



EARNEST MONEY PROMISSORY NOTE & GUIDE

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1. Overview

Buying real estate is an expensive and time-consuming activity. If you are a home buyer, you may be facing competition from other potential purchasers, pressuring you to make ever higher offers in a shorter period of time. Frequently, sellers will demand that you show your seriousness by providing a deposit on the property.

Although you may wish to demonstrate your good faith intent to buy the property, giving cash to a prospective seller isn't a good idea. Moreover, it may not be easy to produce the deposit at the exact moment the seller demands it. In such cases, a buyer may wish to offer an earnest money promissory note as evidence of its good faith intent to purchase the property.

This package contains everything you'll need to customize and complete your earnest money promissory note. The sample document and instructions should provide you with a good starting point for information about loan terms and deal structures. Whatever your deal, a written note can minimize confusion, misunderstanding, and error, and clearly set forth the parties' expectations and fulfillment obligations. In every way, this promotes successful and profitable personal and business arrangements.

2. Dos & Don'ts Checklist

- An earnest money deposit is money is put up by a potential buyer of real estate to show that it is seriously interested in making the purchase. The money is usually paid within 24-48 hours after the offer is accepted, and is held by a third party or escrow company until the deal is completed. Sellers may ask for this because they are worried that they are tying up their property without a guaranteed payment and discouraging other interested buyers.
- Usually, if the buyer doesn't perform according to the contract, the seller gets to keep this earnest money. If the deal isn't closed, and the buyer wasn't at fault, the buyer is entitled to a return of the deposit. If the sale is completed, the deposit may be used as partial payment of the purchase price, or may be returned to the buyer. The laws on this vary from state to state, and you and the other party may have agreed to different terms in your purchase agreement. Review your contract and local laws for additional information.
- It's difficult to determine the right amount of an earnest money deposit. Real estate transactions can be lengthy and complicated, and deals can fall apart for any number of reasons. If the deposit is large and something goes wrong, the buyer risks losing all of its initial investment. If it's small, the seller can't be confident that the buyer won't walk away from the deal. If there are multiple offers on the table, the seller may not seriously consider the proposal of the buyer who put up the least amount of money. Moreover, if the buyer offers a large earnest money deposit, it may end up earning the seller's confidence and having its offer accepted.

- There is no legal minimum for an earnest money deposit. Many real estate agents recommend a deposit of between 1% and 2% of the offer. However, this amount may be higher or lower based on many factors, including the market conditions prevailing in your area and the price and type of property being sold (e.g., vacant land, resale of an existing home, etc.). In a seller's market, with many buyers desiring few property offerings, it makes sense for a buyer to extend a large earnest money deposit to induce the seller to accept its offer. In buyers' markets, large earnest money deposits may persuade sellers to accept lower purchase prices.
- Earnest money deposits can take any form agreed to by the seller. In some cases, the buyer will offer an earnest money promissory note instead of making a direct payment. This gives the buyer some assurance that it will not lose the money deposited if the deal falls through. However, sellers may be reluctant to accept a promissory note instead of money in hand, knowing that they would have to sue the buyer to receive the deposit if the buyer decided not to go through with the purchase. The parties can seek a compromise by making the note payable before the closing (e.g., after inspections, within a certain defined period, etc.), giving the seller assurance that the buyer has every intention of completing the deal and allowing the buyer some breathing room in its payments.
- The owner must be aware that the earnest money deposit will be made in the form of a promissory note (i.e., not in cash) before it accepts the purchase offer. This fact must also be stated clearly in the purchase agreement itself. In some states, a seller's agent who accepts a deposit in the form of a note without informing the owner may be subject to sanctions and fines. If and when the seller accepts this form of deposit, the broker or agent must secure the note in a safe place (e.g., an office safe) until it becomes payable.
- Before sitting down to sign, decide exactly what your goals are for the note. How much is sufficient earnest money? What interest rates will be applicable? Under what conditions will the note become due? A good agreement is one that captures the intentions of the parties accurately. Clarify the terms and conditions of your agreement before memorializing them in writing.
- The use of an earnest money promissory note usually contemplates the existence of a purchase agreement for real property. The enclosed document assumes that a purchase agreement will be created and signed by the parties, but that agreement is not provided as part of this form. The purchase agreement is an essential document and should include information about how the earnest money and the note should be addressed. It may also be a good idea to use an earnest money escrow agreement to instruct your escrow agent or company about if and when to release the earnest money, and to which party.
- Allow each party to spend time reviewing the promissory note. This will reduce the likelihood, or at least the efficacy, of claims that a party did not understand any terms or know what their obligations were under the document.
- Both parties should review the note carefully to ensure that **all relevant deal points** have been included. Do not assume that certain expectations or terms are agreed to if they are not stated expressly in the document.

- Choose a fair interest rate. Although the enclosed note will “rewrite” an unlawful rate to make it legal, it’s a good idea to select a reasonable number at the start. This will decrease the chances of default and make for a less strained relationship between the parties.
- The parties should sign only one original note, and the seller or escrow agent should keep that document. If you are the buyer, you will want to keep the note in the hands of an escrow agent or company. Make at least one photocopy but make sure that any such copy says “COPY” in bold letters on its face. Give one of those copies to the buyer. After the loan has been paid in full, the seller or the escrow agent should return the original note to the buyer.
- Depending on the nature of its terms, you may decide to have your note witnessed or notarized. This will limit later challenges to the validity of a party’s signature.
- If your agreement is complicated, do not use the enclosed form. Contact an attorney to help you draft a document that will meet your specific needs.

3. Earnest Money Promissory Note Instructions

The following provision-by-provision instructions will help you understand the terms of your earnest money promissory note.

The numbers below (e.g., Section 1, Section 2, etc.) correspond to the provisions in the Note. Please review the entire document before starting your step-by-step process.

- **Introduction.** Identifies the document as a promissory note. Write in the date on which the note becomes effective. Identify the parties and, if applicable, what type of organization(s) they are. Note that one party is called the “Payee” and the other the “Buyer.” As you may have guessed, the Buyer is the party that is intending to purchase the real property, and is putting up an earnest money deposit for the “Payee.” The Payee may or may not be the same entity as the seller. Under some purchase agreements, a buyer will put a note directly in the hands of a third party (like an escrow agent).

Designating one party or another as “Payee” may, however, have serious consequences down the road. If the Buyer defaults, only the party that is named Payee in the Note can bring a lawsuit to collect the money. If a broker is the Payee (and not the seller), only that broker can bring the lawsuit.

- **Section 1: Promise of Payment.** This is the “meat” of the Note, where the total amount of the earnest money deposit is stated. This is also where the Payee designates where exactly it should be paid (usually its business address).
- **Section 2: Earnest Money.** Explains that the Note is being provided as a good faith (“earnest money”) deposit on a real estate purchase. Use the space to describe the purchase agreement, and to describe the property that is being bought.
- **Section 3: Payment.** The Parties’ agreement that the earnest money will be paid immediately, when certain conditions are met. There are several options provided and you should select the one that best characterizes your agreement. In the first, the Note becomes immediately payable when all conditions specified in the agreement have been met. For example, if the successful completion

of a property inspection is required before a deal can close, and that inspection was successfully completed, that condition has been met. In the second, the Note must be paid within a certain amount of time after the purchase agreement is agreed to and signed. This is usually between 24-72 hours after that time. There is an open third option that allows you to designate other specific or general conditions after which the Note will be paid (e.g., a specific date, on receipt of financing, etc.).

- **Section 4: Prepayment.** Explains that the Buyer can pay money to the Payee before it is specifically demanded, and that there is no penalty for doing so.
- **Section 5: Events of Default.** Details the situations in which the Payee can declare that a default has occurred under the loan. The first blank allows the parties to determine the amount of time the Buyer has to make its payment after the demand has been made. There is an optional provision at the end, stating that if a default has occurred, the unpaid amount of the Note will start accruing interest. If you do decide to include this clause, select a reasonable interest rate. The other language of the clause ensures that the interest rates set by the parties aren't illegal. In other words, if an agreed-to interest rate is above what the law allows, this section "rewrites" that provision to make it legal.

If you and the other party want to include additional events of default, you can do that in this section.
- **Section 6: Acceleration; Remedies on Default.** A description of the actions the Payee can take if an event of default (as listed in Section 4) occurs.
- **Section 7: Waiver of Presentment; Demand.** Indicates that if an event of default occurs, the Payee doesn't have to explain to the Buyer that it is going to take action (for example, that it will require immediate payment of the entire Note). The Payee can simply take action without providing notice.
- **Section 8: Time of Essence (Optional).** An optional provision included to allow you and the other Party to determine how strictly you want to enforce the time limits in your note. Generally, by including this provision the Payee is allowing the Buyer no leeway – if payment isn't within the exact time agreed, the Buyer is in default. By deleting this provision, you are usually allowing the Buyer some reasonable breathing room. If you remove this section, correct the section numbers and references in the Note.
- **Section 9: Successors and Assigns.** States that the Parties' rights and obligations will be passed on to heirs or, in the case of companies, to successor organizations.
- **Section 10: Notice.** Lists the addresses to which all official or legal correspondence should be delivered. Write in a mailing address for both the Buyer and the Payee.
- **Section 11: Governing Law.** Allows the Parties to choose the state and county laws that will be used to interpret the Note. Note that this is not a venue provision: the included language will not impact where a potential claim can be brought. Please write the applicable state and county in the blanks provided.
- **Section 12: Entire Agreement.** The Parties' agreement that the Note they're signing is "the agreement" about the issues involved. Unfortunately, the inclusion of this provision will not prevent a Party from arguing that other enforceable promises exist, but it will provide you some protection from these claims.

- **Section 13: No Implied Waiver.** Explains that even if the Payee allows the Buyer to ignore or break an obligation under the Note, it does not mean the Payee waives any future rights to require the Buyer to fulfill those (or any other) obligations.
- **Section 14: Collection Costs and Attorneys' Fees.** Places the responsibility for paying any costs of collecting money under the Note on the Buyer's shoulders. For example, if the Payee is forced to hire a third party to get its money, the Buyer will pay all of that third party's fees and costs.
- **Section 15: Severability.** Protects the terms of the Note as a whole, even if one part is later invalidated. For example, if a state law is passed prohibiting choice-of-law clauses, it will not undo the entire document. Instead, only the section dealing with choice of law would be invalidated, leaving the remainder of the Note enforceable.
- **Section 16: Headings.** Notes that the headings at the beginning of each section are meant to organize the document, and should not be considered operational parts of the Note.

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EARNEST MONEY PROMISSORY NOTE

\$ _____ [Amount of Note]

This promissory note (the "Note") is made and effective _____ [Date], by and between _____, an [individual] [corporation] [limited liability company] [etc.] (the "Buyer"), and _____, an [individual] [corporation] [limited liability company] [etc.] (the "Payee," and together with the Buyer each a "Party" and collectively the "Parties").

1. PROMISE OF PAYMENT.

FOR VALUE RECEIVED, the Buyer promises to pay to the Payee, at _____ [Address], _____ [City], _____ [State] _____ [Zip Code], or at such other place as the Payee may designate in writing from time to time, the principal amount of _____ Dollars (\$ _____).

2. EARNEST MONEY.

This Note is evidence of the obligation of the Buyer to pay _____ real estate purchase agreement (the "Purchase Agreement") and _____