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How does a seller set an asking price?

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(This is the sixth in a series of articles on issues raised in a purchase-offer contract. In the preceding article, I discussed the different ways that were available to sellers to get an idea of the value of their property. As all sellers are aware, the only true market value of real estate at a given time is the selling price and terms that the seller and a buyer negotiate.)

Once a seller finds his way to a dollar number that he thinks represents the value of his property, he faces a set of decisions about asking price. Should he set an asking price higher than, equal to or less than what he believes is the value of his property? Part of the seller's answer will be determined by what he needs to net out of the sale after-tax. This net number factors in all deductions from sale income—transaction costs, taxes (local, state and federal) commissions, fees and expenses. Another part of the answer is shaped by the seller's judgment of current market conditions. Where a lot of buyers are chasing a relatively few number of properties, the market will bear a higher price. When few buyers are tire-kicking a lot of sale properties, or not tire-kicking at all, the market price can drift below the true value of the seller's real estate.

A third factor is the intensity of the seller's motivation. Desperate sellers may set a too-high asking price to cover their needs even though they doubt that a buyer will come close to it. This is the psychology of hope. It's why we buy lottery tickets, despite the odds. It doesn't work very often. Desperate sellers usually do best by setting an asking price that will attract buyer interest in a buyer's market.

A fourth factor is holding power. The price a seller can exact from the market is directly related to his ability to hold the property as long as it takes to get that price.

Desperate sellers cannot hold for very long, so they have to price lower than they would like.

With these four factors -- net requirement, current market, seller motivation and holding power -- in mind, the seller works up five types of prices for his property when he puts it up for sale.

1. Valuation price, which he determines through intuition, group-think, tax-assessed value, appraisals and opinion—alone or in combination. This is the price that he thinks his property is actually worth in the current market.
2. Initial Asking price, which is where the seller starts the sales process.
3. Wants-to-get price, which is where he hopes he ends up, which is usually lower than the initial asking price.
4. Needs-to-get price, which is what the seller must net to come out acceptably. A needs-to-get price is a sober, realistic value, stripped of hope.

5. Rock-bottom price, below which he will not sell because it nets too little to make the sale worthwhile.

Some sellers work up very precise numbers for each of these five prices, and others wing one or more of them.

With the initial asking price, the seller faces four tactical choices.

First, he could set a very high asking price and indicate a willingness to come down. The seller might include in his advertisement, "Negotiable." This tactic forces a seller to come off the initial price a lot as part of his negotiating strategy, but not below a dollar point that satisfies whatever needs the seller must meet. The seller's strategy is to give a buyer large concessions on initial price as a way of faking the buyer into ending up paying more than he might otherwise.

The downside to this strategy is that some number of able-and-willing buyers won't even look at seriously overpriced properties. This seller, however, is not looking for a knowledgeable buyer and negotiating partner; he's looking for a chump who thinks negotiating a concession of 30 percent off an asking price that's set 50 percent above where it should be gives him a good deal and proves how shrewd he is.

Second, he could set an asking price that's, say, 20 percent above his need-to-get price. Twenty percent gives this seller room to bargain with a buyer and cover the costs of the sale.

My guess is that most sellers use some variation of this method, and most buyers intuitively play along by trying to end up with a 10 to 20 percent discount off the initial asking price.

I have seen sellers hurt by this lazy-boy way of pricing property when they didn't net out their expenses precisely or neglected the tax consequences of a sale.

The downside is that these negotiations are almost always limited to fighting over dollars, that is, where within the 0-to-20 percent overcharge everyone will land. Terms -- which are the great wedge of flexibility in negotiations -- are elbowed off the table. If a buyer is unwilling to pay the seller's need-to-get price, then the process stops.

Third, the seller could set an asking price as a take-it-or-leave-it proposition. This type of seller must have holding power and a willingness to wait until his price is met.

A buyer should, in my opinion, pay a no-budge price only when it is at, or below, what the buyer believes is the value of the property to the buyer. I generally avoid even looking at properties whose prices are advertised as "firm," unless I know that the firm asking price is at or below its value to me.

Finally, the seller could set an asking price that will net what he needs from a sale and be entirely transparent about how he got to that price. Let transparency be the path that your buyer walks into understanding your needs.

In a sense, this is a variation of take-it-or-leave-it. But the difference is the seller shows the buyer that he's done all the negotiating on price he can afford. This is accomplished by showing the buyer honest numbers, honestly arrived at.

This was the Saturn marketing model as opposed to the horse-trading that is the auto industry's norm, which most buyers hate and at which we're no good.

Most buyers cue off asking price, however a seller sets it. I don't. I offer what I think a property is worth to me, given its assets and liabilities and my resources at the time.

In today's market, I think sellers should consider the "transparency approach" to setting an asking price. It distinguishes the seller who does and lends virtue to the seller's stated need.