# Option Period Basics

Kerri Lewis
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The termination option period under the Texas Real Estate Commission (TREC) promulgated contracts is an integral part of the contract for both the buyer and the seller. It is designed to reduce litigation after closing on a house by allowing a buyer time to do more than a walk-through of the property before fully committing to purchasing the property.

**Takeaway**

An option period benefits both parties in a real estate transaction. It allows the buyer time to discover any property defects before committing to the purchase, and it lowers the seller's chances of losing litigation if a defect is discovered after closing.

Simply stated, an option period is a negotiated number of days after the contract is fully executed during which time the buyer can terminate the contract for any reason and get his earnest money back. It is intended to give the buyer time to conduct due diligence on the property—home inspections, including specialty inspections like roof, foundation, hydrostatic or environmental testing—anything the buyer wants to consider before deciding whether this property is, in fact, the right property for him at the agreed-upon contract price.

Most Texas real estate license holders likely learned the basics about option periods when studying for their license exam. However, as with any aspect of Texas real estate, understanding the intricacies and nuances of the law is key to better serving buyers and sellers. To that end, here is everything you ever wanted to know about option periods but were afraid to ask.

## How Long is the Option Period?

The option period is negotiable, meaning the seller and buyer agree to the number of days needed. The seller usually likes a shorter period because it increases the certainty the buyer is going to stay in the contract. The buyer generally wants a longer period to make sure she can get inspections completed and negotiate for any repairs she may want the seller to make based on those inspections.

## In a Hot Market, Should an Agent Recommend the Buyer Decline the Option Period?

This is not a good idea. It could put the agent at risk for litigation if problems are found after closing that could have been discovered during an option period.

While the agent may think not having an option period will make the seller more likely to accept the offer, the agent may not be acting in the buyer's best interest. Many agents argue that inspections are still allowed under Paragraph 7 of the contract whether there is an option period or not. This is true. However, if something turns up under an inspection outside of an option period, the buyer does not have the ability to terminate the contract and have her earnest money returned.

At the very least, the agent should explain to the buyer the pros and cons of not having an option period. The pros of the offer being accepted more readily by the seller may not outweigh the cons of the buyer not knowing if there are major repair or structural issues with the property before risking his earnest money.

## Can a Seller Refuse to Allow an Option Period?

A seller may like the idea of no option period because it decreases the likelihood that the buyer will come back with an amendment asking for repairs or a decrease in the purchase price. However, it increases the seller's and the agent's risk of a lawsuit claiming the seller or agent was trying to hide a condition of the property. It's better to allow the buyer to have an option period to make any independent inspections and assessments of the property the buyer deems necessary.

The agent should remind the seller that allowing a buyer an option period does not obligate the seller to negotiate or agree to any proposed amendment the buyer puts forward. In a hot market, the seller may ask for more option money or a shorter option period, but an agent should caution the seller against shortening the option period to the point where it is not likely the buyer can get inspections completed.

## How is the Option Period Calculated?

Days in the contract are always counted in calendar days, not business days. The language in the contracts states the option period is "_____ days after the Effective Date of this contract…" To count, start with the effective date of the contract as day zero. Each subsequent day is one, two, three, and so forth. For example, if the contract effective date is Nov. 1 and the negotiated option period is for ten days, the option period would end Nov. 11 at 5 p.m. local time where the property is located.

## Do You Need an Option Fee to Have an Option Period?

Yes. Extensive case law in Texas has held that an option fee is necessary to create an option right. In essence, the buyer pays the seller an option fee for the unrestricted right to terminate the contract within the option period and have his (the buyer's) earnest money returned. The contract language in Paragraph 5B makes it clear that the consideration for the Termination Option includes "Buyer's agreement to pay the Option Fee within the time required . . ."

## How Much is the Option Fee?

The option fee is negotiable between the parties. The parties can agree on any amount, but it should not be a token amount. The amount may vary depending on factors such as the number of days desired for the option period or how hot the market is. Obviously, the seller will want the fee to be higher, and the buyer will want it to be lower.

## Where and When is the Option Fee Delivered?

As of April 1, 2021, the option fee is delivered in the same manner and within the same time frame as the earnest money. Paragraph 5A of the contract provides that the option fee must be delivered within three days after the effective date to the escrow agent under the contract. Again, to count days, start with the effective date of the contract as day zero. Each subsequent day is one, two, and three. For example, if the contract effective date is Nov. 1, the option fee would have to be delivered to the escrow agent on or before midnight on Nov. 4.

However, the contract provides an automatic extension if the third day falls on a Saturday, Sunday, or legal holiday. If the effective date is on Thursday, the third day would fall on a Sunday, which means the earnest money and option fee would be due to the escrow agent on Monday. If Monday is a holiday, the earnest money and option fee would be due Tuesday.

Remember, other than procrastinating human nature, there is no law or other requirement to wait until the last day to deliver the option fee and earnest money to the escrow agent. Turning in the earnest money or option fee late has serious consequences, so don't be late.

## Can the Earnest Money and Option Fee be Delivered in a Single Check?

Yes. The contract provides that the earnest money and option fee may be paid separately or combined in a single payment.

## What if the Buyer Deposits the Earnest Money and Option Fee in One Sum and Gets the Amount Wrong?

The contract provides money received by the escrow agent is first applied to the option fee and then to the earnest money. So, if both sums are given in one check and the check is short, the option fee will be paid, securing the option period for the buyer, but the earnest money will not be paid in full.

If the earnest money is not paid in full within the time frame required, the seller can declare the buyer in default under the contract. This gives the seller an opportunity to terminate the contract under the terms of Paragraph 5C.

The takeaway? Double check the math before delivering combined funds.

## Can the Option Fee be Delivered Via Electronic Payment, Such as Through PayPal or Venmo?

Yes, if it is considered good funds by the escrow agent. It's important to check with the escrow agent to see what type of fund delivery methods are acceptable. Also, the payment must be an unconditional delivery, and any fee required by the service must be paid in addition to the option fee amount required by contract.

## What Does "Time is of the Essence" in Paragraph 5 Mean Regarding Options?

It means the two main deadlines for options—time for delivery of the option fee and termination notice sent before the end of the option period—must be strictly met, or there will be consequences.

## How Does the Seller Receive the Option Fee?

If the seller asks the escrow agent for the fee, the escrow agent will deliver it directly to the seller after the escrow agent has determined the option fee was delivered in "good funds." Most title companies wait ten business days before delivering the fee to the seller. If the seller does not ask for it, the option fee will be credited to the seller on the settlement statement at closing.

## What Are the Seller's Remedies if the Buyer Fails to Deliver the Option Fee on Time?

The contract specifically states under Paragraph 5D that the buyer will not have the unrestricted right to terminate under Paragraph 5 if there is no option fee or the option fee is not delivered on time.

## Can a Seller Accept a Late Option Fee?

Yes. A seller can agree to accept a late option fee and allow the buyer to have the option period negotiated under the contract. However, accepting a late payment does not extend the length of the option period.

## Will the Escrow Agent Refuse to Accept the Option Fee if it is Late?

It is not the escrow agent's responsibility to determine if the option fee is paid in a timely manner. The escrow agent will receive and receipt the date of delivery of the fee whenever it is paid. It is the listing agent's job to find out from the escrow agent when the option fee was delivered and to communicate that with the seller.

A best practice is for the agent to contact the escrow agent late in the day on the last day for delivery of the option fee to find out if it has been delivered. If it has not been delivered, the agent should discuss with the seller whether the seller wants to accept the option fee late and still let the buyer have the option period under the contract, or if the seller wants to hold the buyer to the terms of the contract and not allow the buyer to have the unrestricted right to terminate if the option fee is not delivered by midnight.

## How Does a Buyer Terminate the Contract Under the Option Period Provision?

The buyer must give written termination notice to the seller on or before 5 p.m. local time where the property is located on the last day of the option period in the contract. Paragraph 21 of the contract sets out the requirements for delivery of notices between the parties. TREC has a form agents can use with their buyers for termination (use QR code to view it).

## Does a Buyer Have to State a Reason Why They're Terminating the Contract During the Option Period?

No. Paragraph 5B states the buyer has purchased an "unrestricted right" to terminate the contract. This means the buyer can terminate the contract for any reason or no reason at all.

## Can the Seller Back Out of the Contract During the Option Period?

No. The right to terminate under the option period is bought and paid for by the buyer and does not extend to the seller.

## How Does One Extend an Option Period?

Although many people refer to it as an extension, the buyer is really purchasing a new option period.

Texas case law suggests an option period cannot be "extended" without the payment of an additional option fee, and the additional fee must offer something of value to the seller and not just a token amount. Agents should use Paragraph 6 of TREC's Amendment to Contract form (use QR code to view it), to evidence the additional option period. Under the amendment provision, the option fee for the additional period is paid directly to the seller (not the escrow agent) at the time the amendment is executed.

## Is the Option Fee Refundable to the Buyer if the Transaction Doesn't Close?

No. The option fee is never refundable. The buyer purchased the right to have an unrestricted right to terminate the contract for a period of time.

## Is the Option Fee Credited to the Sales Price if the Transaction Closes?

Yes. The contract specifically provides for this in Paragraph 5A.

## How Long is the Option Period on a Back-Up Contract?

Under TREC's Addendum for "Back-Up" Contract form (use QR code to view it) , if the buyer has purchased an option period under the contract, the unrestricted right to terminate begins on the effective date of the Back-Up Contract and ends after the number of days stated in the contract for the option period *after* the back-up contract goes into first position.

This is quite an advantage for a buyer in a back-up position because the buyer can continue looking for another property and terminate the back-up contract and get his earnest money back if he finds one before going into first position or even after going into first position if terminated before the negotiated option period ends.

## Is the Option Fee Refundable Under a Back-Up Contract if the First Contract Closes?

The option fee is never refundable. The buyer purchased the right to have an unrestricted right to terminate the contract for a period of time.

Nothing in this publication should be construed as legal or tax advice. For specific advice, consult an attorney and/or a tax professional.

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*Lewis (kerrilewis13@gmail.com) is a member of the State Bar of Texas and former general counsel for the Texas Real Estate Commission.*