Seller Concessions, Appraiser Pressure, and the Bailout
December 15, 2009

By J. Allan Payne, MAI, SRA

As a seasoned appraiser, I feel it important to articulate some facts and conclusions about the real estate market. As part of this effort, I have done a simple market study to identify seller paid concessions and base this discussion around that. Following is a study of the sales within the last 180 days within a specific defined market neighborhood. This study was spurred by the request by a VA reviewer to change my appraisal and to not deduct for seller concessions on comparables. The study shows that 26% of all the sales in this neighborhood did not use any seller concessions at all. It also showed that 15% of all sales raised the price in order to cover the concessions and it demonstrated a range for seller concessions of 016.9% with a mode at 3%, an average of 2.6%, and a median at 2.7%. I would conclude from this that there is no standard for seller concessions and that, without standard concessions that are not "normal", concessions, therefore, are outside the definition of "market value" and must be deducted from comparables in order to meet and reflect the definition of cash equivalency required by the definition of market value.

As part of the Fannie Mae 1004 form and the Freddie Mac form 70 (page 4 of 6), dated 2005, market value definition reads,

> "Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto and the price represents the normal consideration for the property sold unaffected by special or creative financing or seller concessions granted by anyone associated with the sale."

In order to meet this portion of the definition, good appraisers have been deducting seller concessions from the reported sales price of the comparable sales used in order to adjust them to market value and then have proceeded with the other adjustments they felt necessary. There is some confusion on this point which is raised by the explanatory paragraph on the Fannie Mae form which reads,

> "Adjustments to the comparables must be made for special or creative financing or sales concessions."

That sentence is not confusing, but the next might be,

> "No adjustments are necessary for those costs which are normally paid by sellers as a result of tradition or law in the market area."

Some appraisers have taken this to mean that, since they frequently do see seller concessions, that this becomes normal and, therefore, they do not need to adjust them out of the sales price. The explanation continues,

> "These costs are readily identified since the seller pays these costs in virtually all sales transactions."

Interesting that it says, "virtually all", not "prevalent" in the definition. This is where my study becomes helpful. In the market area I studied, in the last 180 days, there were 54 sales of homes priced between $100,000 and $200,000. 14 Of those homes, or 26%, did not have sales concessions. Of those that did have sales concessions, they ranged between 0% and 6.9% of the sales price. To me, it is clear that these seller concessions are not "costs which are normally paid by the sellers. . ." Certainly, it does not qualify as, "seller pays these costs in virtually all sales transactions." Therefore, I would contest that appraisers should deduct seller concessions.

VA and other underwriters have made the case to appraisers that they can deduct or not deduct seller concessions based on, "the appraiser's judgement." This is taken directly from a sentence in the explanation of market value on the Fannie Mae 1004 and the Freddie Mac form 70, which reads,

> "Any adjustment should not be calculated on a mechanical dollar per 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 judgement."

While it is true that appraiser's judgement is important and while it is true that financial calculations do not always represent the market's reaction, this sentence in the instructions should not be a carte blanche for reducing the adjustment as some appraisers have been instructed to do. Some appraisers have been instructed that 3-4% seller concession normal and that they should only deduct for concessions over that amount. But, this flies in the face of the study of local market, which found out that 25% of the sales did not have any concessions at all.

In considering the definition of cash or cash equivalent, the term cash is referred to as "cash to the seller" (how much money does the seller actually receive?). With that interpretation, all of the seller concessions should be deducted on the sales comparables in order that the price be reflective of cash. For instance, if a seller advertises his house for $203,000 and receives an offer for $200,000 minus 3% seller concessions, the concessions amount to $6,000. Therefore, the seller receives $194,000. This amount is really the cash equivalent price that he sold the house for, not $200,000, not $196,000. That point is not available for the appraiser's judgement because it is a simple fact. It is not established as normal for sellers to pay 3% seller concessions and it is not established that it happens in virtually all sales transactions.

Now, there are some costs that do happen in virtually all sales transactions and really are normal in certain markets, such as inspection fees, title fees, or real estate commissions. In the market of this study, real estate commissions are normally 6% of the sales price and Realtors on the MLS sell 97% to 98% of all the properties that sell. It can be considered normal and standard as a tradition in the market area and it is a cost incurred in virtually all transactions. But, that is not the case with seller paid concessions.

It is my experience that a similar study to the one quoted in this article could be done in lots of different neighborhoods. In starter home neighborhoods, it is more common to have seller paid concessions than in custom neighborhoods. But, this appraiser has seen concessions as low as zero and sometimes as much as 10%, 15%, or 16% of the sales price. I have seen concessions on luxury homes as much at $50,000.

When an appraiser does not deduct the concessions paid by the seller from the reported price and the uses that comparable on an adjustment grid, it will result in an indication of value much higher than the market value according to the official definition of market value. It states, again,

> "Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto and the price represents the normal consideration for the property sold unaffected by special or creative financing or seller concessions granted by anyone associated with the sale."

So what happens when appraisers do not deduct for seller paid concessions? The indicated value of the house he is appraising is higher. So what happens? The buyer effectively borrows money to pay for the seller paid concessions. What does that do? It inflates the price of the house. And then what happens to the next house? The appraiser uses that house that had sold as a comparable the next time and it inflates again, and we have a cycle of artificial inflation because buyers and sellers are not aware that the seller concessions were building to the reported price. Even statistics, national sales summary charts, etc., are based on the reported price, not the cash equivalent price and if you continue to do this for a few years, multiplying the difference and the appreciation each time, we end up with a very high appreciation rate on homes selling for more than people can afford to pay and foreclosure rates accelerating.

But then, remember, the buyer who is now facing a foreclosure actually financed into the loan balance the seller concessions over and above the real value of the property. Then, we have a bail-out of Fannie Mae and Freddie Mac. Our country is now facing a financial crisis, as it is called. Part of this problem could have been avoided if appraisers, underwriters, regulators, and/or loan administrators had made it clear that seller concessions are to be deducted completely on every sales transaction where the seller actually contributed dollar values toward the buyer's ability to qualify for the required loan.

With the letter such as the one I am attaching to this article, from a person of authority instructing him that concessions are normally zero to 4% and that they should not have been deducted in the case of this appraisal, amounts to appraiser pressure - another cause of the current financial crisis. Most appraisers work on a piecemeal fee system. They get paid for the appraisals they do. If the appraisals are good, they get more appraisals to do. If they deduct for seller concessions occasionally, the value resulting will be below the real sales price (especially on those at 15% where the price was actually raised to cover the seller concessions). Therefore, appraisers feel pressure to deliver an acceptable appraisal. It used to be that an acceptable appraisal was a quality written report, thorough and accurate. But, in recent years, a quality appraisal has included the bottom line, sufficient to justify the requested loan. This can often be achieved by ignoring a negative adjustment, such as seller concessions.

As a seasoned appraiser, I would like to conclude this article by urging solid appraisal guidelines with respect to seller concessions, cash equivalency, and market value definitions as part of the bailout and reform of the lending industry.

SALT LAKE CITY SELLER CONCESSIONS STUDY			
Sales	***900 South to 2100 South, State Street to 1200 West***		
9/24/08	***Last 180 Days, $100,00 to $200,000, 53 Sales in Area***		
#	**Price**	**Concessions**	**% Concessions**
1	$114,000	$845	0.7412%
2	$117,500	$0	0.0000%
3	$119,500	$3,585	3.0000%
4	$120,000	$8,545	7.1208%
5	$130,000	$8,000	6.1538%
6	$125,000	$0	0.0000%
7	$123,500	$4,070	3.2955%
8	$129,000	$2,500	1.9380%
9	$118,500	$3,555	3.0000%
10	$129,000	$0	0.0000%
11	$130,000	$0	0.0000%
12	$132,500	$4,000	3.0189%
13	$133,900	$0	0.0000%
14	$138,950	$4,000	2.8787%
15	$135,500	$3,500	2.5830%
16	$139,500	$8,880	6.3656%
17	$125,000	$3,750	3.0000%
18	$136,900	$3,700	2.7027%
19	$138,000	$0	0.0000%
20	$139,000	$4,000	2.8777%
21	$126,000	$0	0.0000%
22	$144,800	$7,344	5.0718%
23	$148,000	$4,720	3.1892%
24	$145,000	$1,000	0.6897%
25	$140,000	$0	0.0000%
26	$147,000	$8,820	6.0000%
27	$159,155	$9,655	6.0664%
28	$154,750	$10,630	6.8691%
29	$149,900	$0	0.0000%
30	$149,000	$4,470	3.0000%
31	$150,000	$4,500	3.0000%
32	$150,000	$4,500	3.0000%
33	$157,900	$4,647	2.9430%
34	$159,000	$9,540	6.0000%
35	$155,000	$0	0.0000%
36	$157,000	$3,237	2.0618%
37	$149,000	$0	0.0000%
38	$159,900	$0	0.0000%
39	$161,500	$9,690	6.0000%
40	$14,500	$0	0.0000%
41	$161,000	$2,500	1.5528%
42	$160,000	$4,800	3.0000%
43	$166,500	$0	0.0000%
44	$160,000	$5,000	3.1250%

45	$167,900	$2,000	1.1912%
46	$179,900	$10,953	6.0884%
47	$169,000	$5,070	3.0000%
48	$185,800	$10,974	5.9064%
49	$182,600	$5,478	3.0000%
50	$180,000	$5,400	3.0000%
51	$187,731	$5,550	2.9564%
52	$183,000	$5,000	2.7322%
53	$195,000	$5,850	3.0000%
		Range of % Concessions	0.0000% to 3.0000%
		Range of $ Commission	$0 to $10,974
		Mean (Average) Concession	2.66%
		Median Concession	2.7%
		Mode Concession	3.0%
		# That Raised Price	8
		% That Raised Price	15%
		# Without Concessions	14
		% Without Concessions	26%

Conclusion: There is no consistent standard for concessions. Without a standard, concessions are not “normal”. Therefore, concessions outside the definition of “market value” and must be deducted from comparables in order to meet the cash requirement.

See definition and explanation comment or FNMA 1004 form and Freddie Mac form 70, page 496, March, 2005 copy attached.

Individual Condominium Unit Appraisal Report

This report form is designed to report an appraisal of a unit in a condominium project or a condominium unit in a planned unit development (PUD). This report form is not designed to report an appraisal of a manufactured home or a unit in a cooperative project.

This appraisal report is subject to the following scope of work, intended use, intended user, definition of market value, statement of assumptions and limiting conditions, and certifications. Modifications, additions, or deletions to the intended use, intended user, definition of market value, or assumptions and limiting conditions are not permitted. The appraiser may expand the scope of work to include any additional research or analysis necessary based on the complexity of this appraisal assignment. Modifications or deletions to the certifications are also not permitted. However, additional certifications that do not constitute material alterations to this appraisal report, such as those required by law or those related to the appraiser's continuing education or membership in an appraisal organization, are permitted.

SCOPE OF WORK: The scope of work for this appraisal is defined by the complexity of this appraisal assignment and the reporting requirements of this appraisal report form, including the following definition of market value, statement of assumptions and limiting conditions, and certifications. The appraiser must, at a minimum: (1) perform a complete visual inspection of the interior and exterior areas of the subject unit, (2) inspect and analyze the condominium project, (3) inspect the neighborhood, (4) inspect each of the comparable sales from at least the street, (5) research, verify, and analyze data from reliable public and/or private sources, and (6) report his or her analysis, opinions, and conclusions in this appraisal report.

INTENDED USE: The intended use of this appraisal report is for the lender/client to evaluate the property that is the subject of this appraisal for a mortgage finance transaction.

INTENDED USER: The intended user of this appraisal report is the lender/client.

MARKET VALUE: The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: (1) buyer and seller are typically motivated; (2) both parties are well informed or well advised, and each acting in what he or she considers his or her own best interest; (3) a reasonable time is allowed for exposure in the open market; (4) payment is made in terms of cash in U. S. dollars or in terms of financial arrangements comparable thereto; and (5) the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions* granted by anyone associated with the sale.

*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 a market area; these costs are readily identifiable since the seller pays these costs in virtually all sales transactions. Special or creative financing adjustments can be made to the comparable property by comparisons 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.

STATEMENT OF ASSUMPTIONS AND LIMITING CONDITIONS: The appraiser's certification in this report is subject to the following assumptions and limiting conditions:

1. The appraiser will not be responsible for matters of a legal nature that affect either the property being appraised or the title to it, except for information that he or she became aware of during the research involved in performing this appraisal. The appraiser assumes that the title is good and marketable and will not render any opinions about the title.

2. The appraiser has provided a sketch in this appraisal report to show the approximate dimensions of the improvements. The sketch is included only to assist the reader in visualizing the property and understanding the appraiser's determination of its size.

3. The appraiser has examined the available flood maps that are provided by the Federal Emergency Management Agency (or other data sources) and has noted in this appraisal report whether any portion of the subject site is located in an identified Special Flood Hazard Area. Because the appraiser is not a surveyor, he or she makes no guarantees, express or implied, regarding this determination.

4. The appraiser will not give testimony or appear in court because he or she made an appraisal of the property in question, unless specific arrangements to do so have been made beforehand, or as otherwise required by law.

5. The appraiser has noted in this appraisal report any adverse conditions (such as needed repairs, deterioration, the presence of hazardous wastes, toxic substances, etc.) observed during the inspection of the subject property or that he or she became aware of during the research involved in performing this appraisal. Unless otherwise stated in this appraisal report, the appraiser has no

Payne

From: Lofland, Andrew P., VBADENV [Andrew.Lofland@va.gov]
Sent: Tuesday, September 23, 2008 11:09 AM
To: jeanette@payneappraisal.com
Subject: Appraisal review
Signed By: andrew.lofland@va.gov

Jeanette H. Payne,

In reviewing the appraisal dated 09/17/2008 (41-41-6-0221312), the following items were noted.

Good report, however, prevalence of concessions not specified in appraisal. Must have a dollar amount or percentage of concessions that is prevalent for the market area. Example statement: The prevalence of concessions in the subject's market is 0-$7,000 or 0-4%.

Fencing for the subject appears on page one, however, not accounted for on the grid.

Please make the above corrections/explanations to the report and upload the full appraisal to eappraisal. Please reply back when complete.

Sincerely,

Andrew Lofland
VA Staff Reviewer