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Appraisal Gap No Longer Sacred

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Most homebuyers are financing their new home through a Lender. They prequalify, and the lender agrees to provide a specific percentage of the Appraised Value of the home.

In other words, the buyer's down-payment is the corresponding percentage of that appraisal. Most 'conventional' financed buyers are trying to put 20% down, although it may be as little as 10% or even 5% depending on how much money they have in savings. An FHA buyer only needs 3.5% down and a military veteran can use VA with a 'zero' down-payment.

If the appraisal comes in below the agreed purchase price then the buyer's loan is accordingly reduced. If a borrower is finding 20% down on a $500,000 home, then the lender has agreed to fund 80% of the appraisal value. Let's say the appraisal comes in at $480,000. Where the buyer previously expected a loan of 80% ($400,000), that is now reduced to 80% of the appraisal = $384,000. Suddenly the buyer is $16000 short in their home loan! What to do?

In the past, the MLS contract clause would kick in that said the sales price was 'contingent' on the appraisal and seller must re-negotiate the price. In the above example sellers were under pressure to reduce the price from $500,000 to $480,000 if the appraiser said that is what it was worth. This enabled the homebuyer to still obtain their 80% loan to value without needing to find other money to make up the "Appraisal Gap".

Homebuyers budget very carefully for their down-payment and often need the seller to adjust value to reality after the appraisal. The appraisal gap was usually covered by the seller reducing the sales price.

The Appraisal Gap is, in 2023, is no longer sacred. In the competitive market right now, where there are often 5 buyers for every listing, the homebuyer is trying to find ways to beat out the other guy for the home, knowing that they will pay more than reasonable value.

Common competitive moves in an offer include limiting inspection repairs to health and safety only, purchasing the property as-is with no repairs, paying for some closing costs normally a seller responsibility and now – insuring the seller against the appraisal gap so seller will not have to reduce price even if the appraisal comes in low.

In other words, the buyer will find cash to make up the gap between the appraised value and the agreed upon sales price.

In this market, where a $350,000 listing may sell for $400,000, the gap could be substantial. If the $350,000 property sells for $400,000 to one of the hungry buyers and the appraisal comes in at $375,000, the gap will be $25,000 cash that the buyer will have to pay on top of their pre-approved lender down-payment to close the deal at $400,000.

Homebuyers are commonly offering some 'appraisal gap' insurance and the gap offer may be $5,000, $10,000, $20,000 or even more. All depends on how motivated that homebuyer is and how much cash he/she can find.

The Appraisal Gap is no longer sacred in a hot seller's market and now a common ace being played in the home buying game. Once the market cools back to normal supply and demand conditions we can expect the old rule to return. In the meantime, seek counsel from your Realtor when presenting your offer.

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