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Buyers of New Homes: Beware of Losing Deposits if Builder Goes Belly-Up

Thinking of purchasing a new home from a builder? The purchase, whether entry level or a mansion, is not as simple as it appears. Your real estate broker becomes invaluable in guiding you through the process.

When you find that perfect property, the builder will require that you enter into a very complex, hard to understand contract. Each builder has its own form, prepared by his attorney, to protect his interests, not yours.

Also remember that, unlike your broker, the builder's on-site sales person works only for that builder, not you, and is there to sell you the builder's product. At best, he or she might give you a basic and certainly one-sided explanation of the contract. Unfortunately, your broker cannot legally give you advice on the builder's contract. Colorado law

requires that real estate brokers work only with state-approved forms. Builder contracts are not Colorado approved, so your broker must advise you to obtain legal advice to explain and advise you on that contract.

But that aside, I have a bigger concern. All builder contracts require that you deposit with the builder an earnest money deposit and also that you pay in advance for all upgrades. Current economic conditions

have resulted in many builders, big and small, filing for bankruptcy protection. When this occurs, the money deposited with the builder falls under the jurisdiction of the bankruptcy court. How the bankruptcy court treats the deposit is usually determined by whether the money was deposited in a separate trust account or co-mingled with

the builder's operating capital. When deposited in a specified trust account, the court will usually order that money released to the buyers, but when co-mingled with the builder's operating capital there is a good chance that the buyer, as an unsecured creditor, could lose most or all of that money.

I advise clients that this risk can be mitigated by requiring as a condition of contract, that the earnest and upgrade money be deposited in a separate trust account – preferably with a third party such as an unaffiliated title company. This simple, inexpensive precaution could save you thousands.

To further your protection, ask your attorney, in addition to advising you on the contract, to prepare or at least approve the escrow instructions that will govern the application of the earnest and upgrade deposit. If the builder doesn't agree, there are other builders. Remember, it *is* after all a buyer's market.

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By **JIM SMITH,**
Realtor®

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