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.

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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.

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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I. Definitions

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

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

II. Verifying Concessions

Appraisers are required by the *Uniform Standards of Professional Appraisal Practice* (USPAP) to collect, verify and analyze all information necessary for credible assignment results. This is particularly important with regard to sales and financing concessions. The Comment to the definition of "Market Value" in USPAP states, in part, that the conditions included in market value definitions generally fall into three categories:

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

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

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

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

- *Listing agent (or seller's agent)*
- *Selling agent (or buyer's agent)*
- *Buyer*
- *Seller*
- *Lender*

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[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 2012-13 Edition, "Definitions U-4"* (The Appraisal Foundation)

- *Title Company*
- *Appraiser's own records*
- *Published data*
- *Third party appraisal databases*
- *Public Deed Records*
- *Other appraisers*
- *Tax affidavit*

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

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

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

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

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

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

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

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

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

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

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

Examples of what an appraiser may consider:

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

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

III. When Does an Appraiser Adjust For Concessions?

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

Illustration:

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

The existence of concessions will be dictated by the type and definition of value used in the appraisal assignment. USPAP defines "Value" as:

the monetary relationship between properties and those who buy, sell, or use those properties.[7]

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

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

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

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

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

The above statement:

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

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

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

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[7] *USPAP 2012-13 Edition, "Definitions U-5"* (The Appraisal Foundation)

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

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

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

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

IV. <u>Methodology</u>

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

<u>*Special or Creative Financing*</u>

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

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

<u>Illustration A</u>: Dollar-for-dollar (cash equivalent) analysis

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

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

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

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

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

Illustration B: Paired Sales Analysis

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

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

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

Illustration C: Paired Sale Analysis

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

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

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

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

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

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

<u>Seller Paid Loan Discount Points or Buy-Down Programs</u>

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

<u>Illustration</u>:

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

$100,000 FHA-insured mortgage. The seller paid the lender three points, which is 3% of the mortgage amount of $100,000 or $3,000. The cash equivalent price of the comparable sale is therefore $127,000 ($100,000 - $3,000 +$ 30,000)." [8]

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

Inclusion of Personal Property and Cash Incentives

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

Illustration:

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

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

Settlement Assistance or Seller Contributions

The most common type of seller concession is settlement assistance to the buyer. Settlement assistance exists when the seller pays any fees or costs other than what is generally paid by a seller as a result of tradition or law and are found on virtually all sales transactions. The sellers payment of items such as: loan origination fees, appraisal fees, attorney fees, loan application fees, credit report fees, survey fees, fees for preparation of loan documents, fees for photocopying easements and restrictions, mortgage title policy, loan-related inspection fees, and recording fees, would all be considered concessionary in nature. These fees, when paid by the

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

seller, are considered to be concessionary in nature if they are not paid by the seller as a result of convention or law on virtually all sale transactions.

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

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

<u>Illustration</u>:

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

<u>Statistical Analysis</u>

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

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

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

- Anderson, John E. *Ridge Regression:* “A New Regression Technique Useful to Appraisers and Assessors.” *The Real Estate Appraiser and Analyst* 45, no. 6 (November/December 1979): 48-51.
- Dielman, Terry, *Applied Regression: Analysis for Business and Economics*. 3rd ed. Pacific Grove, Calif.: Duxbury/Thomson Learning, 2001.
- Ferreira, Eurico J., and G. Stacy Sirmans. “Ridge Regression in Real Estate Analysis”. *The Appraisal Journal* 56, no. 3 (July 1988): 311-319
- Freund, Rudolf J., and William J. Wilson, *Regression Analysis: Statistical Modeling of a Response Variable*. San Diego, Calif.: Academic Press, 1988.

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

V. Concessions and Non-residential Property (other than 1-4 unit properties)

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

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

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

Cash equivalency computation judgments:

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

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

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

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

The sum in the lower right corner indicates a cash equivalency value for this property of $569,500. In this case the seller who extended the credit receives extra interest to reward the taking of somewhat more than 75% risk on the first lien. Extensive verification is required to assure that the arithmetic and input judgments model the typical investor and seller motivations in an accurate manner. The cash equivalency adjustment is $630,000 less $569,500, or $60,500. Verification will indicate whether the seller captures all of this in extra price or it is split between seller and buyer.

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

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

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

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

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

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

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

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

VII. Suggested Further Reading

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