

Escalation Clause

An escalation clause is a real estate contract, sometimes called an escalator, that lets a home buyer say "I will pay x price for this home, but if the seller receives another offer that's higher than mine, I'm willing to increase my offer to y price." In theory, an escalation clause is fairly simple. In practice, there are a lot of details involved.

- What is the original offer of purchase price?
- How much will that price be escalated above any other competitive bid?
- What is the maximum amount that the purchase price can reach in case of multiple offers?

For example, buyer Brown offers \$100,000 for a home. Her Realtor adds an escalation clause that, in the case of a higher competing offer, will increase Brown's offer in increments of \$2,000 above the competing offer. Her escalation clause goes up to a maximum of \$110,000.

If no other offers are submitted, Brown's offer remains at \$100,000. If buyer Green offers the seller \$103,000, then Brown's offer would automatically escalate to \$2,000 above that, bringing Brown's offer to \$105,000. If buyer Orange offers \$111,000 for the home, then Brown's maximum of \$110,000 will be eclipsed, and Orange will have the top offer.

Will the seller accept an escalation clause?

Some home sellers simply state that they will not accept an offer with an escalation clause. They would prefer that every buyer submits exactly what they're willing to pay. Sellers sometimes prefer this method because it motivates buyers to outbid one another on the first try. It also streamlines the paperwork and the decision-making process.

Escalation clauses should only be used when the buyer is fairly confident that there will be multiple offers, or when the buyer expects to pay an escalated price. If a buyer submits an offer with an escalation clause, they're laying all their cards on table. The seller knows immediately how far the buyer will go to secure the home.

If that offer ends up being the only offer submitted, it technically remains at its original price. A Realtor representing the seller will know, however, to counteroffer to the buyer at a higher, escalated price, since the buyer is clearly willing to pay more. While there's no guarantee that the buyer will agree to the higher price, it is likely that they will. A buyer gives up a lot of negotiating power and potentially leaves money on the table when using an escalation clause that goes unmet by a competitor.

Has the seller's agent clearly stated a one-day review or multiple rounds of offers?

In hot markets, there's a wide variety of offer-review processes. Some state that the property is going on the market on Friday, and all offers will be reviewed the following Thursday. The seller and their Realtor will make a final decision that day. This situation can be ideal for the escalation clause, when a buyer knows it's an all-or-nothing offer.

Other sellers take a back-and-forth approach. They may collect offers from buyers for one week, and then respond to a handful of the best offers by saying "Send us your highest and best offer." This technique is particularly disliked by many consumers and professionals for its lack of clarity, but it's important to know that it exists.

Before writing an offer, a buyer's Realtor can inquire to feel out the details and make sure the buyer is prepared for the situation. Writing an escalation clause on the initial offer in a multistage situation could put the buyer in a weak position during the second round. It's perfectly legal for a seller's Realtor, with the seller's permission, to reveal to all potential buyers what the top initial offer is and to ask everyone to beat it. In this case, the escalation clause would flesh out that buyer's maximum, and they would lose a competitive edge.

Bid with careful confidence and know that each situation is unique

If you're considering an escalation clause, your Realtor is probably knee-deep in researching the circumstances around the seller's process of reviewing offers. The Realtor's knowledge of normal practices and probable outcomes in your market will make your offer much more likely to succeed.

Escalation clauses can cause a lot of stress for home buyers, but when they're boiled down to the basics, they're fairly straightforward. Remember to be realistic, to be comfortable with how much you're willing to offer, and to confidently go after a home at that price. Buyers shouldn't be tempted to escalate their purchase price above what they are comfortable paying. At the same time, they should realize that inventory and interest rates are low, and aggressively pursuing a good home at a good price is necessary to winning in a competitive market. Potential buyers who are only looking to get a steal often end up not being buyers at all.