January 9, 2009
LandThink, #14

Offering price strategies: High offer or low?

By Curtis Seltzer
Landthink contributor

(This is the ninth in a series of articles about issues that sellers and buyers face when negotiating a purchase-offer contract.)

Let's assume that you, the buyer, have determined the value of the seller's property for your purposes and have calculated your buyer's price, that is, what the property is worth to you.

It's now your job to submit a written offer that includes a specific price.

The seller is asking $1.2 million for 500 acres. Your pre-offer research has determined that its value to you is about $650,000. The appraisal value is $900,000, but the market has softened since the appraisal's comps were sold. The tax-assessed value is $800,000.

Here are the choices you face.

Option One is "Play it straight." You are not willing to pay more than $675,000, so you offer $600,000 in hope that you can negotiate a deal at $675,000 or less.

You include a detailed letter explaining to the seller all the property liabilities and uncertainties that your research uncovered, as well as the over-valuation of several assets. You make a point of mentioning that three important material defects were not disclosed to you. The seller's appraisal of five months ago is now outdated, you explain. A current appraisal would come in at less than $750,000 and would not include price discounts for the defects you've described. You carefully explain the problems with relying on appraisals to determine a property's intrinsic, individual value.

This approach risks turning off the seller to working with you, since you've offered exactly 50 percent of his asking price. The seller will see this as a low-ball offer despite your best efforts to be transparent about your reasoning and the evidence on which it's founded. If the seller frames your offer as an insult, he won't negotiate. The only way to convince the seller that you're not being arbitrary about your low offer is to show him the research you used to reach your offer.

The seller wants to get at least $900,000 from the sale and will settle for $800,000, or maybe $750,000. But your offer gives the seller no confidence that time spent negotiating with you on the basis of an offer of $600,000 will get you to where he wants to be.

Unless, of course, you convince him of the depth and sincerity of your interest.

Option Two is "Roll High." You are not willing to pay more than $675,000, but you plot a different strategy. Instead of offering $600,000, you offer $1.1 million. That's above the seller's appraisal value of $900,000, which the seller likes a lot. But you tie the offer to three butt-biters.

First, you offer only a $10,000 down payment and insist on seller-financing.

Second, you make your offer contingent on a three-month study of the property's "assets and liabilities," the results of which must be acceptable to you. If the results are unacceptable, you may void the contract offer without penalty.

Third, you state that the seller should pay your closing costs.
You are not acting in good faith. Your plan is to concede the seller financing in return for a $5,000 down payment. Your plan is to concede the seller paying your closing costs. But you are not willing to concede your 90-day study contingency, because that is the heart of your deception.
After three months in escrow, you plan to tell the seller that his property did not prove up as you had expected. A number of problems were found, and several assets were worth less than you had anticipated. Therefore, you are exercising your absolute right to void your offer because the results of the study were unacceptable.
However, you tell the seller that you will submit a no-contingency contract for $625,000, with a $5,000 down payment (with maybe some seller financing) and a fair division of closing costs.
Your plan from the beginning has been to tie up the seller with your bogus contingency, string him out for three months and soften him for your hardball offer.
The $1.1 million number was sucker bait.
Both choices are driven by the fact that you have done your homework before submitting an offer. You know that the property is only worth $650,000 to $675,000 to you, and that you won't pay more. So your negotiating problem is to figure out a strategy that promises the most chance of getter the seller to join you at that price.
Option Two risks infuriating the seller with your tactics. This seller is perfectly within his rights to tell you to jump into a bottomless lake wearing diver boots.
You've balanced that risk against the tightening squeeze the seller finds himself in after three months of waiting for you in a softening market…to explode a cigar in his face.
I've seen both options work…and I've seen both fail.
The Third Option is, Take-It-Or-Leave-It. Your buyer's price is $650,000, which is what you offer with no contingencies and a reasonable down payment. You explain how you arrived at that offer, and that you don't want to give the seller the impression that you're willing to come up in price. I've seen this succeed and fail too.
Each of these offering price strategies has been driven by the fact that you know the property is only worth $650,000 to $675,000 to you, and that you are unwilling to pay more.
Is there a fourth option?
Maybe. Here's an example.
You offer $750,000, with the seller financing $350,000 at 0 percent interest payable in one lump sum of $350,000 in 15 years. Although you are paying $100,000 more than your $650,000 price, you are getting that $350,000 interest free. If you had financed all $650,000, you would have ended up paying more in interest over 15 years than under your proposal. You end up financing only $400,000 of the $750,000 selling price. And the last $350,000 will be paid in dollars eroded by inflation. These specific numbers are to illustrate the approach. The workability of actual numbers will depend on many factors.
Keep in mind that mortgage interest is tax-deductible up to its cap. That means a dollar in interest the buyer pays is less dear than a dollar in principal.
The buyer needs to plug in specific numbers to craft a proposal that makes financial sense from the buyer's point of view. The extra price paid has to be more than offset by the

savings on interest when tax consideration are factored in. The interest the buyer saves on conventional financing has to be significantly more than the extra money in sales price. Here's another example.

The seller values his 500 acres for hunting, but needs cash to finance his retirement. So the buyer can propose a ten-year, no-cost hunting lease to the seller as part of his $650,000 offer. The seller comes up $100,000 short, but he keeps what he really wants in the property—the hunting rights.