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Waiving the Appraisal Gap Can be Both a Bargaining Chip and Big-Time Risk for Home Buyers

If the house you're buying appraises for less than its contract price, it could affect your mortgage. Here's what to know

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While luxury home sales have declined in many markets, pockets of heated activity remain, where inventory is scant and bidding wars are still common. If you're looking for a home in one of these markets, should you make yourself a more competitive buyer by waiving the so-called appraisal gap to entice a seller to accept your offer?

Appraisal gaps, which occurred in 11% of residential transactions in June 2023, according to CoreLogic Inc., a real-estate data and services provider, arise when homes appraise for less than the contract price. They often occur in tight markets where buyers have to bid above the asking price to secure a home.

“We're still seeing supply and demand challenges in certain markets,” said Shawn Telford, CoreLogic's chief appraiser. “There are gaps between the contract price someone's willing to pay and what the market data shows the home would likely be selling for in a typical market without the undue influences of the fear of missing out.”

Waiving the appraisal gap simply means that a buyer will move ahead with the purchase at the agreed-upon price no matter what the appraised value of the home. That's great for sellers—it means the buyer is serious and locked into the deal. But while waiving the gap may give buyers a leg up in a competitive bidding situation, it also shifts a tremendous amount of risk onto them since they can lose their down payment if they lack sufficient funds to make up the difference.

Although real-estate agents often refer to “appraisal waivers,” in most states, there is in fact no appraisal contingency in a standard home-purchase agreement. Instead, the issue arises in the context of the mortgage contingency because a lender’s mortgage commitment is conditioned upon receipt of a satisfactory appraisal. If the appraisal comes in for at least the purchase price, the deal proceeds as planned. If it comes in too low, however, that will affect the loan-to-value ratio used by a lender to qualify the buyer—and often results in the lender approving a lower mortgage amount.

For example, for a buyer putting down 20% on a \$1 million home, the maximum amount of the loan would be \$800,000. But if the appraisal came in for \$900,000, under the 80% loan-to-value ratio the buyer qualified for, the lender would only finance \$720,000. If the buyer waived the appraisal gap, that means that the buyer would have to come up with \$280,000 in cash to close, rather than the \$200,000 originally anticipated. That’s fine if the buyer has the additional cash on hand. But if they don’t, and they can’t qualify for a 90% loan-to-value mortgage, they may need to back out of the deal and face the loss of their down payment.

“If the appraisal comes in low, it’s going to change the financing options,” said Alec Hanson, chief marketing officer for loanDepot. “Even if the customer can still qualify on the new terms, maybe that’s not what they want for their financial situation.”

Donna Soda, an agent with Premier Sotheby’s International Realty in Lakewood Ranch, Fla., said that appraisal waivers can incentivize a seller to accept one buyer’s offer over another. She has had deals where the appraisal came in below the purchase price, and the buyer and seller renegotiated to lower the price. But she’s also had a deal where her clients agreed to waive the appraisal gap and had to come up with an additional \$100,000 in cash at closing when the appraisal came in too low on a \$2.3 million purchase. “That was during the pandemic buying frenzy,” Soda said. “In 2020 and 2021, you would blink your eyes and a property would be off the market.”

Here are some other things to consider before you waive an appraisal gap.

Be cautious. Waiving the appraisal gap means that you, as the buyer, will need to complete the purchase no matter the amount of the appraisal, so make sure you have sufficient cash on hand to make up the difference. Be aware that you are overpaying for the house, so do your due diligence beforehand by checking public records for recent sales or asking your real-estate agent for research on comparable sales. Then, make an informed decision based on the data, not an emotional one based on a fear of missing out.

Cap your liability. If you decide to waive the appraisal gap, limit your liability. For example, you can offer to waive the gap up to \$50,000, rather than leaving your liability open-ended. That way you won't end up paying \$800,000 for a home worth \$600,000.

Request a reconsideration of value. According to the Consumer Financial Protection Bureau, home buyers can ask a lender for a "reconsideration of value" if they feel the original one is inaccurate. Borrowers can point out errors or omissions in the appraisal, such as the use of properties that were not comparable. Deanna Kory, an associate broker at The Corcoran Group in Manhattan, worked with buyers of a New York City condominium where the purchase price was \$4.924 million but it appraised for 10% less. Kory noticed that the appraiser relied on a sale she didn't consider comparable and ignored two recent comparable sales that would have made a "tremendous difference in value." She requested reconsideration and submitted a five-page document refuting the comparable sales the appraiser had selected. The result: The appraised value of the unit was increased to the purchase price, and the deal went through.