

# REAL ESTATE

## Sellers Prevented From Exercising Mortgage Contingency Clause

BY ALAN NOCHUMSON

*Special to the Legal*

Agreements of sale generally contain a laundry list of contingencies that must be satisfied before the settlement date. Most, if not all, of these contingencies allow the buyer to escape from an otherwise unfavorable real estate transaction.

In *Watson v. Gerace*, the 3rd U.S. Circuit Court of Appeals recently prevented homeowners from exploiting a mortgage contingency clause contained in an agreement of sale.

### SELLERS CANCEL SALE

J. Scott and Laura Watson, who owned the second floor apartment in a duplex in Ocean City, N.J., executed a written agreement to sell their apartment to Joseph and Donna Gerace for \$665,000. Under the terms of the contract, the Geraces placed \$15,000 in escrow and agreed to pay the balance with cash and a \$532,000 mortgage.

The contract was a standard form prepared by a real estate company that represented the parties involved through separate agents.

Clause 6 of the contract contained a provision titled "mortgage contingency." According to Clause 6, "[t]he buyer's obligation to complete this contract depends on the buyer getting a written commitment of an established mortgage lender, or the seller, as the case may be, to make a first mortgage loan on the property in the principal amount of \$532,000. ...

"The buyer shall supply all necessary information and fees asked for by the lender. The commitment must be received by the buyer on or before March 22, 2004. ... Should the buyer not receive the written commitment by the above date then this contract shall be null and void and all deposit money will be returned to the buyer; unless the commitment date is extended by buyer and seller. The buyer, at his option, can waive this mortgage contingency at any time. ... Any mortgage commitment signed by the buyer will satisfy this mortgage contingency."

On March 10, 2004, the Geraces obtained a credit approval letter from Wells Fargo Home Mortgage, which they signed on

March 13, 2004. The letter stated "Congratulations! Your loan application has been approved subject to the terms and conditions included on this credit approval letter. A commitment letter will be forwarded to you by your mortgage specialist, once an appraisal report has been reviewed by the lender."

The letter contained a number of conditions, including a verification of the Geraces' financial status, an appraisal of the property indicating a market value of the agreed upon purchase price, and documentation approv-

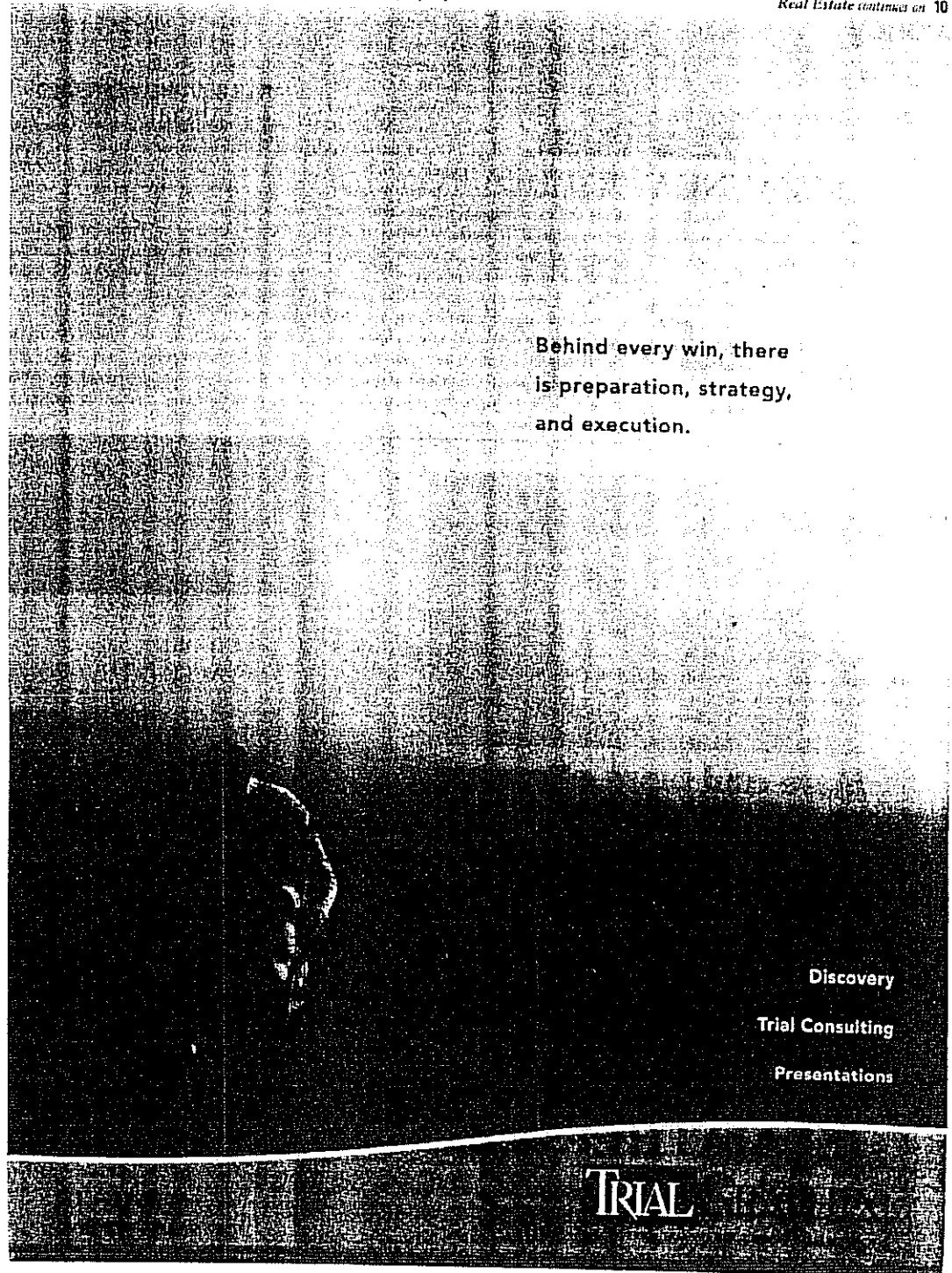
ing a second mortgage of \$33,250.

On March 23, 2004, the Watsons contacted their agent to inquire about the status of the mortgage commitment. They advised him to inform the Geraces that the contract would be considered null and void unless the commitment had been received by him. The following day, the agent faxed a copy of the credit approval letter to the Watsons. Afterward, the Watsons stated that the letter was unacceptable to them and that the contract was null and void. They then requested that their agent re-list the property for sale.

The Geraces nevertheless appeared at the originally scheduled closing. The Watsons, instead of appearing at the closing themselves, filed a complaint in federal court. In their complaint, they requested a declaratory judgment that the contract was null and void.

In response, the Geraces filed an action in the Superior Court of New Jersey for breach of contract, requesting damages and specific performance. The state court case was eventually removed to federal court and consolidated with the Watsons' declaratory

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judgment action. Both parties eventually moved for summary judgment. The district court granted summary judgment for the Geraces primarily on the finding that the credit approval letter satisfied the mortgage contingency clause.

## 3RD CIRCUIT SIDES WITH BUYERS

On appeal, the 3rd Circuit upheld the district court's ruling strongly stating that "[i]t was in writing, it was received by the buyers before the deadline, and the loan it approved met the stated financial criteria."

The 3rd Circuit summarily rejected the Watsons' argument that the credit approval letter was not a "mortgage commitment" because it did not definitely bind Wells Fargo to fund the mortgage. Instead, the 3rd Circuit found that, "[w]hile the credit approval letter does refer to a separate 'commitment letter,' it is clear from its language that it binds Wells Fargo, subject only to specified conditions."

The 3rd Circuit also found the Watsons' reliance on a line of cases standing for the proposition that a conditional commitment cannot satisfy a mortgage contingency clause as misguided, to say the very least. The Watsons argued that, because the second mortgage and the appraisal were outside the control of the Geraces, the commitment was too uncertain. The 3rd Circuit found the cited cases as inapposite because, in those cases, the mortgage contingency clauses were conditional on the successful sale of the buyers' previous homes.

The 3rd Circuit noted that "[t]here, unlike here, the conditions not only had a substantial likelihood of nonfulfillment through no fault of the buyers, but actually failed before the deadline in the mortgage contingency clause. In contrast, the conditions were both likely to be and actually were fulfilled. The second mortgage was also issued by Wells Fargo; the credit approval letter refers to it as 'a component of this transaction.' There is no evidence in the record that there was any genuine risk that the second mortgage would not be available. The appraisal could have blocked the mortgage commitment only if it had been for a value beneath the agreed sales price."

In all, the 3rd Circuit emphasized that the Geraces "had the undisputed ability to comply with the remaining conditions, were under a good-faith duty to do so, and did comply with them."

The 3rd Circuit also seemed perplexed as to why the Watsons had any right to cancel the agreement of sale per the mortgage contingency clause. The 3rd Circuit first stated that the Geraces, under the contract itself "had sole and unfettered discretion to determine whether the mortgage contingency they received was sufficient." The 3rd Circuit pointed out that the contract specifically provided that "[a]ny mortgage commitment signed by the buyer will satisfy this mortgage contingency."

In a forcefully worded rebuke to the Watsons, the 3rd Circuit ruled that "[i]f the buyers found the credit approval letter sufficient and signed it. The buyers had the option to waive the mortgage commitment entirely, strongly suggesting that they could waive it to whatever extent the mortgage commitment was insufficient. Further, the mortgage contingency clause makes the mortgage commitment

## AREA MORTGAGE RATES

Lender	Fixed Rates		Adjustable Rates	Jumbo Rates*	Commercial
	30 yr.	15 yr.	1 yr.	30 yr. Jumbo	Yes/No**
East Coast Financial 800-353-9440	6.25/0	5.88/0	N/A	6.38/0	No
Abel Mortgage 610-212-3730	6.25/0	6.00/0	N/A	6.50/0	No
American Home Finance 888-429-1940	6.25/0	6.00/0	4.63/0	6.50/0	No
Executive Home Mortgage 866-234-0504	6.25/0	6.00/0	N/A	6.50/0	No
Home Finance of America 800-358-5652	6.25/0	6.00/0	N/Q	6.50/0	No
America's Best Mortgage 800-711-8189	6.38/0	6.13/0	N/A	6.63/0	No
etcapital 877-785-5626	6.38/0	6.13/0	5.63/0	6.50/0	No
N.E. Mortgage Lender 877-559-3621	6.38/0	6.13/0	5.25/0	6.63/0	No
Stepping Stone Lending 800-638-2659	6.38/0	6.13/0	N/A	6.63/0	No
Wilmington Mortgage 610-558-3099	6.38/0	6.13/0	N/Q	6.63/0	No
1st Metropolitan Mortgage 800-328-0557	6.50/0	6.25/0	N/A	6.75/0	No
Absolute Mortgage Company 888-904-6637	6.25/0	5.88/25	5.38/0	6.50/0	No

\* A "Jumbo" or non-conforming mortgage is a loan amount in excess of \$417,000.  
\*\* Indicates if a lender offers mortgage loans for commercial properties. Call to discuss rates and terms.

Rates compiled by the National Financial News Services, a mortgage information and financial clearing house in West Chester, Pa. Rates may be for new applicants only; information on terms other available programs and APRs may be obtained by calling the lender directly. Consumers wishing additional rate information call 610-344-9953. Rates valid April 21, 2006. For additional information on mortgages go to: [www.PhillyMortgageRates.com](http://www.PhillyMortgageRates.com)

a condition precedent to the buyers' obligation to complete this contract," indicating that the mortgage contingency clause operates for the buyers' benefit."

## PENNSYLVANIA LAW

The standard forms approved by the Pennsylvania Association of Realtor (PAR) are used for most residential real estate transactions in Pennsylvania. Paragraph 6 of the standard agreement contains the mortgage contingency clause. If the parties elect to include the mortgage contingency clause as part of the agreement, the buyer must list, among other things:

- The loan amount of the mortgage;
- The minimum term of the mortgages;
- The type of the mortgage;
- The mortgage lender; and
- The maximum acceptable interest rate of the mortgage.

Under the terms of the agreement, the buyer is required to complete a mortgage application within an agreed upon period of time from the date of the agreement is fully executed by the parties.

If the buyer fails to apply for a mortgage within the agreed upon time period, he is in default of the agreement. The buyer is also in default of the agreement if he furnishes false or incomplete information concerning his legal or financial status or fails to cooperate in good faith in processing the mortgage loan application that results in the mortgage lender refusing to approve a mortgage commitment.

After receiving the mortgage commitment, the seller may only terminate the agreement if:

- The commitment is not valid until the date of settlement;
- The commitment is conditioned upon the sale and settlement of any other property;
- The commitment does not contain the mortgage financing terms agreed by the buyer in the agreement itself; or
- The commitment contains other conditions

not specified in the agreement other than those conditions that are customarily satisfied at or near settlement, such as obtaining insurance and confirming employment status.

## LESSONS LEARNED


In Pennsylvania, a seller, under the PAR form agreement of sale, clearly has the right to terminate the agreement if the buyer fails to obtain the mortgage commitment as set forth in the agreement. As such, buyers in Pennsylvania should be wary of a homeowner who suddenly succumbs to seller's remorse.

To illustrate, if the parties in *Watson* had used the PAR form agreement of sale, the sellers would likely have been allowed to cancel the agreement per the mortgage contingency clause.

The Watsons attempted to terminate the agreement because the mortgage commitment was conditioned upon the Geraces receiving a second mortgage, among other things. Under the PAR form agreement of sale, the Geraces would have been required to reveal whether they intended to finance the sale through a single mortgage or two separate mortgages. If the buyers had not decided on applying for two separate mortgages, the sellers would have been able to cancel the agreement because the buyers could not admittedly have financed the sale without obtaining a second mortgage.

Unlike the agreement in *Watson*, the PAR form agreement of sale does not allow a buyer to waive the mortgage contingency once the provision is included in the executed agreement. Under the plain and unambiguous terms of the agreement, the Geraces could not have simply waived the contingency (which they ultimately did) after failing to obtain the agreed upon financing, placing them in default of the agreement and, therefore, giving the Watsons the ability to simply cancel the sale without judicial intervention.

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