

REAL ESTATE UPDATE: CHANGES TO A DEVELOPER'S ABILITY TO RECEIVE AND USE EARNEST MONEY DEPOSITS BEFORE CLOSING

Key Takeaways

- Residential developers in Washington will soon be able to contract with buyers to have earnest money deposits released to them before closing.
- However, developers should be aware that there will be number of caveats, including a restriction on the amount of money that can be released to them before closing, the ways in which that money can be used, and a new requirement that they maintain a surety bond payable to the buyer.

Background

In most real estate transactions, the buyer will deposit earnest money funds into escrow when the purchase and sale contract is signed by both parties. Then, at closing, this earnest money deposit is applied toward payment of the purchase price. However, sellers of residential real estate often prefer nonrefundable earnest money deposits delivered and released to them as soon as possible. This is for two reasons: (1) to help fund project costs; and (2) the strategic advantage of possessing the earnest money deposit in the event of a dispute with the buyer.

To differentiate their offer in this hot residential real estate market, it's now common for buyers to offer a nonrefundable cash deposit, immediately released to the seller. But developers need to be aware that when they are selling residential units, they may not have the legal right to receive or spend earnest money deposits before closing.

WUCIOA: Understanding the Previous Restrictions on Developers

The Washington Uniform Common Interest Ownership Act ("WUCIOA") became effective on July 1, 2018. This law established a comprehensive statutory regime applicable to all "common interest communities," which includes:

- Condominiums;
- Co-ops;
- Platted communities with homeowners' associations; and
- Other common interest communities that share similar characteristics.

Under WUCIOA, it has been illegal for a developer of a common interest community to receive or spend a buyer's earnest money deposit prior to closing of the purchase and sale of the buyer's unit.

Key Revisions to WUCIOA (Effective July 25, 2021)

Under a recent revision to WUCIOA¹, which goes into effect on July 25, 2021, a residential developer **may** contract with its buyers to have earnest money deposits released to the developer before closing. That is great news for developers seeking to generate cash flow to cover construction costs.

Key Restrictions for Developers

However, under the revised statute, three significant restrictions will apply:

- First, the amount of earnest money deposit released to the developer before closing may not exceed **5%** of the purchase price.
- Secondly, earnest money deposits released to a developer before closing may only be used to pay for the **actual building and construction costs** of the project in which the contracted unit is located; the developer can't simply pocket these funds.
- Finally, in order to lawfully use such pre-closing earnest money deposits, the developer also must maintain a **surety bond** that is payable to the buyer in an amount not less than the earnest money deposit.

Conclusion

In sum, while a developer's ability to receive and spend earnest money deposits prior to closing has its limits and restrictions, these coming revisions to WUCIOA provide developers with a viable option to help supplement cash flow to pay for project construction costs.

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¹ See Engrossed Substitute Senate Bill 5024, Chapter 260, Laws of 2021, which was signed by Governor Inslee on May 12, 2021 and becomes effective on July 25, 2021.

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