



How to Bridge the Appraisal Gap in Today's Real Estate Market

If you're searching for drama, don't limit yourself to Netflix. Instead, tune in to the real estate market, where the competition among buyers has never been fiercer. And with homes selling for record highs,¹ the appraisal process is receiving more attention than ever. That's because, in a rapidly appreciating market, a property is more likely to appraise below the sales price—which can lead to major repercussions for both buyers and sellers.

It's never been more important to understand the appraisal process and the risks involved. It's also crucial to work with a skilled real estate agent who can guide you to a successful closing without overpaying (if you're a buyer) or overcompensating (if you're a seller). Find out how appraisals work—and in some cases, don't work—in today's unique real estate environment.

APPRAISAL REQUIREMENTS

An appraisal is an objective assessment of a property's market value performed by an independent authorized appraiser. Mortgage lenders require an appraisal to lower their risk of loss in the event a buyer defaults on their loan.²

In most cases, a licensed appraiser will analyze the property's condition and review the value of comparable properties that have recently sold. Appraisal requirements can vary by lender and loan type, and in today's market, in-person appraisal waivers have become much more common. If you're applying for a mortgage, be sure to ask your lender about their specific terms.

APPRAISALS IN A RAPIDLY SHIFTING MARKET

An appraisal contingency is a standard inclusion in a home offer. It enables the buyer to make the closing of the transaction dependent on a satisfactory appraisal wherein the value of the property is at or near the purchase price. This helps to reassure the buyer (and their lender) that they are paying fair market value for the home and allows them to cancel the contract if the appraisal is lower than expected.

Low appraisals are not common, but they are more likely to happen in a rapidly appreciating market, like the one we're experiencing now.³ That's because appraisers must use comparable sales (commonly referred to as comps) to determine a property's value. This could include homes that went under contract weeks or even months ago. With home prices rising so quickly,⁴ today's comps may be lagging behind the market's current reality. Thus, the appraiser could be basing their assessment on stale data, resulting in a low valuation.

HOW ARE BUYERS AND SELLERS IMPACTED BY A LOW APPRAISAL?

When a property appraises for less than the contract price, you end up with an appraisal gap. In a more balanced market, that could be cause for a renegotiation. In today's market, however, sellers often hold the upper hand.

That's why some buyers are using the potential for an appraisal gap as a way to strengthen their bids. They're proposing to take on some or all of the risk of a low appraisal by adding gap coverage or a contingency waiver to their offer.

Appraisal Gap Coverage

Buyers with some extra cash on hand may opt to add an appraisal gap coverage clause to their offer. It provides an added level of reassurance to the sellers that, in the

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event of a low appraisal, the buyer is willing and able to cover the gap up to a certain amount.⁵

For example, let's say a home is listed for \$200,000 and the buyers offer \$220,000 with \$10,000 in appraisal gap coverage. Now, let's say the property appraises for \$205,000. The new purchase price would be \$215,000. The buyers would be responsible for paying \$10,000 of that in cash directly to the seller because, in most cases, mortgage companies won't include appraisal gap coverage in a home loan.⁵

Waiving The Appraisal Contingency

Some buyers with a higher risk tolerance—and the financial means—may be willing to waive the appraisal contingency altogether. However, this strategy isn't for everyone and must be considered on a case-by-case basis.

It's important to remember that waiving an appraisal contingency can leave a buyer vulnerable if the appraisal comes back much lower than the contract price. Without an appraisal contingency, a buyer will be obligated to cover the difference or be forced to walk away from the transaction and relinquish their earnest money deposit to the sellers.⁶

It's vital that both buyers and sellers understand the benefits and risks involved with these and other competitive tactics that are becoming more commonplace in today's market. We can help you chart the best course of action given your individual circumstances.

DON'T WAIVE YOUR RIGHT TO THE BEST REPRESENTATION

You need a master negotiator on your side who has the skills, instincts, and experience to get the deal done...no matter what surprises may pop up along the way. If you're a buyer, we can help you compete in this unprecedented market—without getting steamrolled. And if you're a seller, we know how to get top dollar for your home while minimizing hassle and stress. Contact us today to schedule a complimentary consultation.

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Sources: 1. Wall Street Journal 2. US News & World Report 3. Money
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5. Bigger Pockets 6. Washington Post