Managing the impacts of appraisal gaps in a hot housing market



As has been well reported over the past year, the United States is in a very hot seller's real estate market. An inclining market, as opposed to a declining market, can bring challenges with purchase appraisals. In the current market, with inventory low and homes selling quickly at a high price, an appraisal can be a lagging indicator of value and lead to challenges with completing the purchase of a home.

A hot market leads to valuation challenges

A shortage of inventory is the main factor fueling the hyperactive real estate market. It is not uncommon to have multiple offers on a well-priced property. When this happens, realtors urge buyers to present their "highest and best" offer, which often drives buyers to make an offer above asking price. The seller must then select which offer is best and typically accepts the highest offer. A higher price generally results in a happy seller but could lead to issues with buyers needing financing.

In accepting a higher offer, a new "market value" of the home is created. This can be a concern when and if the buyer is utilizing a mortgage for the purchase and an appraisal is completed. The job of a purchase appraisal is to determine value based on historical sales of similar homes.

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Appraiser guidelines support a home's value based on the ***historical*** data of comparable sales—typically within the last 90-180 days—that are close in proximity to the home. A lender will only lend based on the lower of either the appraised value or the purchase price. Often times that historical data has not caught up with the real market data.

Minimizing the impact of an appraisal gap

With the current hot market, lenders are seeing a significant number of "low" appraisals versus the accepted purchase price. When this happens, a buyer has three options of how to proceed:

1. The buyer can negotiate with the seller to reduce the price or meet in the middle somewhere.
2. If the buyer and their realtor feel the appraiser has missed some pertinent information, they can provide additional data to the appraiser via the lender.
3. The buyer can put more money down to avoid mortgage insurance implications (if applicable).

There are a few things buyers can do upfront to protect themselves in this market:

1. Work with their realtor on a realistic offer. If paying over list price, and an appraisal does not support the value, be prepared with options necessary to keep the deal intact.
2. Talk to their loan officer about this inclining market to understand all available options should an appraisal come in low and what it could mean to their loan scenario.

Corporate clients will also want to consider what the long-term effects of this market may be on relocation policies. If a transferee pays significantly over list price and the market corrects, and then they relocate again quickly, they may be in a loss-on-sale situation. Currently we are not hearing from any prognosticators that a bubble is imminent. For more guidance and information on this topic, please reach out to your U.S. Bank Corporate Programs contact.

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