ILLINOIS STATE BAR ASSOCIATION

AUGUST 2018 VOL 64 NO.2

Real Property

The newsletter of the Illinois State Bar Association's Section on Real Estate Law

# A better strategy: Reduce the contract purchase price in lieu of credits to buyers

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## 1. Reducing the purchase price benefits all parties.

- No waiting for Buyer's lender to approve a credit since no credit exists;
- Parties won't be tempted to credit money outside of closing if the lender disallows the credit;
- A reduced contract purchase price lowers the risk that the property will appraise to a value below the contract purchase price. That, in turn, lowers the risk that the deal could fall through. In the event the property does appraise below the agreed purchase price, the Seller is not stuck with both a promised credit for repair to buyer and losing out on proceeds by having to lower the purchase price to the appraised value in order to keep the deal together;
- State, county, and municipal transfer taxes that are based upon the purchase price will be reduced which certainly benefits the Seller. But it also benefits the Buyer for those municipalities which levy the transfer taxes against the Buyer (e.g., Naperville and Chicago charge both buyer and seller).

## 2. Reducing the purchase price saves the seller money.

If the original purchase price was teetering just above the capital gains tax exclusion amount, then a reduced price in lieu of a credit might allow Seller to qualify for the exclusion amount ($250,000.00 or less for a single person and $500,000.00 or less for married couples filing jointly).

In addition, Seller will pay less for all these fees based on the purchase price:

- Real estate broker's commission;
- Title insurance premium;
- State and county transfer Taxes.

**Example #1**: A $5,000.00 credit to the buyer on a purchase price of $355,000 could instead be a price reduction to $350,000.00 and would save the seller:

- $250.00 on a five percent broker's commission;
- $20.00 in owner's title insurance fees (depending on the title company);
- In Oak Park, for example, $40.00 is saved in transfer taxes ($8.00 per $1,000 of the purchase price);
- $5.00 in state transfer taxes ($0.50 per $500 of the purchase price) and $2.50 in Cook County transfer taxes ($0.25 per $500 of the purchase price).

Total potential savings: $317.50. This is nearly enough to pay for the survey or the broker's add-on "administration fee." Is saving a few hundred bucks nominal? Three hundred dollars is not deemed inconsequential when your client is shopping around for an attorney, hoping to save on attorneys' fees, or when your client finds a defect in the final walk-through. Probably like you, I've seen buyers threaten to kill the deal over a $15.00 final walk-through item at closing! Compare the effort it takes to suggest this easy strategy as opposed to arguing a final-walk through issue.

**Example # 2:** In lieu of a $10,000 credit to the buyer, a reduction in purchase price from $355,000.00 to $345,000.00 saves the seller:

- $500.00 on a 5 percent broker's commission;
- $20.00 in title insurance fees (depending on the title company);
- $80.00 in transfer taxes in the municipality of Oak Park;
- $10.00 in State transfer taxes and $5.00 in Cook County transfer taxes.

Total potential savings: $615.00. This savings may be about equal to your attorney fee for residential real estate transactions. **Simply suggest the price reduction in lieu of a credit to the buyer and you've already earned your Seller's attorney fee.**

## 3. Reducing the purchase price saves the buyer money, too.

- Buyer's mortgage amount will be lower because mortgages are typically based on a percentage of the purchase price. A lower mortgage amount means:

- Perhaps a reduced risk of default on the loan;
- Buyer will pay less total funds in interest to the lender;
- Buyer will pay a lower mortgage broker fee;
- Buyer will pay a lower origination fee;
- Buyer will pay less to buy down points on the loan.
- If the loan amount is reduced because the purchase price is reduced, then these buyer's fees will in turn be reduced.
- Buyer's future property taxes may be lower since the increase in property taxes after the sale is based on purchase price;
- Buyer's hazard/homeowner's insurance could be lower since it is based on the appraisal value of the home, which typically matches the purchase price.

## 4. Reducing the purchase price results in a genuine, fair market value upon which comparable purchase prices will be based.

When an appraiser conducts an appraisal, the most recent comparable real properties and the prices at which they recently sold is the main basis for supporting a value on an appraisal. But the appraiser has no means of discovering whether a purchase price reflects the true price the buyer paid, or if the buyer received a significant credit from the seller in lieu of a lower purchase price. Accordingly, every time a credit is given from a seller to a purchaser at closing, it undermines the analyses and artificially inflates the purchase price upon which other future fair market analysis and appraisals and property sales may be based. The true fair market value of the property is when a purchaser pays full price for the purchase price and does not receive any credit back from the seller. When there are no credits from seller to buyer, then purchase price reflects an accurate fair market value against which future property sales can genuinely be compared.

## 5. You won't bear the potential liability of forgetting a credit owed to your client.

It's not easy to remember at the closing table the prior agreements between the parties which were finalized weeks earlier during inspection negotiations. You, as the attorney, must check the final numbers and ensure your client is receiving what was promised in the contract. If you forget a credit, that could result in it coming out of your own pocket to make your client whole. If you simply had pushed for the price reduction in lieu of a credit, you wouldn't have this potential liability in the first place.

## Bonus Reasons

**6. What percentage of buyers actually use repair credits for the purpose of repairing the defects they became so flustered about and adamantly demanded be repaired?**

I don't know the answer, but I'll venture a guess that most spend it on furniture for the new home, instead.

**7. Re-characterization of "repair credits" into "closing cost credits" is not an issue with a price reduction.**

Lenders see credits for inspection repairs as a red flag because a defective property condition could undermine the appraised value upon which the loan is based. Accordingly, any credit to the buyer given after negotiations from the home inspection is labeled a "closing cost credit" to avoid mucking up the loan approval process. You won't have to bother with labels if a credit doesn't exist, and none would exist if you simply lowered the purchase price in lieu thereof.

**Are you hesitant to change the purchase price because you believe the Buyer's loan application process will be delayed?**

This is probably not an issue for most transactions. Usually, credits to the buyer come up during home inspection negotiations within a week or so after the contract has been signed. At this stage, typically a buyer's loan application has not yet been submitted or has recently been submitted. At this point, typically the lender will have enough leeway to accommodate the change in purchase price. But in some cases, the lender may require an Addendum signed by the parties, and if the Buyer is required to explain the reason for the reduced purchase price, this could affect underwriting.

**Bottom Line: Change your modus operandi.** Get out of the knee-jerk response of credits to the buyer to address inspection defects. Instead, suggest that the parties lower the purchase price and by so doing, you'll simplify the transaction, save yourself additional work, and have advocated for the best interests of your client.

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