

Overcoming a Low Appraisal

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There are buyers’ markets and there are sellers’ markets. And then, there’s 2021. Historical low housing supply coupled with high demand has made this the most challenging markets in recent memory for your house-hunting members. Some challenges are obvious and known to your members as they enter the market.

However, there is one challenge lurking that will likely catch them by surprise—and it will cost them a lot of money, if not the deal. That is, unless you can help them.

CHALLENGES FOR HOMEBUYING MEMBERS

The most obvious challenge facing those looking to buy is, of course, low inventory. Nationally, the number of listings dropped considerably over the course of a year. Realtor.com estimated that as of April 2021, active listings were down 53% from the same period last year.

Another challenge is rising costs. You don’t have to be U.S. Secretary of the Treasury Janet Yellen to understand that when supply is this low and demand this high, prices go up.

The National Association of Realtors® (NAR) reported that the median exist-

ing single-family home price jumped to an annual historic high of 18.4% in March. In 182 of the 183 metro areas tracked by NAR, the median sales price of existing single-family homes was higher in the first quarter, compared to a year earlier. And in 89% of those metros, costs were up by double digits.

In the face of this hyper-competitive market, your home-shopping members are looking for ways to have their offer rise above all the others. Many do this by waiving contingencies and often submit offers that exceed the asking or listing price. In fact, according to a recent Redfin report, 48% of homes sold

for above their asking price, which is 20% higher than the same time last year.

While this over-asking-price strategy may help your members win against other offers, it can also create an unanticipated challenge—a low appraisal.

OVERCOMING A LOW APPRAISAL

It’s an all-too-common scenario in this market, but let’s take a moment to set the stage: Your members have finally had their offer accepted. Yes, they had to “overbid” by offering \$300,000 on a home that was listed at \$275,000. Even so, elation sets in as they begin imagin-

CHART 1

Listing price	\$275,000
Purchase price	\$300,000
20% down payment	\$60,000
Monthly mortgage payment (P&I)	\$1,078
Appraised value	\$275,000

ing what color to paint the bedroom.

In this scenario (Chart 1) your members are putting 20% down, or \$60,000. Assuming an interest rate of 3.5% on a \$240,000 loan, your members are expecting to pay a monthly principle and interest payment of \$1,078 in this scenario.

Unfortunately, the home doesn't appraise at \$300,000. Instead, the appraisal comes in at the original asking price of \$275,000. Your members are now faced with solving this new dilemma. What can your members do?

- They could walk away from the transaction, but they're already emotionally invested in the home.
- Renegotiating with the seller in this type of market seems like a non-starter.
- They could make up the difference by adding more cash to the deal. This option, of course, assumes they have the resources to do so.

CREDIT UNION TO THE RESCUE

There's another option your members may not have considered, which is accepting a higher loan-to-value (LTV) instead of trying to adhere to the old myth of needing to put 20% down.

While a 20% downpayment will help them "avoid" private mortgage insur-

ance, what they are really "avoiding" is a solution that allows them to pay the same amount for downpayment yet still have a monthly mortgage payment similar to what they originally thought they'd be paying.

Let's look at our scenario again, using the same assumptions as before for a couple of home-buying members with a credit score of 760 and a debt-to-income ratio of 35%.

In Scenario 2 (Chart 2), instead of needing an additional \$20,000 for a downpayment to save the deal, your members can maintain their originally planned downpayment of \$60,000. True, their monthly payment is higher than in Scenario 1 due to a larger loan amount and the cost of private MI. But it's only \$30 more than what they originally expected to pay for their monthly mortgage payment.

And don't forget that in Scenario 1, they would need to put an additional \$20,000 down to get that lower payment. At a difference of \$120 a month, it will take your members more than 13 years to recoup the extra \$20,000 they had to put down.

Yes, your members will need monthly private MI. But in this scenario, MI is not viewed as much as an additional

cost, but as an option that saves the deal for your members—and it's a temporary cost at that.

If we assume 3% annual home price appreciation, your members will be able to cancel the private MI in just over three years, which will reduce their monthly payment to \$1,078 after the MI is cancelled. Ultimately, they will have paid under \$1,200 in total for the private mortgage insurance that helped them to save the deal and buy their home.

This example demonstrates how using private mortgage insurance allows your members to:

- Avoid spending an additional \$20,000.
- Add only \$30 to their monthly mortgage payment.
- Cancel the additional cost of private MI after a few years
- Buy their home.

One of the benefits of private mortgage insurance is the flexibility it provides your members. In fact, you might be able to offer a single premium to the same members in this example, which could be paid out of pocket or financed into the loan, lowering your members' monthly mortgage payment to \$1,084 (using the assumptions in our example).

With this strategy, you can help your credit union members save transactions and move into homes—plus build or enhance your relationships with local real estate agents.

It's one more strategy you can use to showcase how your credit union provides value in all markets. ▲

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CHART 2

	Expectations at offer to purchase	Scenario 1 80% LTV based on appraised value	Scenario 2 with Mortgage Insurance
Purchase price	Offered: \$300,000 List price: \$275,000	\$300,000	\$300,000
Appraised value	TBD	\$275,000	\$275,000
Down payment	\$60,000	\$80,000	\$60,000
Loan amount	\$240,000	\$220,000	\$240,000
LTV	80%	80%	87%
Monthly MI*	\$0	\$0	\$30
Monthly P&I + MI	\$1,078	\$998	\$1,108

*Mortgage insurance based on credit union rates as of May 20, 2021 in Milwaukee, WI.