

# How to Handle Low Appraisals

Let's begin today by talking about prices of homes.

We often say that the price is determined by what a willing buyer and seller agree to.

However, that's not quite accurate when there is a loan.

More accurately, when there is a loan, it's what a willing buyer and seller and BANK agree to.

In the big picture: Prices are determined by the balance of two things: Supply and Demand.

However, that is not how Banks price property. They price property strictly by the comps.

**If no one ever paid cash... or no one ever paid over appraisal... prices could not rise.**

Think about it.

If the last 3 sold comps were 195, 200, and 205, due to condition issues only low, medium, high ... and the subject house is average, it will appraise for what? Right - 200K. All day long.

**So someone has to pay more** to have the next set of comps sell for 205, 210, 215.

**It is not unusual in a rising market for appraisals to come in low. In fact, it's NORMAL.**

The problem isn't necessarily the low appraisals. The problem is that we haven't properly set the EXPECTATION of it... for the Seller and Buyer.... and provided options before it happens.

Today we will cover things you can do about it.

Before and During. Your Choices.

## **Before**

1. Advise Buyers and Sellers it COULD happen and WHY (see above)... and what the consequences are. Figure out BEFORE it happens what you will do if it DOES happen. Best way for it not to be a deal-killer. Be MORE SELECTIVE with the Buyers you work with in this type of market.

2. If a Buyer CAN pay cash in a rising market, arrange to do that. Get your loan after you own it (talk to lender in advance about how much a loan you can get... it may only be 70-80%). Or put 40-50% down. Ask the lender "at what down payment is there no appraisal problem."

3. DO THE MATH WITH THE BUYER. Show a buyer what the home is likely worth over the next year based on the rate of appreciation. You don't tell them, but show them comps from the past... and let them come up with estimate %/year. Divide by 12 and that comes up with monthly appreciation. Do the math. Talk to them about losing the home to someone else willing to pay over appraisal and what that new comp will do to the next property coming up for sale. Show them what the value of buying now at the current rate of appreciation and OWNING it 6 months from now. I've had buyers say, *I'll pay \$15K over because in 6 months the house is worth more than \$15K more anyway... and I want this house. Not to mention, this will now be a comp for the next house, raising the values in the neighborhood anyway.* The only danger in this is if appreciation stops. Watch your inventory and sales rates. Watch interest rate forecasts. Does it make sense? — Give your warnings, do the math with them, and let them decide to take the risk or not. Calculating this BEFORE you write offers gives you better offers... and a better decision made if/when the Seller counters them or the appraisal comes in low.

4. If you represent a Seller, get a PRE-APPRAISAL done so you know the facts before you market. Decide if you are going to use the appraisal (in marketing and negotiation) or roll the dice on the Buyer's appraisal. It COULD come in higher if market is still rising and newer comps bring it up. I have seen agents and sellers that include a pre-appraisal as an exhibit in the contract, forcing the buyers lender to at least see it. Appraisers don't like to argue with each other.

5. Discuss with Buyers that their Home Inspection and Appraisal costs are "risk money" if your contract reads that way. Some contracts are stating if the appraisal comes in low and buyer/seller can't agree, that the Seller will reimburse or split the appraisal cost with the Buyer if they the Seller get a copy of the appraisal.

6. Advise Sellers that if the Buyers appraisal is FHA or VA, the appraisal "sticks" to the house for 3-6 month.... In other words, the Seller won't be able to sell to another FHA or VA buyer and get a different appraisal for about 3-6 months.

7. Sell the seller on making sure the appraisal inspection is the most important appointment. Appraisers are HUMAN. The house MUST look it's Absolute BEST when the appraiser comes. Leave comps on the counter for appraiser to take with notes on it. If you have a survey Leave it. If you recent appraisal, leave it. Suck-up to the appraiser...

8. Use Agent to Agent remarks if MLS allows for comps.

## **When it happens:**

Options:

1. If it comes in low, and contract has an appraisal contingency, Buyer may simply cancel. They've likely lost their home inspection and appraisal \$\$ but they don't have to buy the house over appraisal if the contract doesn't say "Buyer will pay X over appraisal".
2. If it comes in low, Buyer may choose to pay the difference and still buy at contracted price. Example: Contract is \$210K on a 90% loan. Appraisal comes in at \$200K. Buyer may pay \$10K more at closing and still mortgage based on a \$200K price (\$180K loan). Most lenders are OK with this as long as extra cash out of pocket... doesn't deplete required reserves.
3. If it comes in low, Seller may choose to come down to appraised value and sell at that price instead. It's a simple matter of a contract addendum with all parties signing.
4. If it comes in low, Buyer and Seller may choose to split the difference in some way. Doesn't have to be 50-50. What can the buyer come up with in cash?
5. Rarely, the Seller could hold the difference in a 2nd mortgage. Most lenders frown on this unless there is already a big down payment.
6. If the price is simply way off based on comps, the appraisal can be "challenged". This process is different with different lenders and loans. And understand the only one that can decide to challenge is the appraiser's client, which is the lender. The buyer can request it, but the lender decides if they will demand a challenge or not.

Tips on challenging the appraisal include:

1. Give the appraiser comps he/she did not use already. They may have missed an important comp... especially if it's in tax roll only and not in MLS.
2. Explain why this new information comp is better than one they used (closer, more alike in condition, more recent, etc.)
3. Point out differences in the subject that might have been missed (upgrades, bigger sq ft of house/lot, updated components the comps didn't have like new roof, appliances, furnace/ac, finished basement, additional bathrooms, etc.)

Another option on conventional financing is to simply get another appraisal. Warning: It could come out the same or lower than the 1st one so be careful.

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Remember that an appraisal issues is a **BORDER experience**. Every party involved is at the border. The Buyer, the Seller, the Buyers Agent, the Seller's Agent, the Lender and the Appraiser. Your job is to see everyone through the green lens... and stay factual, logical, calm, and persuasive. The Seller wants to sell. The Buyer wants to buy. The Lender wants to lend. If everyone will give a little, you can often come to agreement. When anyone digs in their heels, it's harder to get it done. **If enough advance education has been done, it can be an easy problem to solve.**

Google "how to handle low appraisals" if you want a few great articles to share with your clients. The main thing to remember... it IS Normal in a rising market. Stop getting upset about it.

**Be grateful the market is rising! We are paid on a % of the price! Get good at handling this situation and you will close more deals.**