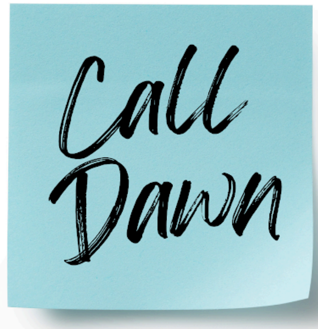
# Mind the Gap: Managing the Appraisal Contingency




When working with your real estate broker, it's essential to present a compelling offer. While offering the right price is crucial, non-monetary factors can also make your offer stand out. One key aspect to consider is the **appraisal contingency**. By agreeing to take on the risk of a low appraisal—sometimes referred to as an **appraisal gap**—your offer can become more attractive, especially when competing with cash buyers.

You'll discuss this and other strategies with your broker when crafting your offer. As your lender, we don't advise on whether you should waive the appraisal contingency or pay above the appraised value. However, we play a vital role in guiding you through:

- Understanding the importance of the **appraisal** in your financing.
- Determining if waiving the **appraisal contingency** is a viable option.
- Knowing how your loan may be impacted if the appraisal falls below your offer price.

## Step 1: Understanding Loan-to-Value (LTV) Ratio

In the loan process, it's natural to focus on your down payment, especially if you've worked hard to save. However, lenders prioritize the **Loan-to-Value (LTV) ratio**, which is the loan amount divided by the property value. This ratio reflects the lender's perspective on the risk of the loan since the property serves as collateral.

To keep the loan process transparent, we minimize jargon, though discussing the **appraisal contingency** and **LTV** may require some technical terms. Simply put, LTV is the inverse of your down payment and plays a crucial role in how lenders assess the loan.

## But what is the "value"?

When considering a mortgage, you're likely asking: **"What is the property value?"** Knowing how much you want to borrow is straightforward, but determining the **value of your home** is crucial. For your lender, the **value of the property** is the lesser of two amounts: the **purchase price** or the **appraised value**.

## The Lender's Perspective:

- **You:** How much am I putting down?
- **Lender:** How much am I lending?

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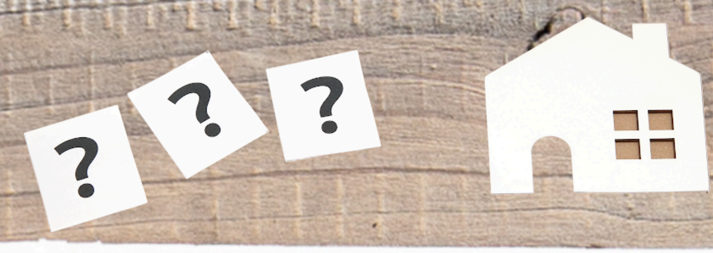

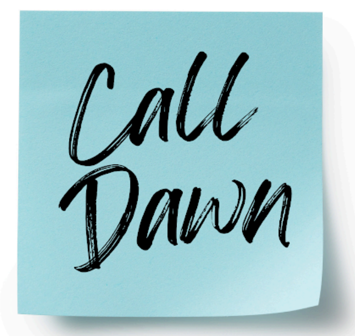


Let's say you put **$100k down on a $500k home**. That equals a **20% down payment** and an **80% loan-to-value (LTV) ratio**:

- $100k ÷ $500k = 20% down
- $400k ÷ $500k = 80% LTV

This creates a balanced equation: **20% down + 80% loan = 100% of the property price**. However, things can get complicated if the **appraised value** is lower than the purchase price.

## When Appraisal is Lower:

If the **appraised value** drops to $450k, the numbers shift:

- **$100k down ÷ $500k purchase price** still equals **20% down**.
- But now, a **$400k loan ÷ $450k appraised value** equals **88.89% LTV**.

As you can see, this changes the dynamic. Here's a **pro tip**: Focus on the **dollar amount** of your down payment, not just the percentage. It makes things easier to understand.

Avoid this confusion:

- **20% down + 89% loan = 109%** (That doesn't work!)

Stick with the basics:

- **$100,000 down + $400,000 loan = $500,000 price**.

## Maximizing Your Loan with a Higher LTV: What You Need to Know

So, what does a higher loan-to-value (LTV) ratio mean for your loan? There are four possible outcomes:

1. **No Impact**: Surprisingly, a low appraisal might not affect your loan. No additional down payment is required, and your loan terms remain unchanged.
2. **Cost Adjustments**: Often, the main shift is in loan costs. If you're comfortable with the changes, the loan can proceed without needing more money down.
3. **Loan Restructuring**: In some cases, you might need to switch loan programs or add secondary financing. Again, no extra down payment might be necessary.


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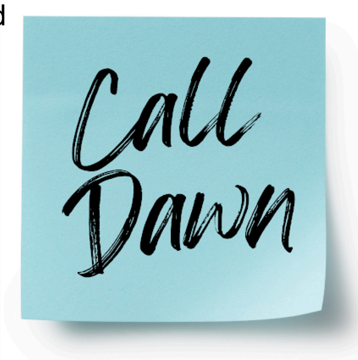
4. **Additional Cash Required**: If your loan amount divided by the appraised value exceeds the acceptable LTV for your loan option, you may need to come up with more cash to close the deal.




If the fourth option is the only path forward, and the extra funds required are beyond what you can provide, it could limit or even prevent you from making an offer with an appraisal contingency waiver.

Here's an example scenario: with a $400k loan on a $500k property that appraises at $450k, the likely outcome would be:

- No additional down payment required
- The slight reduction in closing costs
- Addition of mortgage insurance (as either a one-time premium or a temporary increase in your monthly payment)

## Step 2: Understanding Your Loan Options

Your situation is unique, and while this guide provides a general overview, our personalized conversations will delve deeper into your specific needs. Our expertise in real estate financing means we can offer a variety of loan options tailored to you. Both you and your real estate broker need to be aware of the tools available for your offer-writing toolkit. Here are some key concepts and principles to consider:

- The larger your down payment, the more flexibility you'll have with your appraisal contingency.
- A smaller down payment may limit your options.
- Loans that allow for a higher loan-to-value (LTV) ratio can provide more leeway for a robust appraisal contingency.
- Don't overlook mortgage insurance; it can be beneficial in certain situations.
- Appraisers determine value by analyzing comparable sales ("comps") in the area, and sometimes the luck of the draw with comps can influence the appraisal.
- Unique properties may pose challenges for appraisers in finding comps that accurately reflect their distinctive features.
- Always consult your real estate broker regarding property value.

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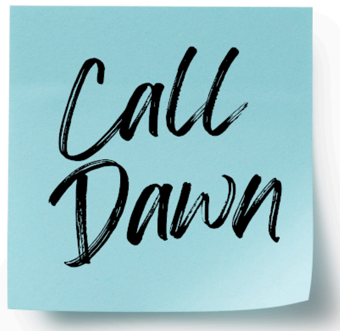
## Step 3: Crafting Your Offer




You've found your dream home—now it's time to write your offer! As you and your broker discuss the terms, we'll be here to refine your appraisal contingency strategies based on the specific property. To assist us in this process, please be ready to answer a few key questions:

- What amount are you planning to offer?
- What is the lowest appraisal value you or your broker expect for the home?
- What is the maximum cash you can allocate for your down payment and additional purchase costs?
- What monthly payment amount are you comfortable with?

We'll fine-tune the numbers to help you present the strongest possible offer, increasing your chances of having your offer accepted and moving forward in your journey to homeownership.

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