

Escalation Clauses: What YOU Need to Know

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Given the fact that most of Virginia is still in a seller’s market, I would imagine that you are having to deal with escalation clauses on a not-infrequent basis.

To start off, let’s define “escalation clause.” In simple terms, an escalation clause allows a buyer to ensure that he won’t be outbid on a home, up to a set maximum price. The clause typically increases an offer by a certain amount or percentage over the highest offer received by a seller. So, for example, a buyer (let’s call him Buyer 1) might put in an offer to purchase a home for \$300,000. If he really wants the house and the market is hot, he can include an escalation clause that increases his price by \$5,000 over any other bona fide offer the seller may receive, up to a maximum of \$350,000.

In that same situation, let’s say another buyer (Buyer 2) submits an offer to purchase the house for \$325,000. Because that is under the Buyer 1’s maximum, the escalation clause would increase Buyer 1’s purchase price to \$330,000.

If, however, Buyer 2 had come in with an offer of \$350,000 or higher, Buyer 1’s escalation clause would not allow him to trump that offer. Buyer 1 would then have to either submit a new offer or hope that the seller would choose his offer anyway.

It’s important to mention that in the Virginia REALTORS® clause language (and in most other clauses around the Commonwealth), the escalation clause increases the buyer’s offer relative to other net offers. Net offers eliminate things like seller concessions to the buyer; if a potential buyer submits a \$500,000 offer but asks for \$5,000 in seller concessions, it’s really a \$495,000 offer for purposes of the escalation clause.

Our clause language requires the listing firm to provide the selling firm with a copy of the highest bona fide purchase offer, just to make sure the seller isn’t artificially inflating the price. Other contracts in the state may require a complete copy of the contract or other documentation.

Importantly, sellers are not bound by the escalation clause language. In our example above, even though Buyer 2’s offer increased Buyer 1’s price to \$330,000, the seller could counter back with some other price (be it the maximum price of \$350,000 or some other, higher number).

There are lots of things to think about when drafting and inserting an escalation clause into a contract. First, is the maximum cap that you set really a number that your buyers can live with? You should make absolutely sure that they are comfortable with that max number in the event that competing offers get it there.

You should also consider by what increments the offer should increase. Too low (say \$100) might make the seller think that the offer isn’t really serious. Too high, however, could cost your

clients money that they otherwise wouldn't have to pay. It's a delicate balance and one that will be determined by the market and the value of the home, among other things.

Let's visit some recent questions that were submitted to the [Legal Hotline](#) regarding escalation clauses:

“We made an offer with an escalation clause. The sellers selected another offer, but we agreed to be a back-up offer. The listing agent stated that the purchase price for the back-up offer should be our escalated sales price. Can they use the escalation clause in this instance?”

Escalation clauses are driven by other bona-fide offers. In the case of a back-up offer, you're stepping in because the other offer has collapsed. Without a separate bona-fide offer, the escalation clause will not apply. If you want to serve as a back-up offer, it might be a good idea to remove the escalation clause language and instead establish a set purchase price.

“Buyer 1 offers \$300,000 but includes an escalation clause that he will beat any other offer by \$500 up to \$310,000. Buyer 2 offers \$305,000 but includes an escalation clause that he will beat any other offer by \$500 up to \$315,000. Can I use these two clauses against each other?”

Absolutely. In situations like this, the offers will automatically increase until you max out one side. Using these numbers, Buyer 1's max purchase price is \$310,000. Buyer 2's escalation clause says he'll beat that by \$500, meaning the result would be a \$310,500 purchase price for Buyer 2. Of course, the seller can still accept Buyer 1's offer, even though it will be for less money than Buyer 2's.

“I have two offers. One is for \$525,000, with sellers paying \$10,000 in closing costs. The second is for \$515,000, with no closing costs and an escalation clause up to \$545,000. What amount do I use for the first offer to determine how high the escalation clause can go?”

This depends on the language of your contract. VAR's standard clause booklet says that you should use offers “net of concessions” to determine how high the price goes. If that language was used in this contract, the first offer would be \$515,000 (\$525,000 minus the \$10,000 in closing costs). The escalation clause would then increase the second offer by whatever increment was agreed upon. Make sure you read your escalation clause language closely!

“I submitted an offer with an escalation clause. The listing agent came back to me with a counter that was my client's max, but when I asked him for a copy of the other offer he said they didn't have one. Can he do that?”

Just because your offer has an escalation clause doesn't mean that the seller has to abide by it. The seller can counter back with your maximum price or any other price/terms that he or she chooses. If the seller was not countering but was rather just upping the price based on your client's escalation clause, then he would most likely have to provide a copy of the other offer (make sure you check the language of your clause).

Make sure you explain to your clients (whether sellers or buyers) the pros and cons of escalation clauses. Make sure that your buyers are always comfortable with the max price, even if you don't think they'll get there.

Consider using a spreadsheet to help show you (and your clients) how the different offers interact in an escalation clause situation. Also, always make sure you're familiar with the specific language in your clause.