage contingency clause ensures that if a buyer promptly applies for a loan from a qualified lender, but fails to obtain a firm commitment for financing within the specified time period, then the buyer may elect to cancel the contract and receive the return of the initial downpayment. It should be noted that the commitment letter should not be confused with the “pre-approval letter.” A pre-approval letter is typically a nonbinding letter of very little legal weight issued by a bank prior to conducting a more detailed investigation of the borrower and the property.

There is often a great deal of confusion in the New York real estate market as to whether a mortgage contingency clause is “necessary.” The common explanation given is that buyers should request the clause because it affords them added protection if they are applying for financing, while sellers should avoid the clause because it may result in delays caused by the buyer’s loan approval process, or by having to find a new buyer altogether in the event that the buyer in contract cancels under this clause.

Whether a mortgage contingency clause is “necessary” depends on several factors, including: (1) the financial status of the buyer; (2) the appraised value of the unit for sale; (3) in the case of co-ops and condominiums, the financial viability of the co-op or condominium community of which the unit is a part; (4) overall real estate market conditions (e.g., buyer’s market, seller’s market, lender’s market). For example, a relatively wealthy individual buying a co-op unit that appraises below the contract price and in which the bank’s underwriters are not satisfied with the financial condition of the co-op may be denied a loan, where a person with relatively less wealth buying a condo that appraises exceptionally high in a financially solid building might be approved. And in either case, the overall real estate market conditions may result in a very different reality. For example, in a “seller’s market,” a seller who has prospective buyers banging down the door with offers well above asking price will have little incentive to agree to a mortgage contingency, while in a “buyer’s market,” the same seller might have no other option but to include the contingency or lose a potential buyer.

It should also be noted that there is no “standard” mortgage contingency clause in New York, although there are a number of common clauses circulating through the industry. Some clauses act like protective bubbles that surround the buyer for a time, and then “pop” and disappear altogether once certain conditions are met. Other clauses act more like shields that guard the buyer from certain conditions throughout the entire contract process. It may be possible to find a middle ground that can will satisfy the buyer’s need for financial protection, while reassuring the seller that the contingency period will be short. Therefore, we strongly urge prospective buyers and sellers to consult with their attorneys about this clause in particular, and about the overall process of negotiating a deal from the time of offer/acceptance, to signing the contract, to closing!

Jack Harari, Esq.
Partner, Weidenbaum & Harari, LLP
212-832-7400

PLEASE NOTE: The Weidenbaum & Harari, LLP Definition Series is intended for informational purposes only and is not intended to constitute the dissemination of legal advice. Some of the legal language discussed herein is subject to negotiation between the parties involved and/or interpretation by a court of law. If you are a client of Weidenbaum & Harari, LLP, we would encourage you to speak with the attorney handling your specific transaction for further details. If you are currently represented by another attorney, we urge you to speak with your attorney. If you do not yet have an attorney, we may be able to assist you, and welcome your inquiries.