

Best Practices for use of the KCRAR Purchase Price Escalation Addendum

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Due to the low inventory of residential real estate coming onto the market and a high demand from buyers competing for those properties, many real estate companies have been using a “Purchase Price Escalation Addendum” (or Escalation Clause). This has created multiple versions of an escalation addendum used in our area. Due to this, the KCRAR Forms Committee created a form that could be used by all members of KCRAR.

The purpose of this addendum is for a buyer to make their best effort to purchase a property that they want. Using this form will help the buyer make their best offer in a competitive market without the buyer paying more than necessary. Use of the addendum also may help the seller obtain the best offer for their property.

The “Purchase Price Escalation Addendum” can be attached to the initial offer or added during negotiations on a Counter Offer Addendum.

It is advisable that a buyer who is considering making an offer using the Purchase Price Escalation Addendum, or a seller considering accepting an offer with the escalation addendum, be fully informed of the various scenarios that can occur as a result of using the addendum.

Best Practices for the use of the Purchase Price Escalation Addendum are as follows:

Paragraph 1.

The first paragraph states that prior to any acceptance by the seller of any offer, the buyer submitting this addendum may choose to offer more than the original offer price and more than a “Competing Offer” by a given amount up to a maximum amount. *The Competing Offer is the highest offer that triggers the escalation of the offer selected by the Seller.*

An important term in this paragraph is “Net Purchase Price.” The definition of Net Purchase Price is the purchase price less any identified expenses or costs to be paid by the seller which could include: a warranty, seller paid closing costs or other financing charges.

In the event of multiple offers with one escalation addendum, the listing agent would calculate the net purchase price of all offers.

Example 1: A property has a list price \$240,000. Buyer A offers the asking price (\$240,000) with a Purchase Price Escalation Addendum. The Purchase Price Escalation Addendum states an increase in purchase price of \$2,500 over the highest net purchase of the “Competing Offer” up to a maximum price of \$255,000. Buyer A is not asking for any additional expenses to be paid by the seller. Buyer B’s offer is for a purchase price of \$250,000 with additional terms of the seller paying for a home warranty at \$600, and seller paid closing costs of \$5,000.00. The Net Purchase Price of Buyer’s B offer would be \$244,400.

Buyer A who submitted the purchase price escalation addendum is saying that they will pay \$2,500 over the highest Net Purchase Price of the Competing Offer (in this case, that would be \$244,400). With Buyer A's escalation addendum kicking in, it would increase the new purchase price for Buyer A to \$246,900.

Buyer B would be the competing offer to be sent to the buyer agent and Buyer A would be the winner of the escalation addendum purchase price.

Example 2: Buyer C submits an offer on this same property for a purchase price of \$245,000 with an escalation addendum that agrees to go \$5000 over the highest purchase price up to \$275,000. The listing agent could do the step ladder of escalating prices with Buyer A and Buyer C, but the bottom line is that Buyer A's escalation addendum went to \$255,000 and Buyer C's escalation addendum went \$5000 over the highest Net Purchase Price which would be \$255,000 and So Buyer C's escalation would bring him/her to a purchase price of \$260,000.

Buyer C would be the winner of the escalation addendum purchase price and Buyer A would be the Competing Offer to get sent to the buyer agent.

It is important to reiterate that just having the highest Net Purchase Price is not always the best offer or the offer the seller may choose because many things are considered – inspections, appraisals, financing, closing timeframes, etc. but the escalatory addendum addresses the Net Purchase Price!

Paragraph 2:

The new purchase price will require updated financing information from the buyer, including either a new pre-approval letter and/or proof of funds, for either the purchase or down payment.

Paragraph 3:

A Counter Offer Addendum should be used to confirm the new price after the escalation is completed.

Paragraph 4:

The Listing Agent will provide a copy of the Competing Offer to Licensee Assisting Buyer no later than the time Listing Agent returns a copy of the executed contract to Licensee Assisting Buyer.

Listing Agent will remove the name(s), all signatures, and other personally identifying information, including lender information of the other prospective purchaser(s). The Listing Agent will not remove financial terms or costs applied to the offer price, such as Additional Terms and Conditions, limited home warranty, additional addenda including other escalation addenda and additional seller paid closing costs.