NATIONAL ASSOCIATION OF REALTORS®

CONSUMER GUIDE: ESCROW AND EARNEST MONEY

One of the steps between signing and closing on a home is when homebuyers typically deposit money into an escrow account. An agent who is a REALTOR® can help advise you on your offer and how to keep your deposits safe. When it comes to escrow, here's what homebuyers should know:

What is escrow? Escrow is a financial agreement in which a third party, such as an attorney or another settlement or title agent, controls payments between the buyer and seller, only releasing the funds involved when all the terms of the contract are met. As the buyer, once you close on the home, the money you've placed in escrow will often be applied toward your down payment and other closing costs. Other costs that can be covered by funds in an escrow account include property taxes and insurance premiums.

What is "earnest money?" Also known as a "good faith deposit," an earnest money deposit is paid by a homebuyer to show their interest is legitimate and they intend to close on a home. This may be a percentage of the purchase price or a set amount. To protect the funds, earnest money will be held securely in an escrow account until closing or any disputes are resolved. An escrow account is often set up by your lender with a third party such as a bank, title company, escrow agent, or mortgage servicer. During this time, the buyer and seller will be unable to access the funds. Importantly, earnest money is NOT the same as a down payment, which is the money you put toward the home's purchase price.

What happens to the earnest money deposit if the transaction is canceled or interrupted? If the seller stops the sale, the funds in escrow are returned to the buyer. Additionally, if contingencies included in the purchase contract—such as a home inspection, appraisal, or financing, are unable to be resolved—then the money gets refunded to the buyer. However, if the buyer interrupts the sale for other reasons, the seller may get to keep the money. For example, if a buyer waives contingencies prematurely, fails to meet set deadlines, or gets cold feet and abandons the transaction, among other circumstances, this could result in the loss of their earnest money deposit. Work with your agent and a legal professional to ensure you understand the terms of your contract to avoid putting the transaction—and your money—at risk.

Is an earnest money deposit required? There are no laws requiring an earnest money deposit to be attached to a home offer. However, it is a common practice, particularly in some competitive markets and when a buyer's down payment is less than 20% of the purchase value. Certain sellers may require or request earnest money deposits or look favorably on offers that include them.

How much earnest money should I offer? Earnest money deposits can be any amount, but typically range from 1% to 10% of the home's purchase price. The size of your deposit may depend on several factors, including the competitiveness of the market, your down payment amount, whether you include contingencies in your offer, and the seller's preferences. Fixed earnest money amounts rather than percentages of the home's sale price are also becoming more common in some regions.

Are there any risks to placing my money in an escrow account? As with any transaction, the risk for fraud exists when wiring money, but there are steps you can take to protect yourself during the home closing process involving the transfer of funds. Your agent can educate you on how to avoid falling victim to wire fraud scams. Always confirm wire instructions with your bank, lender, and any other known parties involved in-person or on the phone before initiating the transfer. Check out NAR's resource on protecting your money from scams here.

Practices may vary based on state and local law. Consult your real estate professional and/or an attorney for details about state law where you are purchasing a home. Please visit facts.realtor for more information and resources.