



## Rental Services, Inc.

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Concessions, should you use them on your Property?

Dear RSI Client,

Concessions. You can't live with them and you can't live without them, but what does it really mean to the property? Their affect on cash flow and value isn't always clear. Over the last few years, concessions have become one of the biggest problems facing the real estate market.

Why are concessions so bad for the real estate market? In most cases, concessions lower the net operating income of the real estate, which in turn lowers the value. To the average Joe, this looks to be a double hit (lower income and lower value). Actually, in real estate it is a triple hit. First, income goes down, second, the real estate's value is lowered and third, the capitalization rate is raised and this further reduces the value of the property.

The following is a text book example that shows the actual risks involved when an owner or management company uses concessions that reduce the income by 10%.

### EXAMPLE

Value (any real estate) @ 9%	\$100,000
Capitalization Rate	

#### Without Concessions (Assumptions)

Property Income	\$18,000
Property Expenses	\$9,000
Net Operating Income	\$9,000

#### With A 10% Concession (Assumptions)

Income Declines 10%	\$16,200
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Property Expenses (remain the same)	\$9,000
Net Operating Income	\$7,200

Results From A 10% Concession

Capitalization Rate Increases (example 10%)

New Market Value @ 10% Cap Rate	\$72,000
Annual Cash Return On Investment	\$7,200

The preceding figures illustrate the affect on real estate of a 10% concession. The conclusion to be drawn from this example is that a 10% concession could increase the capitalization rate from 9% to 10% resulting in a loss of market value of 28% and a loss in cash flow of 10%. This means that if the real estate were purchased with a down payment of 30%, the buyer would lose the entire investment.

(Allen Cymrot)

The moral, make sure you understand the financial impact of concessions before you give three months of free rent. If you have any questions about concessions please contact me at [jmalone@rsiscreening.com](mailto:jmalone@rsiscreening.com).

Sincerely,

Jeff Malone  
National Marketing Director  
Rental Services/ RSI Screening