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## Seller Add-Ons Contribute to Housing Market Lull, Study Finds

By [Stephanie Taylor Christensen](#) Jul 26, 2011 9:45 am

Incentives from the bubble years inflated home sale prices to allow bigger loans, and now are making a housing recovery more difficult.

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There are many who have been blamed for the housing market crash and slow recovery -- ranging from Alan Greenspan, to the government, to mortgage lenders like **Bank of America (BAC)**, **Wells Fargo (WFC)**, **Chase (JPM)**, and countless others. But as the public waits for a housing market rebound, a recent Ohio State University study hints that a home sales practice that was prevalent in the housing boom may still be contributing to the stalled housing market.

Itzhak Ben-David, assistant professor of finance, conducted the study and wrote about the findings in "[Financial Constraints, Inflated Home Prices from the Real Estate Boom](#)". Using data from home sales in the Chicago area during the housing boom, he investigated the impact of concessions used

to incentivize buyers. The idea of offering concessions to a potential home buyer to "sweeten the deal" isn't uncommon, or illegal. But, when the system is abused to falsely inflate home values and qualify buyers for loans for which they can't maintain payments (a practice Ben-David confirmed took place in areas of Chicago during the housing boom), it creates a long-term ripple effect in the housing market.

Traditional concessions often take the form of seller-paid closing costs, or cash back to be used for minor home repairs realized during the home inspection. Legally, concessions are required to be disclosed to the lender, and must fall within a given range (as of 2010, that number was lowered to 3% of the transaction value; before that time, concessions up to 6% of the transaction price fell within legal limits). Though it is an appraisal industry norm not to include concessions in the formally assessed "real value" of the home, such "perks" often skew the final figure, either due to a relationship the appraiser might have with other involved parties, or simple knowledge of the concessions. While a few thousand dollars worth of traditional concessions won't heavily affect a home's real versus appraised value, the exorbitant, and often illegal, concession practices that Ben-David uncovered can, and did.

Beginning in 2000, the housing and mortgage markets opened up to buyers not financially equipped to take on the long-term burden of a traditional mortgage loan. In situations where a potential buyer couldn't produce the required down payment for a loan, sellers got creative with concessions to "expand the scope of the transaction" by including items like cash bonuses, cars, appliances, and other high-value collateral to enhance the value of the deal. As a result, the real estate transaction price appeared higher to outside parties like lenders, allowing

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buyers to borrow more than the home was actually worth. Real estate ads including thinly veiled phrases like “let’s talk about cash” and “buy with no money down!” are indicators for such transactions, and are some of the “trigger phrases” that Ben-David looked for in his research.

In his study of more than 768,000 residential transactions that took place in Cook County, Illinois, between 1995 and 2008, Ben-David uncovered such indications that buyers financed more than the actual value of the home, based on such high-value concessions. Ben-David estimates that between 2005 and 2008, up to 16 percent of home sales in Chicago included such “add-ons”, falsely inflating home prices up to 9%. To add further damage, the practice was most prevalent in lower income areas that have been most impacted by the housing downturn. In addition to the inflated values, the foreclosure rate was higher among highly leveraged buyers, despite little difference in mortgage interest rates from more qualified borrowers. Additionally, the falsely inflated transactions were most common when the seller had a greater stake in the deal, acting as the owner-agent, or in a situation where a Realtor received both sides of the commission from the sale.

While the data included in the study was limited to housing in Illinois, researchers can reasonably conclude that the practice, and its aftermath, is likely even more prevalent in once highly-valued housing markets like Phoenix and Florida. “The prediction is that in areas in which price inflation activity was intense, prices should be higher and have a higher volatility. The empirical evidence supports this prediction,” according to the study. Ben-David’s findings present an additional level of complexity toward a housing market correction, noting that “the inflated transactions could have an effect on the aggregate real-estate market.” Because property prices are often based on “comparable assets in the neighborhood, inflated prices could create the impression of rising house prices.”

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