What to do when the appraisal is less than the offer?

By Ilyce Glink and Samuel J. Tamkin
Tribune Content Agency

Q: I have two friends who live in Waukegan, Ill., a terrible real estate market. They have their home on the market and received an offer for $104,000. They aren't making any money on it, and are giving the buyers $3,000 for closing costs.

The appraisal for the buyers' lender (an FHA loan) came in at $98,000. The sale is going to fall through. The sellers don't have any more money to put down at closing to sell the house.

Is there any creative financing they can do to get this sale done? They have good reason to move, as their mother is 72 and ill. Their plan was to move 300 miles south and move in with their mother. Any ideas?

A: While many neighborhoods have rebounded from the housing crisis that started nearly 10 years ago, there are some that haven't. It sounds as though Waukegan, Ill., is one of those areas.

You didn't mention when your friends bought their property, but if they bought it just before or just after the housing crisis began, they might still be in a situation where their home is worth less than the mortgage amount (known as being "underwater"). If the property is worth what the mortgage amount is, they'd be considered "functionally underwater," since they would have to bring cash to the closing in order to pay the closing costs.

When a home fails to appraise out in value, that puts the entire sale in jeopardy, as your friends now know. To save the deal, your friends would have to either lower the purchase price to the appraised amount ($98,000), which will then lower the amount of the mortgage that the buyer will qualify for, or if the house is underwater, come with enough cash to make the lender whole and pay the closing costs.

If the sellers want to lower the price and will take cash for their furnishings, then perhaps there is a deal to be struck.

Or, if they want to act as the bank and lend the buyers the money (which they could only do if there is no current mortgage on the property), then that's a possibility.

A lender will be unlikely to approve the deal with a "creative" mortgage attached. That's why the easiest thing to do is have the sellers simply lower the purchase price. If that's not a possibility because they don't have enough cash to make the deal happen, then it will likely fall apart. At that point, they can try to rent out the property to cover the amount of the mortgage, taxes and insurance or, if the property is worth a fraction of the mortgage amount, they can consider a deed-in-lieu of foreclosure or an official short sale.

And, of those suggestions, the short sale may be the better way to go.

We wish we had better suggestions. Best of luck to your friends.