



TO: All Interested Parties

FROM: Gary Taylor, Chair
Appraisal Practices Board

RE: **First Exposure Draft – *Adjusting Comparable Sales for Seller Concessions***

DATE: October 3, 2011

The Appraisal Practices Board (APB) was officially formed by The Appraisal Foundation Board of Trustees on July 1, 2010. The APB has been charged with the responsibility of identifying and issuing voluntary guidance on recognized valuation methods and techniques, which may apply to all disciplines within the appraisal profession. The APB has prioritized topics to offer guidance in areas which appraisers and users of appraisal services feel are the most pressing.

The Board accomplishes its mission through the use of panels of Subject Matter Experts (SMEs), comprised of widely recognized individuals with expertise in the specific topic being considered, to research and identify all pertinent sources of existing information on the given topic. The APB then vets the issue through this public exposure process, with the goal of ultimately adopting guidance that may include more than one recognized method or technique that addresses the specific topic.

From the APB's perspective, compliance with all guidance issued by the Board is voluntary. However, it is possible that state or federal government agencies, clients and/or user groups of appraisal services, professional appraisal societies, or others may opt on their own volition to mandate compliance with the guidance issued by the APB.

This is the first real property exposure draft issued by the Board, and represents guidance applicable to *Adjusting Comparable Sales for Seller Concessions*. The Board is seeking public comment in response to this exposure draft and based on the comment received, may make revisions to the guidance and issue subsequent exposure drafts. Once the Board believes it has received all relevant comment on this topic, it may vote to adopt the material as official guidance from the APB.

The Board is also currently engaged in developing guidance on other topics. It is anticipated that exposure drafts will be forthcoming in the very near future that relate to these other topics. In

addition, subsequent exposure drafts may include multiple topics for consideration simultaneously.

All interested parties are encouraged to comment in writing to the APB before the deadline of December 2, 2011. Respondents should be assured that each member of the APB will thoroughly read and consider all comments. Comments are also invited at the APB public meeting on December 12, 2011, in Atlanta, Georgia.

Written comments on this exposure draft can be submitted by mail, email and facsimile.

Mail: Appraisal Practices Board
The Appraisal Foundation
1155 15th Street, NW, Suite 1111
Washington, DC 20005

Email: APBcomments@appraisalfoundation.org

Facsimile: (202) 347-7727

IMPORTANT NOTE: All written comments will be posted for public viewing, exactly as submitted, on the website of The Appraisal Foundation. Names may be redacted upon request.

The Appraisal Foundation reserves the right not to post written comments that contain offensive or inappropriate statements.

If you have any questions regarding the attached exposure draft, please contact Staci Steward, Practices Administrator at The Appraisal Foundation, via e-mail at staci@appraisalfoundation.org or by calling (202) 624-3052.

First Exposure Draft
Adjusting Comparable Sales for Seller Concessions

Issued: October 3, 2011
Comment Deadline: December 2, 2011

When commenting on various aspects of this exposure draft, it is very helpful to reference the line numbers, fully explain the reasons for concern or support, provide examples or illustrations, and suggest any alternatives or additional issues that the APB should consider.



THE APPRAISAL FOUNDATION

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APPRAISAL PRACTICES BOARD

Appraisal Practices Board

Voluntary Guidance on Recognized Valuation Methods and Techniques:

Adjusting Comparable Sales For Seller Concessions

This communication is for the purpose of issuing guidance on recognized valuation methods and techniques. Compliance with such guidance is voluntary, unless mandated through applicable law, regulation, or policy.

Date Issued: To Be Determined

Application: Residential and Non-residential Real Property

Issue: As part of its ongoing responsibilities, the APB is tasked with identifying where appraisers and appraisal users believe additional guidance is required. Once such issue identified by the APB is adjusting comparable sales for seller concessions. A common tool used to help facilitate a real property transaction is to have the seller provide financial assistance or incentives to the buyer. Such assistance may be considered a seller concession or financing concession and this is important because it may have an influence on the contract price. The purpose of this guidance is how to identify, verify, analyze and adjust sale comparables for both seller and financing concessions.

Subject Matter Experts: The Appraisal Practices Board and The Appraisal Foundation wish to express our sincere gratitude to each of the following Subject Matter Experts for volunteering their time and expertise in contributing to this document:

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Adjusting Comparable Sales For Seller Concessions

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I. Definitions

1 *Sales Concessions* – A cash or noncash contribution that is provided by the seller or other party
2 to the transaction and reduces the purchaser’s cost to acquire the real property. A sales
3 concession may include, but is not limited to, the seller paying all or some portion of the
4 purchaser’s closing costs (such as prepaid expenses or discount points) or the seller conveying to
5 the purchaser personal property which is typically not conveyed with the real property. Sales
6 concessions do not include fees that a seller is customarily required to pay under state or local
7 laws. In developing an opinion of market value, an appraiser must take into consideration the
8 effect of any sales concessions on the market value of the real property.⁴

9 *Financing Concessions* – A financial payment, special benefit, or non-realty item included in the
10 sale contract as an incentive to the sale. Concessions occur when the seller agrees to pay an
11 inducement or to give some special credit or property to a buyer who agrees to pay a higher price
12 than the buyer would normally pay in return for the inducement or credit. Concessions usually
13 result in artificially inflated sale prices. Often concessions allow financing that would otherwise
14 not be possible. Concessions may be disclosed as part of the sale, but often they are not.⁵

15 II. Verifying Concessions

16 Appraisers are required by the *Uniform Standards of Professional Appraisal Practice* (USPAP)
17 to confirm and verify the data used in their analyses to arrive at a final opinion of value. This is
18 particularly important with regard to sales and financing concessions. The Comment to the
19 definition of “Market Value” in USPAP states, in part, that the conditions included in market
20 value definitions generally fall into three categories:

- 21 1. *the relationship, knowledge, and motivation of the parties (i.e., seller and buyer);*
- 22 2. *the terms of sale (e.g., cash, cash equivalent, or other terms); and*
- 23 3. *the conditions of sale (e.g., exposure in a competitive market for a reasonable time prior*
24 *to sale).*⁶

25 Since concessions can impact the sale price of a property, an appraiser must identify and analyze
26 the presence of concessions.

27 Public records data rarely report anything other than the actual sale price of a property and do not
28 disclose concessionary items included in the sale. Thus, an appraiser must rely upon other
29 sources to identify and confirm any concessionary items.

30 Sources of information that may be used for verification of concessions include, but are not
31 limited to:

- 32 • *Listing agent (or seller’s agent)*
- 33 • *Selling agent (or buyer’s agent)*
- 34 • *Buyer*
- 35 • *Seller*
- 36 • *Lender*

⁴ 2010 *Interagency Appraisal and Evaluation and Guidelines*, December 2010, Page 44

⁵ Modified from *The Dictionary of Real Estate Appraisal*, 5th ed. (Chicago: Appraisal Institute, 2010).

⁶ USPAP 2010-11 Edition, “Definitions U-4” (The Appraisal Foundation)

- 37 • *Title Company*
- 38 • *Appraiser's own records*
- 39 • *Published data*
- 40 • *Third party appraisal databases*
- 41 • *Public Deed Records*
- 42 • *Other appraisers*
- 43 • *Tax affidavit*

44 *Listing agent* – The listing agent can provide direct knowledge of market activity that is
45 important in understanding whether a sales concession was necessary to entice a buyer to buy, if
46 the price was influenced by the concession, or if the concession was insignificant.

47 *Selling/Buyers agent* – The selling or buyer's agent may have knowledge of special buyer
48 motivations; such as any specifics with regard to concessionary items and whether the buyer
49 would have consummated the sale without the concession and any impact the concession may
50 have had on the purchase price.

51 *Buyer* – The buyer can be a source of information about the comparable sale in terms of any
52 sales concessions granted, and how it affected the buying decision. For instance, the buyer can
53 disclose whether they would have paid a different amount for the property were the concession
54 not granted, and whether receiving a concession was the deciding factor for purchasing the
55 property.

56 *Seller* – The seller can identify and confirm concessions and may disclose any impact the
57 concessions had on the sale price, if any. If a property included \$5,000 in concessions, an
58 appraiser may question the seller and verify what they would have accepted had they not paid
59 \$5,000 in concessions.

60 *Closing Department for Real Estate Office, Lender or Title Company* – The staff in a real estate
61 office, lending institution or title company may provide an appraiser with a settlement or closing
62 statement. The statement will show the itemized costs paid by the seller and those costs paid by
63 the buyer. Concessionary items paid by the seller could be verified in this manner and be
64 invaluable, especially when a party to the transaction will not respond to an appraiser's request
65 for information.

66 *Appraiser's Own Records* – If an appraiser previously appraised the property they may have
67 information relating to any seller concessions and/or any creative financing.

68 *Published Data (e.g. Multiple Listing Services)* – Providers of published data generally offer
69 basic information regarding sale transactions. However, concessions are not likely to be
70 included in the details of such sales. Reference to this source is thus likely to be a first step in
71 the process, with further investigation needed.

72 *Third Party Appraisal Databases and other Appraisers* – There are some regional and local
73 databases where appraisers submit information about properties they have appraised. These can
74 be sources of verification if these databases are populated with information regarding seller and
75 financing concessions that have personally been verified by a source deemed reliable.

76 *Public Deed Records* – Deed records may be a good verification source if a noted sale price
77 differs from the price reported by published data providers. When there are questions regarding
78 the accuracy of the information that an appraiser has received from one of the parties to the
79 transaction, deeds can provide additional verification. However, in most cases the deed does not
80 reveal concessions, only the transaction amount. Some states are “non-disclosure” and even the
81 price cannot be verified.

82 *Tax Affidavit* – When a property transfers, most states require the buyer to fill out a true
83 accounting of the cost of the property purchase. These transfer tax affidavits can be useful in
84 determining the true cost of a property and whether the buyer considered a concession to reduce
85 the effective sales price of the property or not. If the buyer considered it a reduction in price, it
86 may be disclosed in this affidavit.

87 Verification of concessions and the impact of concessions on the consideration of a comparable
88 can be done through personal phone calls, text messaging, email or questionnaires and should be
89 documented in the workfile.

90 Examples of what an appraiser may consider:

- 91 • Would the buyer have paid the same amount for the property without the sales or financing
92 concession?
- 93 • What are the details of the reported concession?
- 94 • What impact did the seller/purchaser believe the concession had on the contract price? Was
95 the impact equal to, less than, or more than the actual amount of the concession?

96 Motivations for buying and selling a property are an important part of understanding and
97 analyzing sales concessions and how they may have impacted the sale price of a property.
98 Interviewing market participants is critical in helping an appraiser understand these motivations
99 and determine if the concessions have impacted the normal consideration or sale price.

100 **III. When Does an Appraiser Adjust For Concessions?**

101 If an appraiser identifies and confirms that concessionary items were included in a transaction
102 and if the normal consideration or contract price was impacted by the concession, an appraiser
103 should make an adjustment to approximate the market’s reaction to the concession’s impact on
104 the comparable sale’s contract price.

105 Illustration:

106 *If an appraiser has determined and verified that the seller paid \$5,000 in concessionary*
107 *items, the appraiser would measure the impact of this concession on the sale price and make*
108 *an appropriate adjustment to the comparable sale’s contract price to reflect a price*
109 *“unaffected” by the concessions. The adjustment may be more than, less than, or the same*
110 *amount as the actual dollar amount of the concession.*

111 The existence of concessions will be predicated by the type and definition of value used in the
112 appraisal assignment. USPAP defines “Value” as:

113 *the monetary relationship between properties and those who buy, sell, or use those*
114 *properties.*⁷

115 According to USPAP, value is an economic concept that is an opinion, based on a specific given
116 time, and must be qualified. In most definitions of value the following conditions are prevalent:

- 117 • Payment will be made in cash in U.S. dollars or in terms of financial arrangements
118 comparable thereto.
- 119 • The price represents the normal consideration for the property sold, unaffected by special or
120 creative financing concessions granted by anyone associated with the sale.

121 The first requirement is the basis for cash equivalency, while the second condition stipulates that
122 the value should reflect a price unaffected by concessions.

123 The Government Sponsored Enterprises (GSEs) included the following additional comment in
124 their definition of market value:

125 *Adjustments to the comparables must be made for special or creative financing or sales
126 concessions. No adjustments are necessary for those costs which are normally paid by sellers
127 as a result of tradition or law in the market area; these costs are readily identifiable since
128 sellers pay these costs on virtually all sales transactions. Special or creative financing
129 adjustments can be made to the comparable property by comparison to financing terms
130 offered by a third party institutional lender that is not already involved in the property or
131 transaction. Any adjustment should not be calculated on a mechanical dollar-for-dollar cost
132 of the financing or concession but the dollar amount of any adjustment should approximate
133 the market's reaction to the financing or concessions based on the appraiser's judgment.

134 The above statement:

- 135 1. Requires an appraiser to make adjustments for concessions when warranted.
- 136 2. Defines which costs to the seller are considered concessionary and which costs would not
137 be considered concessionary.
- 138 3. Stipulates that the adjustment for any financing concession should be made to reflect the
139 market's reaction to the financing concession rather than a mechanical dollar-for-dollar
140 cost.

141 In the simplest terms, once an appraiser has identified that a comparable sale sold with a
142 concession, he or she must measure and develop a dollar equivalent of the noted concession, then
143 deduct the dollar amount from the comparable's sale price. The net result is a sale price of the
144 comparable which represents the "normal consideration" for the property sold, unaffected by the
145 concession.

146 An appraiser must be able to recognize and verify what constitutes a seller concession within a
147 market area. Costs or fees that are generally paid by a seller as a result of tradition or law and
148 are found on virtually all sale transactions are not considered to be seller concessions.
149 Conversely, other costs or fees paid by the seller would be defined as seller concessions.

⁷ USPAP 2010-11 Edition, "Definitions U-4" (The Appraisal Foundation)

150 Fees or costs that are generally paid by the seller as a result of tradition or law and found on
151 virtually all transactions could include, but are not be limited to: seller’s title policy, transfer tax,
152 escrow fee, deed preparation, and recording fee. These items are most often thought of as
153 anticipated or expected costs to be paid by the seller.

154 Fees *not* generally paid by the seller may include, but are not limited to: loan origination fees,
155 appraisal fees, attorney fees, loan application fees, credit report fees, loan document preparation
156 fees, photocopying fees for easements and restrictions, mortgage title policy and loan-related
157 inspection fees, discount fees, etc. For all practical purposes, any fees or costs associated with
158 the buyer’s loan would *generally* be considered seller concessions if paid by the seller.

159 The prevalence of seller concessions does not eliminate the need to *measure* the monetary impact
160 of the concession on the sale price, or negate the need for an adjustment.

161 Note: “Market Area” may be defined as:

162 *The geographic or locational delineation of the market or a specific category of real*
163 *estate, i.e., the area in which alternative, similar properties effectively compete with the*
164 *subject property in the minds of probable, potential purchasers and users..⁸*

165 An appraiser must evaluate the impact of said concessions, regardless of the frequency,
166 prevalence, or how “typical” concessions may be within a specific market segment or market
167 conditions.

168 **IV. Methodology**

169 Concessions will generally fall into a two categories: sales concessions and financing
170 concessions. Sales concessions would be the inclusion of personal property, settlement
171 assistance or seller contributions and cash incentives. Financing concessions are special or
172 creative financing and seller discount points or buy-down programs.

173 **Special or Creative Financing**

174 Special or Creative Financing may include owner carried notes or purchase money mortgages.

175 Seller financing may or may not constitute a seller concession, depending on the terms and
176 availability of third-party alternatives. The appraiser should compare the terms of seller
177 financing with those available from traditional lending sources. If the former is more favorable
178 from the borrower’s perspective, the present worth of the differential should be quantified. If the
179 latter is more favorable (an unlikely occurrence), there is no seller concession to be considered.

180 **Illustration A: Dollar-for-dollar (cash equivalent) analysis**

181 *An appraiser completes a discounted cash flow analysis of seller financing terms based on*
182 *market financing terms available at the time the contract was negotiated. The present value of*
183 *the seller-financed mortgage is the sum of two components:*

⁸ *The Appraisal of Real Estate, 13th Edition* (Appraisal Institute, 2008), 55

- 184 1. *The present value of the favorable or below market mortgage payment at the market*
 185 *interest rate for the expected life of the mortgage (10 years – Balloon Payment) or the*
 186 *anticipated life of the loan based on the average life of a loan in a particular market; and*
 187 2. *The present value of the future mortgage balance discounted at the market interest rate*
 188 *for the anticipated life of the mortgage.*

189 *Assumptions: Sale price was \$103,000 with a seller-financed note of \$95,000 at 6.0% on a 10-*
 190 *year balloon and 30-year amortization. Market terms at the time the contract was written were*
 191 *6.5% for 30 years.*

Step 1	<i>Calculate Monthly Payment of Seller Financing = \$ 569.57 (6.0% /30 Year Amt/\$ 95,000 Loan)</i>		Rounded
Step 2	<i>Calculate Present Value of \$569.57 per month for 10 years at Market Rate of 6.5%</i>	<i>Equals</i>	<i>\$ 50,161.18</i>
Step 3	<i>Calculate Remaining Mortgage Balance of Loan in 10 years (6% Rate) of which Equals \$ 79,501.44</i>		
Step 4	<i>Calculate Present Value of the Mortgage Balance (\$ 79,501.44) at 6.5%</i>	<i>Equals</i>	<i>\$ <u>41,576.26</u></i>
Step 5	<i>Sum the Present Value of Monthly Payments and Present Value of Mortgage Balance</i>	<i>Equals</i>	<i>\$ 91,737.44</i>
Step 6	<i>Add the Down Payment of \$8,000 (\$103,000 - \$95,000) to Sum of Present Values</i>	<i>Equals</i>	<i>\$ <u>8,000</u></i>
Step 7	<i>The Result is the Sale Price Adjusted for Seller Financing</i>	<i>Equals</i>	<i>\$ 99,737.44</i>

192 *Given the sale price of \$103,000 and “market equivalent” price of \$99,737.44, the impact of the*
 193 *favorable financing on this sale appears to be \$3,262.56. Therefore, \$99,700 (rounded) would*
 194 *represent the cash equivalent price. This technique is likely to be less reliable than a matched*
 195 *paired sales analysis. To the extent possible, it may be best to simply avoid the use of owner-*
 196 *carried notes altogether. This method also may not be as reliable as it does not account for*
 197 *limited closing costs and other fees associated with typical third party financing.*

198 **Important Note:** Although the math suggests a specific dollar amount adjustment, the appraiser
 199 should verify with a party to the transaction the *impact* of the dollar amount; a participant may
 200 indicate a dollar amount different than that calculated using the mathematical analysis.

201 **Illustration B: Paired Sales Analysis**

202 *Two recently sold homes were identical in all aspects, with one exception:*

- 203 • *Sale 1 sold 10/2010 for \$103,000 with seller-financing. The note was for \$95,000, amortized*
 204 *over 30 years at 6.0%, with a 10-year balloon.*
- 205 • *Sale 2 sold 10/2010 for \$100,000 on third-party financing. The note was for \$95,000,*
 206 *amortized over 30 years with a fixed interest rate at 6.5%.*

207 *Given that the two homes are identical in all other aspects, one can measure the impact of the*
208 *seller financing by comparing the sale prices. The \$3,000 difference can logically be attributed*
209 *to the seller financing. Thus, Sale 1 would require a -\$3,000 adjustment. This method accounts*
210 *for any and all market-perceived effects of the concession: lower interest rate, term, less-than-*
211 *typical closing costs, etc. However, such highly similar comparables are unavailable for*
212 *analysis. As such, the appraiser must extract market supported adjustments for any physical*
213 *differences and adjust the comparables for noted physical differences prior to extraction of any*
214 *impact the concession may have had on the price.*

215 Illustration C: Paired Sale Analysis

216 *Suppose you found three recently sold homes that had the same bedroom-bath count and were of*
217 *equal age, condition, amenities and lot appeal. The only noted difference would be Gross*
218 *Living Area (GLA).*

- 219 • *Sale 1 sold 10/2010 for \$103,000 with **seller-financing**. The note was for \$95,000,*
220 *amortized over 30 years at 6.0%, with a 10-year balloon. This home had GLA of 1500 sf.*
- 221 • *Sale 2 sold 10/2010 for \$104,500 on **third-party financing**. The note was for \$95,000,*
222 *amortized over 30 years with a fixed interest rate at 6.5%. This home had GLA of 1650 sf.*
- 223 • *Sale 3 sold 10/2010 for \$95,500 on **third-party financing**. The note was for \$90,000,*
224 *amortized over 30 years with a fixed interest rate at 6.5%. This home had GLA of 1350 sf.*

225 *To determine the impact of the concession (noted on Sale 1) the appraiser may compare Sale 1*
226 *to either Sale 2 or Sale 3. However, these two sales differed with regard to GLA as compared to*
227 *Sale 1. As such, the appraiser must first adjust these sales for GLA. Once, these two sales are*
228 *adjusted to Sale 1 for size differential, the appraiser will then measure the impact of the noted*
229 *concession.*

230 *Step 1; Determine adjustment for GLA – Sales 2 and 3 were not impacted by concessions*
231 *and are nearly identical with exception to size. As such, the appraiser can complete a paired*
232 *sale of these two sales to extract the adjustment for size. Sale 2 sold for \$ 104,500 and was*
233 *1650 sf while Sale 3 Sold for \$ 94,500 and was 1350 sf. There was a \$ 9,000 difference in price*
234 *and 300 sf difference in size. \$ 9,000 divided by 300 sf would indicate that the market supported*
235 *adjustment for size would be \$ 30/sf.*

236 *Step 2: Compare Sale 1 to either Sale 2 or 3. Sale 3 was 150 sf smaller than Sale 1 and*
237 *sold for \$ 95,500. Given the market supported adjustment for GLA of \$ 30/sf, Sale 3 would*
238 *require an adjustment of \$ 4,500 and would have an adjusted price \$ 100,000.*

239 *Step 3: Sale 3 has an adjusted price of \$ 100,000 and sold on typical third party*
240 *financing while Sale 1 sold for \$ 103,000 on a seller financed note. The \$3,000 difference*
241 *would be attributed to the seller financing, thus the impact of seller concessions was \$ 3,000 and*
242 *the market supported adjustment for this concession would be - \$ 3,000.*

243 **Seller Paid Loan Discount Points or Buy-Down Programs**

244 In some cases, the seller may be asked to pay discount points to buy down the buyer's interest
245 rate to qualify for a loan. Discount points are based on a percentage of the mortgage loan and are

246 the dollar amount paid to the lender by the seller to lower the mortgage rate. As the cost of
247 obtaining financing is generally incurred by the buyer rather than seller, it would be considered a
248 concession if the seller pays a fee to buy-down the buyer's mortgage rate. The amount of the
249 buy-down is typically "sum-certain" and established during contract negotiations.

250 Illustration:

251 *"An adjustment for seller-paid points is one cash equivalency adjustment that is relatively easy*
252 *to calculate. The points are applied to the mortgage amount and the result is deducted from the*
253 *total sale price. For example, consider a comparable property that sold for \$130,000. The*
254 *buyer made a \$30,000 cash down payment and financed the balance of the sale price with a*
255 *\$100,000 FHA-insured mortgage. The seller paid the lender three points, which is 3% of the*
256 *mortgage amount of \$100,000 or \$3,000. The cash equivalent price of the comparable sale is*
257 *therefore \$127,000 (\$100,000 - \$3,000 + \$30,000)."*⁹

258 **Inclusion of Personal Property and Cash Incentives**

259 In some market areas the seller will include personal property or other incentives to entice the
260 buyer to purchase the property. Personal property may be in the form of items such as a
261 refrigerator, washer and dryer or golf cart. An appraiser needs to account for personal property
262 and cash incentives included in the sale and adjust accordingly. An appraiser must use caution
263 when estimating the value of personal property. If the appraiser does not have the experience
264 and knowledge to value personal property, he or she may rely on recognized sources, a personal
265 property appraiser, or possibly conversations with parties to the sale. The appraiser may not be
266 able to rely on any values stipulated in the contract as often times this number is minimized to
267 allow for maximum financing. USPAP Standards 7 and 8 provide further guidance on the
268 valuation of personal property.

269 Illustration:

270 *If 123 Main Street sold for \$200,000 and included a golf cart in the sale price, the appraiser*
271 *would determine the perceived market value of the golf cart from reliable sources. If the*
272 *appraiser determines the value of said golf cart is ~ \$3,500, then the appraiser would make an*
273 *adjustment of - \$3,500 to arrive at an adjusted sale price of \$196,500.*

274 Personal property should be excluded from the contract price of a comparable property; failing to
275 do so would be misleading. Deducting the contributory value of the personal property may
276 require a more complex analysis. The complexity increases for converting non-cash seller
277 concessions such as paid vacations, airline miles, club memberships, and the like into a cash
278 equivalent price. This conversion may require additional interviews with the parties involved in
279 the sale transaction to determine if a monetary value had been agreed upon for the non-cash
280 seller concessions, or if there is an actual dollar value attributed to a specific sale concession
281 such as a golf club membership or a vacation.

282 **Settlement Assistance or Seller Contributions**

283 The most common type of seller concession is settlement assistance to the buyer. Settlement
284 assistance exists when the seller pays any fees or costs other than what is generally paid by a

⁹ *Appraising Residential Property, 4th ed.* (Chicago); Appraisal Institute, 2007, Page 327-328

285 seller as a result of tradition or law and are found on virtually all sales transactions. The sellers
286 payment of items such as: loan origination fees, appraisal fees, attorney fees, loan application
287 fees, credit report fees, survey fees, fees for preparation of loan documents, fees for
288 photocopying easements and restrictions, mortgage title policy, loan-related inspection fees, and
289 recording fees, would all be considered concessionary in nature. These fees, when paid by the
290 seller, are considered to be concessionary in nature if they are not paid by the seller as a result of
291 convention or law on virtually all sale transactions.

292 Settlement assistance is similar to “loan discount points paid by the seller” as it is a sum-certain
293 amount generally agreed upon during contract negotiations. It is reasonable to conclude that
294 payment of this type concession or lack thereof would have been a deciding factor and most
295 likely impacted the price the seller was willing to accept. As such, the impact of said concession
296 may be at least equal to the actual dollar amount of the concession.

297 To determine the impact of settlement assistance on the contract price of a comparable sale, the
298 appraiser may rely on deductive reasoning (along with the appropriate verification) or an
299 interview with one of the agents or other parties to the sale.

300 Illustration:

301 *When verifying a transaction with the selling agent an appraiser is informed that the seller paid*
302 *\$5,000 of the buyer’s closing costs or settlement fees. The home sold for a contract price of*
303 *\$155,000. The agent indicated that if the seller had not been asked to pay \$5,000 in concessions,*
304 *he/she would have accepted an offer of \$150,000. As such, an appropriate adjustment would be*
305 *\$5,000. Deductive reasoning (along with the appropriate verification) would also suggest that*
306 *this may be a reasonable and supportable conclusion.*

307 Statistical Analysis

308 Statistical tools may be employed to support adjustments for seller concessions. Because of the
309 number of independent variables required for analysis of both residential and non-residential
310 properties, the most useful statistical tool is multiple linear regression.

311 The number of variables requires the utilization of an adequate sample size of transactions with
312 and without seller concessions. The fact that concessions may take several forms complicates
313 the regression modeling process. Nonetheless, multiple linear regression may be a valuable
314 analytical tool in quantifying and supporting adjustments for seller concessions.

315 The appraiser should have adequate knowledge of, and experience in, statistical methodology
316 (including appropriate sample size) in order to competently utilize such tools. The following are
317 source materials that may be useful to the appraiser in statistical analysis:

- 318 • Anderson, John E. *Ridge Regression: “A New Regression Technique Useful to Appraisers*
319 *and Assessors.” The Real Estate Appraiser and Analyst* 45, no. 6 (November/December
320 1979): 48-51.
- 321 • Dielman, Terry, *Applied Regression: Analysis for Business and Economics*. 3rd ed. Pacific
322 Grove, Calif.: Duxbury/Thomson Learning, 2001.

- 323 • Ferreira, Eurico J., and G. Stacy Sirmans. "Ridge Regression in Real Estate Analysis". *The*
324 *Appraisal Journal* 56, no. 3 (July 1988): 311-319
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338 **V. Concessions and Non-residential Property (other than 1-4 unit properties)**

339 If concessions are present, the appraiser would use the same methodology as with residential
340 property. However, given that non-residential property is usually significantly differentiated in
341 terms of physical and economic characteristics (e.g., lease and occupancy rates, lease terms and
342 expiration dates, etc) the results may be less reliable.

343 While loan discount points and settlement assistance are less frequent types of concessions in
344 non-residential property, properties are often sold with creative financing. Financing
345 concessions sometimes reflect not only below-market interest rates but also loan-to-value ratios
346 that are above market terms.

347 The following example is intended to demonstrate the appropriate means of determining cash
348 equivalency in such situations.

Terms				
Equity:	\$63,000	10.0%	Weight	16.67%
				(2)
Mortgage(s):	567,000	90.0%	Factor:	83.33%
				(1)
Sale Price:	\$630,000			
(1) Derived from following computation:			\$630,000 x .75	
			<hr/>	
			\$567,000	= .8333
(2) Calculated as 1.00 - .8333				

349 Cash equivalency computation assumptions:

Loan-to-value ratio:	75.0%
Equity down payment:	25.0%
Market rate – 1 st lien	6%
Market rate – 2 nd lien	10%
Holding period	10 years

350 Annual loan payments (based upon actual interest rate of 5% and 30 year amortization) equal
351 \$36,884. Loan balance at end of 10th year equals \$459,659.

352 It is assumed the amount of down payment less than 25% will have to be financed as a second
353 lien at a higher rate of interest than the first lien. To determine cash equivalency, the payment
354 stream is discounted once at a lower first lien market interest rate and once at a higher second
355 lien market interest rate. The two figures are then weighted and combined into a single estimate
356 of the value of the favorable financing based on their relative shares of the new debt, as follows:

Payment Stream:						
1st Lien	@	6%	\$528,141	X	0.8333	= \$440,100
Discounted						
2nd Lien	@	10%	\$403,855	X	0.167	= \$67,444
Discounted						
						\$507,544

Value of financing:	\$507,544
Equity:	63,000
Cash Equivalent Sale Price:	\$570,544
Rounded to:	\$570,000

357 Transactions in which buyers assume existing debt with below-market interest rates should be
358 adjusted to cash equivalency. However, the price/value increment in such situations represents
359 an intangible price/value component and a seller concession.

360 Sale/leaseback transactions present difficulties as comparable sales. Such transactions are
361 frequently financing arrangements in which the seller often agrees to an above-market lease rate
362 in return for an above-market sale price. Due to the problems in deriving accurate market based
363 adjustments for such factors, the sale may not provide a reliable indication of value. The
364 appraiser may consider avoiding the comparable altogether or at least using extreme caution.

365 **VI. Impact and Application of Concessions in the Cost Approach and Income Approach**

366 Cost Approach - Concessions may impact this approach in the following situations:

- 367 • If the land residual technique is used to support site value, comparable sales with seller
368 concessions should be adjusted for any impact said concession had on the sale price prior
369 to application of this technique.

- 370 • When using market extraction to determine Reproduction Cost New (RCN) an appraiser
371 would need to adjust the sale price of any comparable that sold with seller concessions
372 prior to the analysis.
- 373 • If depreciation estimates are derived by use of comparables with seller concessions, the
374 appraiser would need to adjust sales for any impact said concession had on the sale price
375 prior to depreciation analysis.

376 Income Approach - Concessions may impact this approach in the following situations:

- 377 • Capitalization Rate (Ro) – Development of a Cap Rate by extraction from comparable
378 sales with seller concessions may be misleading unless the appraiser measures and
379 deducts the impact of said concession from the sale price. The appraiser should deduct
380 the impact of any concessions on the sale price prior to determining an appropriate
381 capitalization rate.
- 382 • Gross Rent Multiplier (GRM) or Gross Income Multiplier (GIM) – Development of
383 GRM and GIM by extraction from comparable sales with seller concessions may be
384 misleading unless the appraiser measures and deducts the impact of said concession from
385 the sale price. The appraiser should deduct the impact of any concessions on the sale
386 price prior to determining an appropriate GRM or GIM.
- 387 • Master Leases/Rent Guarantees – It is not uncommon for sellers of unstabilized
388 properties to guarantee the purchaser a specified minimum income for a fixed period, in
389 order to achieve a price reflective of stabilization. A portion of the sale price is placed in
390 escrow and is reimbursed to the buyer if the agreed-upon level of revenue is not achieved
391 during the master lease term. While the sale prices of such transactions may arguably be
392 reflective of an “as stabilized” price, it is clear that the price is not that for the property on
393 an “as is” basis, as of the date of sale. The most supportable adjustment in such instances
394 is based upon the quantified impact of the master lease as reported by buyer and seller. If
395 such information is not available, the adjustment may be reasonably based upon the
396 present worth of the revenue “shortfall” during the term of the master lease.

397 **VII. Suggested Further Reading**

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