Pricing & selling land is not easy as pie, but pie isn't so easy either
By Curtis Seltzer
Creative Real Estate Magazine, May, 2008.

BLUE GRASS, Va.—The one rap against land ownership that I hear repeatedly is this: Land is illiquid.

What does that mean…exactly?

Land cannot be sold instantaneously. The market for land is not like the market for stocks, commodities and futures. I concede the point. Instantaneous trading can lead to mistakes as often as it leads to profits.

My rejoinder is simple: So what? Every investor gets into real estate knowing that it cannot be bought or sold immediately.

The illiquidity rap has a second part, which goes something like this. Land can take a long time to sell.

I concede that point too.

In my 35 years of experience, I've seen tracts that don't sell. Why? They are either priced way above market price or have some dreadful negative that turns them into a buyer's zone of repugnance.

Investors are familiar with the funny logic embedded in the idea of market price. After a sale, market price is whatever price the property sold for. Before a sale, market price is an opinion of what it will sell for. A seller can only price way above market before a sale, not after. When property doesn't sell because it is overpriced, buyers search for the real market price, below which it won't be sold.

Every seller gets timely feedback as to whether his asking price is above market by the number and quality of purchase offers submitted. Property usually becomes increasingly liquid as a seller comes off his asking price. Where a seller chooses to stick with an above-market price, he's choosing to be illiquid.

Since the seller never knows market price until a sale is made, let's assume that we can roughly project the correct market value of a property by comparing it to the recent selling prices of several comparable properties. This, as readers know, is an appraiser's opinion of the property's market value fairly and honestly estimated.

The appraisal price may or may not be at market. Only buyers and seller can determine that price going forward from the property's asking price.

So how should sellers price land for sale to avoid illiquidity?

A seller's asking price can play off an objective appraisal price. If the asking price is higher, the seller should hand the appraisal to buyers with an explanation of why he thinks the higher price is justified. If the asking price is below the appraisal price, the seller is signaling time is more important to him than hoped-for incremental dollars. The first tactic gives up time in hope of netting more money by starting high, while the second gives up money in the hope of netting a satisfactory amount in a quick sale.

When sellers work off an appraisal, they must be scrupulous about not leaning on the appraiser to hit a number. One way to avoid influencing an appraiser is to ask a disinterested third party -- a lawyer that you do not routinely use, for example -- to commission the appraisal while keeping you blind and remote. This is a bit contrived, but it could reassure buyers of the integrity of the seller's appraisal number.

Tracts that are less than 1,000 acres are not expensive to appraise. Large farms and large mineral and timber tracts take more expertise and will cost more.

What the seller obtains by handing an honest appraisal to a buyer is an objective, third-party, professional opinion of current value. Buyers may still be suspicious, thinking the number is cooked. If a buyer seems genuine, a seller can offer to pay half the cost for a second appraisal done by an appraiser that buyer and seller jointly retain if the buyer will agree in advance to pay the average price of the two appraisals. Depending on market conditions, this can be a good deal for both buyer and seller, particularly the latter.

What the seller obtains by giving a buyer an inflated appraisal is destruction of his credibility. Some believe that seller dishonesty produces a quick sale. I think it's equally arguable that seller dishonesty produces illiquidity. Buyers should walk away from deceptive, dishonest sellers. Buyers should never bargain off a cranked appraisal.

* * *

Let's say that the appraisal number based on comps is $1 million for a 500-acre farm with improvements.

The next typical step for sellers is to figure in a broker's commission and some slop for negotiating, then price the property at, say, $1.2 million. The hope is to settle at the appraisal price, which the seller genuinely believes is market value.

The asking price, of course, will be seen by every buyer as being above market. Which, of course, it is, by about $200,000.

This typical seller approach may or may not produce a quick sale at $1 million in a normal market where quickness at market price is the measure of liquidity. It usually generates a sale within three to 12 months, which is not very liquid.

A FSBO could hand an honest appraisal to a buyer and say, "$1 million is my price because that's what the property is worth. No commissions; no negotiating." Americans buy much of their stuff by paying a no-budge, no-haggle, seller-affixed price.
Think groceries, college tuition, apparel, energy, medical care and so on. We bargain over cars and property for reasons of history, not efficiency. I think the FSBO would move his property pretty quickly in most markets as long as he is willing to build trust by disclosing everything he knows.

* * *

There's another way to approach setting a selling price for land. It's based on the idea that conventional comps analysis does not fully value both some assets in rural property and the discrete assets as parts of the entirety. Appraisals judge properties against each other, as one whole against another whole. Tweaking is usually limited to improvements and acreage.

If you compare the value of the property's assets bundled in an appraisal's entirety against their disaggregated values, you often find the components discounted when they're appraised as an entirety. This 500-acre farm's values might break down something like this:

		Discounted Value as entirety	Potential Disaggregated fair value
1	On five acres: 10-room, 1920s vernacular wood farmhouse in good condition; modern (but not fancy) plumbing	$300,000	$450,000

	and heating; room for home office; two baths; 1970s-style kitchen 2 wood barns in good condition; one suitable for horses 1 shop shed with concrete floor, heating, electric, overhead hoist 1 1/3-acre pond Frontage on state-maintained hardtop road. All utilities, including Internet and satellite tv		
2	$15,000 of farm equipment can be part of any deal		
3	100 acres of level-to-rolling crop land; has road frontage; good dirt	$175,000	$250,000
4	145 acres of pasture; developable; hilly; good views	$245,000	$370,000
5	250 acres of woods ($100,000 worth of merchantable timber by honest cruise)	$270,000	$370,000
6	oil-and-gas rights convey; no other mineral resources	$10,000	$20,000
7	wooded ridge at the back of the property could be developed for wind turbines	0	$10,000
8	development rights have tax value as donated conservation easement	0	$100,000
		$1,000,000	$1,570,000

Both columns are accurate numbers.

Conventional entirety appraisals do not as a rule value timber on the stump, minerals, wind rights and water resources. Appraisers usually use a standard straight-through value for timberland regardless of whether it actually contains $100/acre in immediate commercial value or $1,500. The potential sale of development rights or the tax benefits deriving from their donation through a conservation easement are rarely mentioned in an entirety appraisal unless the client makes a specific request or they are obvious.

Is it fair to value an entirety for a selling price based on its break-up value?

Sure. Knowledgeable buyers do this routinely.

Finally, land is always pricier on a per-acre basis in smaller chunks. It’s easy to sell 100 of the 145 acres of pasture for 50 percent more than what you just paid for it as part of a 500-acre entirety.

I’m not criticizing appraisers for their work. I’m simply making the point that an entirety appraisal produces as a one-money entirety price. Both sellers and buyers should be aware that more value can be uncovered by valuing the component parts.

Valuing disaggregated entirety assets usually produces a higher total value than an entirety approach.

In this example, the seller might set his asking price at between $1.3 and $1.4 million, pay the commission and negotiating hits and still sell for more than the appraisal value of $1 million. This seller loses nothing by taking this approach.

* * *

I advise sellers that the way to get higher prices is to disclose everything -- what you know, what you don't know and what you're not sure about -- and be scrupulously honest with buyers. Sellers can get higher prices by stripping risk out of the sale for buyers. Sellers need to extend a hand of trust and honesty.

Truth in advertising. Don't puff or lie to buyers in advertisements. Each time a buyer catches a seller in an exaggeration, minimization or outright whopper, the seller loses credibility.

Disclose, disclose, disclose. Provide an information package in the first contact with the buyer, either directly or through your listing agent.

Include relevant deeds and other important recorded documents, survey, topo map with boundaries drawn by a surveyor, tax information (annual payment and assessed values), easements, neighborhood information, defects in the property that are not obvious, problems with structures, photographs, appraisal if available, mortgage information (monthly payment, balance, term left, rate, lender), your purchase price, additions/improvements you've made, insurance coverage, permits status and regulatory information, something about you and your reason for selling.

Include information about the property's assets. Provide honest evaluations of timber, minerals and farmland. If the property generates income, provide accurate numbers.

Remember: trust-building is the key to selling in a buyer's market.

Be honest. Don't conceal, mislead, not mention or lie.

Be helpful. Find out answers; provide documents. If you can help with financing, do so in today's market. Perhaps the buyer can save money by working through your lender, title insurance provider and insurance agent.

Negotiate. Every seller wants a buyer to make an offer and negotiate. Don't issue take-it-or-leave-it ultimatums. Be open, flexible and reasonable. Don't personalize low-ball offers. They're business, not personal.

Buyers are looking for sellers they can trust. They back away from sellers who they can't trust. Trustworthy sellers can get higher prices and faster sales. Properties owned by trustworthy sellers are more liquid without spending or giving up a seller's dime.

Equally important, what kind of person do you want to be?