

the Mortgage Bulletin

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Can a buyer rely on an appraisal?

Sometimes we need a short break from the serious times in which we live. And so we offer the following before seriously answering the headline question.

A person flying in a hot air balloon realizes that they are lost. They reduce the height and spot a person on the ground below.

They lower the balloon further and shout, "Excuse me. Can you help me? I promised my friend I would meet him half an hour ago, but I don't know where I am."

The person below says, "Yes. You are in a hot air balloon, hovering approximately 30 feet above this field. You are between 40 and 42 degrees North latitude and between 58 and 60 degrees West longitude."

"You must be an escrow officer," says the balloonist.

"I am," replies the person below, "how did you know?"

"Well," says the balloonist, "everything you have told me is technically correct, but I have no idea what to make of your information and the fact is, I am still lost."

The person below says, "You must be a loan officer"

"I am," replies the balloonist, "but how did you know?"

"Well," says the person below, "you don't know where you are, or where you are going. You have made a promise that you have no idea how to keep, and you expect me to solve your problem."

OK, the break is over. Now to answer the question – "What good is an appraisal?"

We all know that mortgage lenders universally require an appraisal by a licensed appraiser as part of the loan approval process. And most mortgage financing pre-approvals contain the following condition. "This approval is subject to the lender's approval of an appraisal by a qualified appraiser."

It follows then, that a buyer can comfortably remove a financing contingency (if in fact the purchase agreement contained a financing contingency) when the appraisal supports the price being paid. Right?

Well, not really.

If the buyer has offered \$1,000,000 and needs 90% financing (\$900,000) in order to make the purchase, the fact that the appraisal comes in at \$1,000,000, although somewhat comforting to the buyer, is not good enough.

We say this because, as you will recall, the loan pre-approval is conditioned upon THE LENDER'S APPROVAL OF AN APPRAISAL BY A QUALIFIED APPRAISER. This means that the lender has final approval of the appraisal.

It is unusual, but possible, that the lender might challenge the value reached by the appraiser. The lender could reduce the appraised value to \$950,000.

We won't do the math right here, but the result of such a decrease in appraised value creates a \$45,000 gap in the transaction. So the buyer can either fork up another \$45,000 if it is available or, if it isn't available, default on the purchase agreement.

Of course there is another alternative and that is for the seller to agree to reduce the price. But it is clear that the buyer is at least momentarily in severe jeopardy.

How can a prudent buyer avoid this problem? First, make sure you are dealing with a loan agent whose appraiser has a record of accuracy and the ability to defend their appraisals if challenged. Second, don't remove a financing contingency until the appraisal is approved by the lender.



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