

# **Guidelines for the Preparation & Use of the Pennsylvania Association of Realtors® Appraisal Contingency Addendum to Agreement of Sale (Form ACA)**

## **General Notes on Usage of PAR Standard Forms**

The Pennsylvania Association of Realtors® Standard Forms are developed by the PAR Standard Forms Committee for use in a wide variety of transactions and market areas. To provide maximum flexibility to the parties, many provisions contain blank spaces that can be filled in as appropriate. Further, it is helpful to remember that where pre-printed language is not agreeable to the parties it can be crossed out and/or modified, with the parties dating and initialing the change in the margins. As a general rule, text added by the parties that changes pre-printed text, or pre-printed text altered by the parties, will prevail over pre-printed language should a dispute arise.

As stated in the title, these are only *guidelines* for the proper use of this form. The Guidelines presented here should be used in conjunction with, and as a supplement to, your professional education, and are in no way meant to substitute for proper professional education. Seek guidance from your Broker and/or your legal counsel if you have any questions about the proper use of this or any PAR form in a transaction.

To make these Guidelines more useful there may be helpful “extras” added to the main text. Many of the “NOTE” or “Practice Tip” items you will see are based, in part, on the experiences of PAR members and legal counsel, and are designed to point out some of the more practical items involved in filling out this form.

## **Background Information**

In transactions that are contingent upon mortgage financing, the mortgage financing contingency in the PAR Agreement of Sale provides a type of “back door” appraisal contingency. As written, it states that if a buyer is unable to obtain mortgage financing after meeting all other criteria, that buyer will not be required to purchase the property and will get back all deposit monies. Where a property appraises for less than the amount required by the lender, causing the lender to refuse financing, the buyer would be able to be released from the transaction.

In some transactions there is no mortgage contingency, however, and even in others with the contingency there may be reasons why a buyer would want or need to confirm a minimum appraisal value in order to move forward with the transaction. An obvious example is a cash transaction where the buyer wants to be sure that the property has a minimum value to justify the purchase. In other circumstances, a buyer may need financing but is making a substantial down payment on the property; although the buyer may be able to get financing based on a lower appraisal, that buyer might not want the property if it is valued below a certain level.

A note under the title of the form indicates that this form is not to be used with FHA or VA financing. Both FHA and VA financing are federally-backed loan programs that have special

borrower benefits and requirements not typical of conventional loans. One such benefit is the borrower's right to terminate the contract if the purchase price is not reflected in the appraisal value. Stated another way, when a buyer uses FHA or VA financing, the minimum appraisal value must match the purchase price and the buyer must have the right to terminate the agreement of sale if the minimum appraisal value is not met. Because one of the options of this form waives the buyer's right to terminate the agreement of sale, use of this form is not recommended if the buyer is using a VA or FHA loan product.

## Paragraph 1: APPRAISED VALUE

This paragraph of the form identifies the lowest possible amount at which the Property should appraise called the "minimum appraisal value."

### MINIMUM APPRAISAL VALUE: DOLLAR AMOUNT

Simply fill in the dollar value at which the buyer would like the property to appraise. The parties can negotiate the amount to be inserted, and the number could be higher or lower than the Purchase Price. Keep in mind that in addition to the appraised value being equal to or greater than the amount expressed, the appraisal must have been carried out in a manner acceptable to the underwriter, if financing is being obtained.

*Example:* Buyer A is purchasing a home for cash. The list price is **\$200,000** and Buyer A makes a full-price offer, which is accepted. To ensure that they are purchasing the property for a fair value, Buyer A requires that the property be appraised for **at least \$200,000**.

*Example:* Buyer C is purchasing from sellers who are liquidating an estate. Sellers claim to be selling the property at below market value in an effort to quickly resolve the administration of the estate and the agreed-upon **purchase price is \$200,000**. Buyer C has plans to flip the property after making minimal improvements and wants to be sure that the market value of the property truly is greater than the purchase price, so they make the purchase contingent upon the property appraising for **at least \$225,000**.

**Note:** The language of the form states that the minimum appraisal value is either the Purchase Price or a specific dollar amount, *whichever is less*. If the parties want to set a minimum appraisal value that is higher than the Purchase Price, the words "whichever is less" on line 5 should be crossed out with the deletion initialed and dated by the parties.

Failure to write in a specific dollar amount on the line provided will result in an interpretation that defaults to the minimum appraisal value being equal to the Purchase Price.

### MINIMUM APPRAISAL VALUE: PURCHASE PRICE

If the Buyer or lender wants to make sure that the Property is not being purchased for more than its appraisal value, this is the appropriate method to use. This can also capture the fluctuations in Purchase Price that could come from the Price Escalation Addendum (Form PEA).

*Example:* Buyer E is purchasing the property with a mortgage contingency. The home was listed for **\$200,000**. Buyer E is in a time crunch and makes a full-price offer. The property will be financed with a \$30,000 down payment and a mortgage for the remaining **\$170,000**. Buyer E has to move quickly and is comfortable with paying more than the appraised value but knows that their mortgage approval will not be valid if the loan-to-value ratio of the mortgage is greater than 90%. To ensure that the mortgage commitment is not compromised, Buyer E makes the purchase contingent upon the property appraising for **at least \$189,000** because  $\$170,000 / \$189,000 = 89\%$  (Loan Amount / Property Value = LTV).

*Example:* Buyer G is making an offer in a very competitive market with a price escalation clause that could potentially increase their purchase price to a maximum of **\$275,000**. Buyer G wants to protect their investment but doesn't know the final purchase price at the time the offer is submitted. Buyer G includes an appraisal contingency addendum with **no dollar amount specified** on Line 4 which means that the appraisal value must be equal to the final purchase price.

### **THE CONTINGENCY PERIOD**

The default Contingency Period in this addendum is 30 days after execution of the Agreement. This means that the appraisal must be completed within this time period, and if Option 1 is selected in Paragraph 2, that the parties' negotiations must also be completed within that time period (unless an extension is agreed upon in writing). If market conditions are such that 30 days isn't enough time to get the appraisal completed and an appraisal report delivered, extend this time period in the Addendum before signing rather than waiting until the deadline draws close and trying to extend it then. Failure to complete the appraisal within the Contingency Period has serious consequences for Buyer.

**Practice Tip:** If a buyer is going to be using this appraisal contingency with a mortgage, it will be up to the lender to arrange for the appraisal. Brokers and agents may want to consider this fact when discussing lenders with their clients. If a certain market has a long wait to obtain appraisals, it may be obvious from the start that the default time period will need to be extended. If certain lenders seem to take substantially longer to get appraisals completed, that may be a factor for a buyer to consider when selecting a lender and may be a factor that a seller would want to consider if selecting between competing offers.

### **THE APPRAISER**

When Buyer is obtaining mortgage financing, the mortgage lender will almost always require that the appraisal be done by an appraiser selected and engaged by the lender. Where the purchaser is not using a lender, the appraisal can be done by any Pennsylvania-certified appraiser selected by the buyer.

**Note:** There are various types of appraisers, each of which may have certain restrictions on the types of appraisals they are permitted to perform. Regardless of the category of appraiser, each must obtain a certificate from the Pennsylvania Appraiser Board and is therefore considered to be a "certified" appraiser. If there is some reason to specify additional criteria for an appraiser, it can be inserted in the form.

## Paragraph 2: ELECTING OR WAIVING A CONTINGENCY

There are two options (cleverly titled “Option 1” and “Option 2”) for how the parties will handle the appraisal report. The first is a typical contingency-style option; the second is really more of a waiver, where the buyer can signal a willingness to move forward in some way regardless of the appraisal result. Buyer **must select one of the options** in order for the form to have any meaning after the appraisal is completed and give the parties direction on what happens after the appraisal is completed.

### OPTION 1: THE CONTINGENCY

1. If the Property appraises *at or above* the minimum appraised value, **or if Buyer fails to complete the appraisal within the Contingency Period**, then the Buyer agrees to move forward with the deal under the existing terms of the Agreement of Sale.
2. If the Property appraises *below* the minimum appraisal value or is appraised in a manner that is not acceptable to the underwriter, if any, then Buyer has the option to terminate the Agreement and walk away from the transaction unless Buyer and Seller can reach a written agreement for any concessions that would cause Buyer to continue moving forward.

**Practice Tip:** Consider using the Change in Terms Addendum (PAR Form CTA) to deliver the appraisal report to Seller and to negotiate a resolution between the parties.

**Note:** While the option to renegotiate is available, nothing in the language of this addendum requires Seller to reduce the purchase price to the appraised value.

3. If the Contingency Period ends and the Buyer has neither terminated the contract nor reached a mutually acceptable written agreement with the seller, then the contingency is waived and Buyer loses the right to terminate under this particular contingency. Buyer would still be able to exercise whatever rights to terminate exist under the Agreement of Sale and any addenda.

### OPTION 2: THE WAIVER

Option 2 is not a traditional contingency, in that Buyer is **not** reserving the right to terminate and is **not** anticipating any further negotiations between the parties. Option 2 is for buyers who want to know the value of the property, but also want to signal to sellers that they’re willing to move forward with the deal regardless of the appraisal results.

1. If the Property appraises *at or above* the minimum appraised value, or if Buyer fails to complete the appraisal within the Contingency Period, then Buyer agrees to move forward with the transaction *and* both parties agree in advance to modify certain terms of the Agreement as necessary to ensure that the transaction can move forward *with no changes to the purchase price*.

For example, if it becomes necessary for the buyer to change the loan amount in the mortgage contingency to ensure they can obtain financing and close on the property, they are agreeing in advance to make that change.

2. Any changes that are necessary under Option 2 will automatically override any prior terms in any mortgage/financing contingencies, but with all other terms of the Agreement of Sale staying in place.
3. If the Property appraises *below* the minimum appraisal value or is appraised in a manner that is not acceptable to the underwriter, if any, **Buyer still does not have the option to terminate the Agreement**. If the minimum appraisal value is not met, two things happen. First, the addendum becomes null and void; it doesn't do anything or change anything. Second, the regular terms of the Agreement of Sale still apply, including those from the mortgage/financing contingency.

**Note:** If elected, the mortgage contingency paragraph of the Standard Agreement for the Sale of Real Estate (Form ASR) provides *Seller* (not Buyer) with the right to terminate the Agreement unless Seller receives documentation showing the lender's approval of the financing. Seller may also terminate the Agreement if the lender's approval contains conditions that are not removed by Buyer within 7 days of the deadline. But it also requires Buyer to continue to make a good faith effort to obtain financing if the Seller doesn't choose to terminate, and the Buyer would be in default if they failed to do so. Similar language exists in most of the sales contracts written by PAR.

Because Option 2 takes away Buyer's right to terminate the Agreement, it is essential that both parties do the math to ensure that they are fully aware of how the appraisal could affect the transaction and that it is actually serving the intended purpose.

*Example:* Buyer B and Seller sign an agreement for Buyer B to purchase Seller's property for \$500,000 with a down payment of \$100,000 and an 80% LTV mortgage of \$400,000. The agreement also contains an appraisal contingency with a minimum appraisal value of \$250,000 and Option 2 elected. The property's actual appraised value is \$475,000.

Since the minimum appraisal value was met (and the terms of Paragraph 1 of the addendum therefore satisfied), Buyer B must continue with the purchase of the property for \$500,000. According to these terms, Buyer B might need to do something like:

- Still secure a loan at 80% LTV (\$380,000) and bring \$120,000 in cash (an extra \$20,000)
- Still secure a loan of \$400,000, but change to a loan product based on an 85% LTV (or higher)

Whichever choice, or mix of choices, Buyer utilizes, each will automatically override the existing terms of the Agreement of Sale.

*Example:* Buyer D and Seller sign an agreement for Buyer D to purchase Seller's property for \$500,000 with a down payment of \$100,000 and an 80% LTV mortgage of \$400,000. The agreement also contains an appraisal contingency with a minimum

appraisal value of \$500,000 and Option 2 elected. The property's actual appraised value is \$475,000.

Since the minimum appraisal value **was not** met (and the terms of the addendum therefore **not** satisfied), the buyer is still agreeing to move ahead but the existing terms of the mortgage or financing contingency in the agreement of sale still control without the buyer needing to make any changes to the terms. This could result:

- If the lender still requires an 80% LTV then a loan could only be approved at \$380,000. Buyer *could* elect to close by bringing an additional \$20,000 in cash.
- If the lender still approves a loan for \$400,000 the LTV would now be 84.2%. Buyer *could* elect to accept that loan with any additional costs or fees (e.g., a higher interest rate and/or paying PMI).

**Note:** If elected, the mortgage contingency paragraph of the Standard Agreement for the Sale of Real Estate (Form ASR) provides *Seller* (not Buyer) with the right to terminate the Agreement if a loan is not approved or if the loan terms are different from those stated in the contingency. But if Seller chooses not to terminate, the Buyer is required to continue to make a good faith effort to obtain financing up until closing. A Buyer who attempts to terminate under the mortgage contingency, or who stops trying to obtain financing, could be in default of the Agreement. Similar language exists in most of the sales contracts written by PAR.

**Note:** What is a “good faith effort,” anyway? “Good faith” is actually a legal term defined generally as a state of mind or course of behavior that shows honesty, the lack of an intent to defraud, or honoring of one’s duty. Applied here, a buyer who must continue to make a good faith effort to obtain financing is not required to do *anything humanly possible* to get the loan approved like sell a kidney to earn an extra \$20,000 for closing. A buyer is only going to be required to continue to participate in the process honestly with the intent to fulfill their obligations under the Agreement.

## Signatures

Buyer and Seller should initial and date the addendum to make it part of their agreement.