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FOR BUYERS: When To Remove Loan Contingency?

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When is the right time for a buyer to remove a loan contingency? This is a very important question because, as a buyer, your 3 percent deposit is being put at risk. If you are buying a $2.5 million home, which is the median price for a home in the Palisades, that comes to $75,000 that could be at risk.

The California Association of Realtors Residential Purchase Contract has standard default time periods for contingencies. The three most important contingencies are the physical inspection, the loan and the appraisal. The default for each is 17 days. In our marketplace, however, buyers usually shorten the inspection contingency to 7 to 10 days but keep the loan contingency default at 17 days or more. Many buyers have been increasing the time period to 21 days because it has become significantly harder to get a loan.

In fact, the new revised Residential Purchase Contract, which is coming out in three months, changes the default time to 21 days. Since the loan contingency is the last contingency to be removed, it is the final chance for a buyer to get out of a deal without jeopardizing their deposit.

There is still a major disconnect between what borrowers think and what lenders think. Most borrowers believe that getting a loan will be relatively painless and that it won't take a long time. Unfortunately, it's just the opposite, especially since the Dodd Frank Wall Street Reform and Consumer Protection Act, or Dodd Frank Act, was passed in 2010 after the housing bubble and financial crisis that caused several large U.S. banks to go under.

Even borrowers who make a million dollars a year, have a million dollars in the bank and have perfect credit may have a very hard time getting approved for a loan. Lenders are not in the business of lending money, rather they are in the business of denying loans to people.

Why? The reality is that many lenders got burned so badly by the last real estate downturn that they have overcorrected.

The mortgage market will continue to undergo significant change in 2014 and 2015 as banks refine loan products, underwriting guidelines and other aspects of their mortgage operations to ensure compliance with the new Dodd Frank Rules. The new rules are extremely complicated and have numerous ongoing amendments. The volume and complexity of the rules have created a lot of confusion with the banks. These new rules affect all aspects of the mortgage business from origination to loan servicing.

A reputable well-known lender may issue a letter pre-approving a borrower and then two to three weeks later either deny the loan or change the loan parameters. Some agents mistakenly think once they get the direct approval from the lender, it is okay to have their buyer remove their loan contingency. A seller may also put pressure on a buyer to remove their loan contingency.

We always ask the lender or mortgage broker if they are comfortable advising the borrower to remove their loan contingency and almost all of them do not recommend it (at least in writing) due to the liability involved. Once a buyer formally removes all contingencies, their 3 percent deposit ($75,000) is at stake because if they cannot get a loan to complete the purchase they could lose that money.

So if you have a 30-day escrow and it takes 25 to 30 days to get a loan approval (or to know loan docs are ready), what is a borrower to do?

As a buyer, pick a lender or mortgage broker who is not only reputable and experienced but also great at constant communication and transparent with the process. Make sure your agent is up front with the listing agent and seller, informing them that it may be 21 to 25 days to get a loan approval. And make sure your agent asks for a 45- or 60-day escrow and not a 30-day escrow.

Anthony Marguleas has been the broker and owner of Amalfi Estates for 20 years. He has been personally involved with over 1,000 transactions and viewed over 2,000 real estate contracts. For the past 12 years he has guest lectured at UCLA to over 1,500 students for their real estate class covering topics such as contracts and negotiations. He has also co-authored California Real Estate Client Strategies and has published over 150 articles that have been featured in the Wall Street Journal and the LA times. He has individually sold over $550 million in properties, and was recently selected by The Wall Street Journal as one of the top 250 agents in the country out of one million agents.