



***A Message from the Indiana Association of Realtors®
Legal Department***

Best Practices Concerning the Appraisal Gap

May 2021

As the market inventory is low and demand high, the real estate market is extremely competitive these days resulting in creative ways for buyers to gain an advantage. One tool being used by buyers is an appraisal gap coverage provision. The buyer agrees to cover the gap if the appraisal comes back lower than the purchase price up to a specific dollar amount. Because there are issues that may arise surrounding this appraisal gap contingency in a purchase agreement, the following advice is being provided on this topic.

What language should be incorporated if a client desires to cover the appraisal gap as a bargaining tool?

In the further conditions section of the purchase agreement, a buyer may use language comparable to the following:

“If the appraisal value comes in below the purchase price, Buyer agrees to cover the difference in cash between the appraisal amount and purchase price up to and including \$_____ (gap amount). This will supersede any conflicting provision contained in the appraisal, financing or other sections of the purchase agreement.”

With this supplemental language, there is no need to cross out existing sections of the appraisal contingency in the purchase agreement that may conflict with the appraisal gap verbiage.

Is Buyer required to pay more than the purchase price?

No. It is important to remember the appraisal gap will not cause the purchase price to increase. For example, purchase price is \$300,000 with an appraisal gap of \$15,000 and appraisal comes in at \$290,000. This does not mean the sales price will be \$305,000.

Is Seller required to sell below the purchase price?

No. The sample language provided above will provide a floor, i.e., the purchase price. For example, an accepted purchase price is \$250,000 and the agreed upon appraisal gap is \$20,000. Appraisal comes in at \$200,000. Does the buyer get the property at \$220,000? No, if the appraised value plus the gap amount is lower than the purchase price, then the seller can terminate.

Continued on page 2 >>



INDIANA ASSOCIATION OF REALTORS®

143 W Market St, Ste 100, Indianapolis, IN 46204
(800) 284-0084 | indianarealtors.com



If an appraisal comes back lower than the agreed upon gap, the parties can still negotiate, if desired, and agree to a new purchase price using an Amendment. The parties will not be bound by the appraisal gap previously agreed upon in this instance. For example, a \$300,000 house with a \$15,000 appraisal gap has an appraisal come back at \$280,000. The parties would have to agree to amend the purchase price in this scenario as the appraisal gap is more than the \$15,000 agreed upon by the buyer or the contract may be terminated by either party.

Proof of Funds

It is advisable for the seller to require Proof of Funds for this appraisal gap coverage. Brokers should address where the cash gap money is coming from and provide proof that it exists to the seller's satisfaction. These are all negotiable terms between the parties, of course.

Questions

For any questions regarding the above guidance, please contact the IAR Legal Hotline at 1-800-444-5472 as a managing broker or authorized agent, Monday-Friday, 9am-5pm.

