Inspection Contingency

What is it? With an inspection contingency, the buyer has a specific time period during which he must conduct a home inspection after mutual acceptance or contract ratification. The buyer may be able to negotiate with the seller or even walk away based on what comes up during the inspection, without losing his earnest money deposit. Because the buyer has the ability to void the contract based on the inspection report, this contingency is often the scariest from a seller's perspective. With some types of inspection contingencies, a buyer can also request repairs from the seller as a condition of the purchase; this can also be off-putting for the seller. In many markets, a buyer can choose to conduct a pass-fail inspection rather than one where the buyer can ask for repairs; that may be preferred by the seller.

To waive or not to waive? In some parts of the country, buyers regularly waive the inspection contingency and instead conduct a pre-inspection. The pre-inspection is done before a buyer makes an offer. With a pre-inspection, the buyer still gets an inspection report, but makes an offer with full knowledge of any issues – and the seller doesn't have to worry that the buyer will back out after the ratification. In a competitive market where a buyer may make a number of offers on homes without winning, paying for these pre-inspections can add up quickly! Depending on where you live, a buyer may have some options that can set the seller's mind at ease without waiving this contingency. For example, the buyer could offer a shorter contingency than the norm, say five days instead of a customary seven.

Appraisal Contingency

What is it? The appraisal contingency allows the buyer to renegotiate or walk away from the deal if the appraisal comes back lower than the ratified price. The appraisal is an independent assessment of the value of the property and required by any lender. The appraisal contingency and the financing contingency are interconnected because your lender will base your loan amount on the appraisal value, or the ratified price, whichever is lower. For example, if you are making a 20 percent down payment on a $500,000 home, your lender has agreed to loan you 80 percent of the home’s value, or $400,000. If the appraisal comes in at the value of the home or higher, then those numbers stay the same. But if the appraisal comes back saying that the home is only worth $450,000, the bank will still loan you 80 percent, but 80 percent of the lower value, and thus will only loan you $360,000. You are still under contract to pay $500,000 for the home, and so you’ll have to come up with the difference or use one of the options the appraisal contingency offers, which is 1- void the contract, 2- accept it and increase your down payment, or 3- renegotiate with the seller.

To waive or not to waive? Each situation is unique, but I don’t often recommend waiving the appraisal contingency if you are financing the purchase. If a buyer is set on purchasing a particular house and is willing and able to increase the down payment if the appraisal comes back low, then waiving this contingency can strengthen an offer.

Financing Contingency

What is it? The financing contingency says that your purchase of the home is contingent on securing financing within a set period of time, and the buyer sets the length of the contingency in the contract. It protects you in case something goes wrong and you are unable to get a loan. As I mentioned above, the financing contingency is intricately tied to the appraisal.

To waive or not to waive? If you are paying all cash for a home, you would certainly waive this contingency. If you aren't paying all cash, waiving the financing contingency can be risky for some buyers, especially when purchasing at the upper edge of their affordability. If for some reason your loan falls through, you would still be legally obligated to purchase the home; this contingency can protect you in this unlikely event. In some cases a buyer may opt to keep the appraisal contingency but waive the financing contingency. The appraisal contingency will protect the buyer if the appraisal affects financing. But the financing contingency could be your only protection if something unforeseen happens, such as the loss of a job.

It is important to understand all these contingencies and what they mean in your individual situation.