Be Prepared for the Low-Appraisal Blues

When a home's value comes in lower than expected, that's not the time to panic

By Leslie Heimer

Photo illustration by Paula Douglass

Once contracts are executed and the earnest-money check clears the bank, homebuyers likely set their sights on finalizing financing. And why not? With interest rates in the 5 percent range and rising, time is of the essence.

With a recovering real estate market and pent-up demand, the housing market is still hot, and purchase-transaction activity is increasing. That said, many buyers are wringing their hands when faced with a big decision if the appraisal comes in lower than the agreed-to contract price.

Typically, an appraisal evaluation is conducted after the purchase price has been agreed upon. It is not uncommon in this active market to see the appraisal come in $5,000, $10,000 or even $15,000 lower than expected.

This presents a real conundrum for the borrower and one that many buyers have not experienced (certainly not in the last decade). It's also a dilemma for you as the mortgage professional, in addition to your real estate partners, who are no doubt anxiously awaiting your call with the appraisal results.

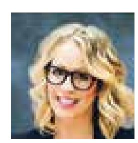
This can be dicey territory. We know that appraisals are not quite an exact science. It can become a challenge to mitigate the risk of watching your transaction crumble as you assist your client in their preferred direction.

Set expectations

First off, you have to time the appraisal right. Often you want to avoid ordering the appraisal too early in the loan-underwriting process if your client's credit, assets, and income and liquidity position are still being analyzed. Appraisals are expensive, and no one wants outstanding invoices as the result of an incomplete transaction.

Once the financing eligibility is solid, send out your appraisal order. Then keep your real estate partners informed about the scheduling and any updates, etc.

Ask your real estate agent to attend the home inspection. This can be helpful should the appraiser need extra data points or would like to ask a question about the neighborhood. The agent can provide in-sights into an area or can talk about upcoming closings to be used



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as sales comparisons. Caution your real estate partners to not be too aggressive and give the appraiser room to do the job.

Appraisers are often fearful of being recorded and sometimes nervous about engaging in too much conversation, because of bad past experiences with overly aggressive agents. This type of behavior is unprofessional and does not help our industry. We should all work as a team, with a mutual respect for all spokes in the wheel.

Section 1472 of the Dodd-Frank Act, known as Appraiser Independence, was established as part of the financial reforms enacted after the last housing crisis. It sets restrictions on mortgage professionals in their communications with an appraiser.

This new process is an attempt to eliminate implied pressure on the appraiser to inflate values that may be unjustified based on sales comparisons. These rules are taken very seriously and, with the added pressure on appraisals in today's accelerated marketplace, it's important to heed these rules.

Last, be prepared and have a plan B. Set expectations for your clients should a low appraisal come in.

Is this home the perfect home for your client's family? Are they content, having already agreed to the price and terms of the purchase contract and mortgage loan? Are they in an adequate cash position that would allow them to pay over appraised value or accept the decreased equity in their home after closing?

The homebuyers may have already created their Pinterest board with pictures of their new home and have their current home packed up in boxes. They may already be daydreaming of where they will put the pool table and entertainment system, or have de-signers lined up to measure the new walk-in closet. Understand that this is an emotional time.

Move forward

Now, let's say the appraisal does come in low. How will you advise your client? First, you have to keep a calm and cool head. Brace yourself for the irritated calls from your real estate partners, some of whom will likely lay into you about "the comparables that should have been used," or the incompetence of the appraiser.

In this situation, arguing, complaining and blaming are not forward motion. In addition, we all know that appraisal appeals are rarely an effective option for changing the predicament.

Allow the Realtors to take the lead in renegotiating the purchase price to something comfortable for both parties. Explain to the buyer that this is a situation that occurs often in today's changing market and offer a reassuring tone that helps them not to panic.

Perhaps the downpayment and terms will not change, but only the equity is reduced, and the buyer is fine with that. Depending on your market, attempting to renegotiate the price could be risky if there is another family waiting in line with a backup offer to scoop up the new home. It can be difficult to convince your buyer of this, and certainly it's a delicate dance to choreograph.

If a Federal Housing Administration (FHA) loan is involved, it often helps to caution the listing agent about the nature of FHA appraisals, which stick with the house. Page 128 of the FHA Handbook includes highly specific and detailed requirements about how the regulators will define value, account for sellers' concessions and comparable adjustments, and how the appraiser's judgment will stand. In addition, based on the way FHA loans work, future buyers needing financing also may be stuck with the FHA-appraised value, so it would not be productive to cancel this contract and re-list — unless the next buyer is using cash.

Fortunately, the low-appraisal challenge is an indication of a healthy real estate market and thriving economy. The values will catch up to the demand as more transactions occur, and more comparable sales are available for appraisers to use in their evaluations. ■