



## **APB Valuation Advisory #2:** ***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:** March 7, 2012

**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.

The purpose of this document is to provide additional guidance on generally accepted methods and techniques. The methods and techniques discussed herein may not be the only way to solve this problem as there may be other equally acceptable methods and techniques. The practitioner that uses these other techniques should be able to present and support their use of an alternative technique and support the logic of their analysis. Practitioners that use the guidance contained in this publication must understand and be able to utilize these techniques to provide credible results.

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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.<sup>4</sup>

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.<sup>5</sup>

## 15 II. Verifying Concessions

16 Appraisers are required by the *Uniform Standards of Professional Appraisal Practice* (USPAP)  
17 to collect, verify and analyze all information necessary for credible assignment results. 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).*<sup>6</sup>

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*

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<sup>4</sup> 2010 *Interagency Appraisal and Evaluation and Guidelines*, December 2010, Page 44

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

<sup>6</sup> USPAP 2012-13 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 dictated 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.*<sup>7</sup>

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 some 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. Costs or  
147 fees that are generally paid by a seller as a result of tradition or law and are found on virtually all  
148 sale transactions are not considered to be seller concessions. Conversely, other costs or fees paid  
149 by the seller would be defined as seller concessions.

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<sup>7</sup> USPAP 2012-13 Edition, "Definitions U-5" (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 An appraiser must evaluate the impact of said concessions, regardless of the frequency,  
162 prevalence, or how “typical” concessions may be within a specific market segment or market  
163 conditions.

#### 164 **IV. Methodology**

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

#### 169 **Special or Creative Financing**

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

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

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

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

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

185 *Assumptions: Sale price was \$103,000 with a seller-financed note of \$95,000 at 6.0% on a 10-*  
186 *year balloon and 30-year amortization. Market terms at the time the contract was written were*  
187 *6.5% for 30 years.*

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

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

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

197 Illustration B: Paired Sales Analysis

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

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

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

211 Illustration C: Paired Sale Analysis

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

215 • Sale 1 sold 10/2010 for \$103,000 with **seller-financing**. The note was for \$95,000,  
216 amortized over 30 years at 6.0%, with a 10-year balloon. This home had GLA of 1500 sf.

217 • Sale 2 sold 10/2010 for \$104,500 on **third-party financing**. The note was for \$95,000,  
218 amortized over 30 years with a fixed interest rate at 6.5%. This home had GLA of 1650 sf.

219 • Sale 3 sold 10/2010 for \$95,500 on **third-party financing**. The note was for \$90,000,  
220 amortized over 30 years with a fixed interest rate at 6.5%. This home had GLA of 1350 sf.

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

226 Step 1; Determine adjustment for GLA – Sales 2 and 3 were not impacted by concessions  
227 and are nearly identical with exception to size. As such, the appraiser can complete a paired  
228 sale of these two sales to extract the adjustment for size. Sale 2 sold for \$ 104,500 and was  
229 1650 sf while Sale 3 Sold for \$ 95,500 and was 1350 sf. There was a \$ 9,000 difference in price  
230 and 300 sf difference in size. \$ 9,000 divided by 300 sf would indicate that the market supported  
231 adjustment for size would be \$ 30/sf.

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

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

### 239 **Seller Paid Loan Discount Points or Buy-Down Programs**

240 In some cases, the seller may be asked to pay discount points to buy down the buyer's interest  
241 rate to qualify for a loan. Discount points are based on a percentage of the mortgage loan and are  
242 the dollar amount paid to the lender by the seller to lower the mortgage rate. As the cost of  
243 obtaining financing is generally incurred by the buyer rather than seller, it would be considered a  
244 concession if the seller pays a fee to buy-down the buyer's mortgage rate. The amount of the  
245 buy-down is typically "sum-certain" and established during contract negotiations.

#### 246 **Illustration:**

247 "An adjustment for seller-paid points is one cash equivalency adjustment that is relatively easy  
248 to calculate. The points are applied to the mortgage amount and the result is deducted from the  
249 total sale price. For example, consider a comparable property that sold for \$130,000. The  
250 buyer made a \$30,000 cash down payment and financed the balance of the sale price with a

251 \$100,000 FHA-insured mortgage. The seller paid the lender three points, which is 3% of the  
252 mortgage amount of \$100,000 or \$3,000. The cash equivalent price of the comparable sale is  
253 therefore \$127,000 (\$100,000 - \$3,000 + \$ 30,000).”<sup>8</sup>

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

### 257 **Inclusion of Personal Property and Cash Incentives**

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

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<sup>8</sup> *Appraising Residential Property, 4<sup>th</sup> ed.*(Chicago); Appraisal Institute, 2007, Page 327-328

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*. 3<sup>rd</sup> 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
- 325 • Freund, Rudolf J., and William J. Wilson, *Regression Analysis: Statistical Modeling of a*  
326 *Response Variable*. San Diego, Calif.: Academic Press, 1988.

- 327 • Hair, Joseph F., Rolph E. Anderson, Ronald C. Tatham, and William C. Black. *Multivariate*  
328 *Data Analysis with Readings*, 3<sup>rd</sup> ed. New York: Macmillan, 1992.
- 329 • Levine, Stephan, Krehbiel, and Berenson. *Statistics for Managers Using Microsoft Excel*, 3<sup>rd</sup>  
330 ed. Upper Saddle River; Pearson Education Inc., 2002.
- 331 • Neter, John, William Wasserman, and Michael H. Kutner. *Applied Linear Statistical Models*.  
332 3<sup>rd</sup> ed. Homewood, Ill.: Irwin, 1990
- 333 • Reichert, Alan K., James S. Moore, and Chien-Ching Cho. “Stabilizing Statistical Models  
334 using Ridge Regression.” *The Real Estate Appraiser and Analyst* 51, no. 3 (Fall 1985): 17-  
335 22.
- 336 • Wolverton. Marvin L., PhD, MAI, *An Introduction to Statistics for Appraisers*. Chicago;  
337 Appraisal Institute, 2009.

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 an appropriate method of determining cash  
348 equivalency in such situations. A transaction price of \$630,000 was seller financed with a loan-  
349 to-value ratio higher than the market 75% and a below market rate of interest of 5% and a term  
350 of 30 years with annual payments. Market rates of interest are 6% on first liens. We will treat  
351 the debt in excess of 75% as junior financing carrying a higher risk rate of 10%.

352 Cash equivalency computation judgments:

Loan-to-value ratio <u>1<sup>st</sup> lien</u> :	75.0%
Equity down payment: <u>2<sup>nd</sup> lien for the balance of purchase price</u>	<del>25.0%</del> \$63,000
Market rate – <u>1<sup>st</sup> lien, 30-year term</u>	6%
Market rate – <u>2<sup>nd</sup> lien, 30-year term</u>	10%
Holding period	10 years

353 Monthly loan payments (based upon the contract interest rate of 5% and a 30-year amortization  
354 term) equal \$2,536 on the first lien.

355 Given that the amount of debt in excess of 75% of the purchase price would have to be financed  
356 as a second lien at a higher rate of interest than the first lien, 10% has been judged to be  
357 appropriate, with a 30-year term and monthly payments. To determine cash equivalency, the  
358 amount of the first lien is calculated at 75% of the purchase price, the equity remains at \$63,000,  
359 and the amount of the second lien is the gap between: a) the price; and b) the sum of the first  
360 loan and equity. Monthly payments on the first and second liens are calculated at the contract  
361 rate for the 30-year maturity on each loan, and the payoff balance is calculated, also at the  
362 contract interest rate for the ten-year holding period. Once the monthly payment and balloon  
363 cash flows have been calculated at the contract rate they are discounted to present value using the  
364 respective market yield rates on first and second liens. These present values are added and  
365 combined with the equity investment to get the cash equivalent price. The loans have been  
366 converted to their present values, or cash equivalent values, as though they were being sold in a  
367 secondary market.

<b><u>Illustration of Cash Equivalency on Investment Property</u></b>					
		<b><u>Monthly Payments at 5%</u></b>	<b><u>Balloon, Monthly Payments at 5%</u></b>	<b><u>Market Discount Rate</u></b>	<b><u>Present Value at Market Rate</u></b>
Amount of 1 <sup>st</sup> lien = 75% x \$630,000	\$472,500	\$2,536.48	\$384,341.25	6%	\$439,716
Amount of the 2 <sup>nd</sup> lien = Price less equity and 1 <sup>st</sup> lien, financed at 5%	\$94,500	\$507.30	\$76,868.25	10%	\$66,783
Equity cash	\$63,000				\$63,000
<b>TOTAL</b>	<b>\$630,000</b>				<b>\$569,500</b>

368 The sum in the lower right corner indicates a cash equivalency value for this property of  
369 \$569,500. In this case the seller who extended the credit receives extra interest to reward the

370 taking of somewhat more than 75% risk on the first lien. Extensive verification is required to  
371 assure that the arithmetic and input judgments model the typical investor and seller motivations  
372 in an accurate manner. The cash equivalency adjustment is \$630,000 less \$569,500, or \$60,500.  
373 Verification will indicate whether the seller captures all of this in extra price or it is split between  
374 seller and buyer.

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

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

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

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

- 385 • If the land residual technique, abstraction method or the allocation method is used to  
386 support site value, comparable sales with seller concessions should be adjusted for any  
387 impact said concession had on the sale price prior to application of this technique.
- 388 • When using market extraction to determine Reproduction Cost New (RCN) an appraiser  
389 would need to adjust the sale price of any comparable that sold with seller concessions  
390 prior to the analysis.
- 391 • If depreciation estimates are derived by use of comparables with seller concessions, the  
392 appraiser would need to adjust sales for any impact said concession had on the sale price  
393 prior to depreciation analysis.

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

- 395 • Capitalization Rate (Ro) – Development of a Cap Rate by extraction from comparable  
396 sales with seller concessions may be misleading unless the appraiser measures and  
397 deducts the impact of said concession from the sale price. The appraiser should deduct  
398 the impact of any concessions on the sale price prior to determining an appropriate  
399 capitalization rate.
- 400 • Gross Rent Multiplier (GRM) or Gross Income Multiplier (GIM) – Development of  
401 GRM and GIM by extraction from comparable sales with seller concessions may be  
402 misleading unless the appraiser measures and deducts the impact of said concession from  
403 the sale price. The appraiser should deduct the impact of any concessions on the sale  
404 price prior to determining an appropriate GRM or GIM.
- 405 • Master Leases/Rent Guarantees – It is not uncommon for sellers of unstabilized  
406 properties to guarantee the purchaser a specified minimum income for a fixed period, in  
407 order to achieve a price reflective of stabilization. A portion of the sale price is placed in  
408 escrow and is reimbursed to the buyer if the agreed-upon level of revenue is not achieved  
409 during the master lease term. While the sale prices of such transactions may arguably be  
410 reflective of an “as stabilized” price, it is clear that the price is not that for the property on

411 an “as is” basis, as of the date of sale. The most supportable adjustment in such instances  
412 is based upon the quantified impact of the master lease as reported by buyer and seller. If  
413 such information is not available, the adjustment may be reasonably based upon the  
414 present worth of the revenue “shortfall’ during the term of the master lease.

## VII. Suggested Further Reading

- 415 International Association of Assessing Officers, *Standard on Verification and Adjustment of*  
416 *Sales* (Kansas City; International Association of Assessing Officers, 2010)
- 417 Levine, Stephan, Krehbiel, and Berenson, *Statistics for Managers Using Microsoft Excel*, 3<sup>rd</sup>  
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- 419 *The Appraisal of Real Estate*, 13<sup>th</sup> ed. (Chicago; Appraisal Institute, 2008)
- 420 *Dictionary of Real Estate*, 5<sup>th</sup> ed. (Chicago; Appraisal Institute, 2010)
- 421 *Appraising Residential Properties*, 4<sup>th</sup> ed. (Chicago; Appraisal Institute, 2007)
- 422 Ratterman, Mark R, MAI, SRA, *Valuations by Comparison: Residential Analysis and Logic*,  
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- 424 Ratterman, Mark R, MAI, SRA, *Financing and Sales Concessions: Do We Adjust or Not?*  
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426 23)
- 427 Colorado Real Estate Commission and the Colorado Board of Real Estate Appraisers (joint  
428 position) *Do Seller Concession Impact Value?* (posted Nov 10, 2007 on Armbrust Real  
429 Estate Institute; Issued July 11, 2003)
- 430 Gloria Pointer, Valuation Officer Houston Regional Loan Center, *Department of Veterans*  
431 *Affairs Memo 2105*, (February 20, 2008)
- 432 Fisher, Jeffery D., Robert S. Martin, *Income Property Valuation* (Dearborn Financial  
433 Publishing, Inc., 1994: pp. 309-323)
- 434 California State Board of Equalization, *Cash Equivalency Analysis* (Assessors Handbook  
435 Section 503; March 1985, reprinted August 1997)
- 436 Johnson, Ken H., Anderson, Randy I, and Webb, James R., *The Capitalization of Seller Paid*  
437 *Concessions*. (Journal of Real Estate Research - Volume 19, Number 3 – 2000)
- 438 Thimgan, G.E., *Property Assessment Valuation*, 3<sup>rd</sup> ed. (Kansas City, MO: International  
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- 440 Gloudemans, R. and R. Almy, *Fundamentals of Mass Appraisal*, (Kansas City, MO:  
441 International Association of Assessing Officers, 2011)