REAL EASTATE

Mortgage Contingency Clause Needn't State Interest Rate

By Andrew Lieb

A mortgage contingency clause conditions the buyer's performance on the obtainment of a mortgage. Without such a clause, a buyer would risk default if the buyer required financing to purchase. This clause shifts the risk to the seller. To mitigate the risk to the seller, the seller's attorney is charged with setting forth precise terms within the contract of sale, under which the buyer must comply, in order for the clause to be available. This means that in order for the seller to share in the buyer's risk of being unable to obtain a mortgage, the buyer must have a precise protocol of the type of mortgage to apply for as well as a clear understanding of its duties to actively seek approval. While a basic mortgage contingency clause with open terms may not render a contract unenforceable, it certainly exposes a seller to unnecessary risk because a buyer is left with indefinite direction to pursue the mortgage.

The Fourth Department was recently faced with the issue of whether a mortgage contingency clause that did not state "the interest rate and term of the mortgage" was enforceable under the statute of frauds and while the court held that the missing terms did not render the contract unenforceable, attorneys should not now become lax in drafting mortgage contingency clauses. Instead, the decision in *Ferchaw v. Troxel* should motivate attorneys otherwise, and attorneys should be vigilant to not only utilize the standard paragraph 8 in the Jointly Prepared form Contract by the Bar Associations, but also to tailor that paragraph to the facts at hand by way of a Rider or redlining. Remember, a mortgage contingency clause shifts the risk of default from the buyer to the seller so the seller should only accept the buyer's risk under clearly defined terms that put forth a precise methodology for the buyer to pursue financing.

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The issue before the court in *Ferchaw* was whether the contract was enforceable pursuant to General Obligations Law §5-703(2), which only requires a written memorialization of the consideration for the contract, subscribed by the party to be charged; but it does not require precise terms of how that consideration will be paid. The framework under which this case was heard was pursuant to Article 15 of the Real Property Actions and Proceedings Law where the claimant sought a declaratory judgment that the subject contract was valid and enforceable. In fact, this claim was brought by the buyer in order to pursue the purchase, not to determine if the buyer was able to escape the contract based upon the exculpatory nature of a mortgage contingency clause, as we traditionally see cases on this topic arise. Therefore, the court was not faced with a breach case where it was asked to interpret the mortgage contingency clause and whether the buyer pursued the mortgage in good faith or through diligent efforts only to be denied a commitment by a lender and where the buyer was now seeking the return of its earnest money. Instead, the instant decision was quite narrow to its facts and needs to be analyzed and understood within that light only. One can only wonder how such a determination would result if the subject mortgage contingency clause in the *Ferchaw* case was instead analyzed in a breach of contract case. Could the buyer ever be able to escape a real estate contract with such open mortgage contingency terms? Would those terms just be added by the court and if so, how, by trial? There seems to be a lot of risk in lax mortgage contingency terms based upon the unknown; risk that is unnecessary and risk that our job as transactional attorneys requires us to mitigate.

Interestingly, the seller's attorney expressly did not approve of the contract in *Ferchaw*. However, this fact was not operative to the decision because the contract was not contingent on attorney approval with a properly placed clause to that effect as utilized in our county's local real estate brokerage form, the Sales Agreement, by the Long Island Board of Realtors. Regardless of the existence of an attorney's approval clause, the practice of parties contracting concerning a significant investment, such as a Suffolk County residential property, while only relying on the chance that their attorney has time to review and approve or disapprove the contract within "3 business days," instead of coming to an agreement to agree by their brokers and then having the attorneys work out the precise terms of the binding contract, is quite scary in the first place.

Ferchaw therefore should remind practitioners of the importance of telling our clients never to sign a Sales Agreement that was not prepared by an attorney. To substantiate this position, one need only look at the Financing Clause in the LIBOR form contract where it only states, in pertinent part, as follows: "This sale is subject to and conditioned upon the buyer obtaining a (variable rate) (fixed rate) mortgage in the amount of $_____ with interest at prevailing rate amortized over a period of not less than _____ years. Buyer understands that he/she/they is/are obligated to make a good faith effort to obtain such financing." In contract, the mortgage contingency clause in the Jointly Prepared form contract utilized by attorneys is approximately a page long in single spaced type and specifies such things like that the loan must come from an Institutional Lender, that it shall be a first mortgage loan, that the loan shall be obtained at purchasers full cost, it addresses issues that emerge from a mortgage existing on the purchaser's current home, it speaks to the need for an appraisal to obtain a mortgage, it contrasts mortgage brokers from institutional lenders, it discusses the submission requirements on a buyer, it creates a process to cancel the contract, it defines terms, and much more.

So, before you shift risk in a contract by offering a mortgage contingency clause, make sure that each rule is clearly outlined for the buyer to get a mortgage or to be held in default. Remember, if *Ferchaw* had been a breach case, not an Article 15 case, a long and costly trial would likely have been required to render a decision; which could have been easily avoided by the parties had they only entering a contract that was drafted and negotiated by competent counsel.

Note: Andrew M. Lieb is Managing Attorney of Lieb at Law. P.C. and a frequent contributor to this publication