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How should sellers find the values of their properties and set asking prices?

By Curtis Seltzer
Landthink contributor

(This is the fifth in a series of articles about issues raised in a purchase-offer contract.)

The seller's asking price is one step in the sell-buy process that either encourages or discourages buyers from submitting a purchase-offer contract. This article discusses how sellers approach the questions of determining their property's value and setting an asking price. The next article will discuss how seller's view asking price tactically.

I've found sellers, including myself, setting an asking price for real estate by fixing its value in one of at least several ways.

Seat of the pants. Sellers normally know more about the property they're selling than any other party. Over time, sellers get a price-feel for how their places compare with others in terms of assets and liabilities. When it comes time to sell, many sellers integrate the information they've acquired over the years and intuit their way to a price.

Need. When the economy is lousy, some sellers find themselves pinched for cash and forced to sell real estate. Where the property is secured by a mortgage, the sale price is hoped to be sufficient to pay off the debt, transaction costs, taxes on gain and meet as much of the crisis need as possible. In the best circumstances, the seller will have some profit left; in the worst, sale of the real estate will leave him short of meeting his cash needs.

This seller must take the amount of his cash need and weigh that against what he thinks the market will bear for an asking price. The need-seller, in other words, like all others has to employ some method of coming to an asking price, apart from the numbers of dollars needed, which is his motivation for selling.

If I need $100,000 and I know my property won't bring more than $40,000, it does me no good to set the asking price at $100,000. My best approach is to substantiate a price as much over $40,000 as I can, usually by disaggregating the property's assets, valuing them individually, then adding them together.

Competitive Market Analysis (CMA). If the seller is listing the property, the listing broker can undertake a CMA to determine recent selling prices of roughly comparable properties. Brokers experienced in the local market will help a seller tweak that information in light of the comps used, the property to be sold and current market conditions. This is often a very practical approach. But it's subject to influence when an agent or broker inflates a suggested "CMA-based" selling price in order to snag a listing.

Appraisal. Some sellers pay for an appraisal as a way of establishing the current market value of their properties. They then set an asking price, above or below appraisal value. Appraisals are opinions of value, based on selecting the recent selling prices of three comparable properties sold within the previous six months. The appraiser adjusts the value of the seller's property in light of each comp and arrives at a reasonable estimate of current market value.

Buyers tend to put some faith in seller-supplied appraisals, because they are supposed to be unbiased. Appraisals are readily manipulated to get to a certain number. Appraisers are free to choose the comps they want to use (and not choose others) and make further adjustments. A seller-commissioned appraisal is subject to pressure a seller may choose to apply to the appraiser to hit a high valuation.

The other problem with appraisals that I've found is their too-general level of analysis. Appraisals rarely dollar in or dollar-out quality-of-individual-asset considerations. Timberland, for example, that contains $1,500 in immediate timber-sale value is usually valued at the same price as timberland that has $750 in timber value. Improvements are valued by type, age and square footage, but quality factors -- materials, details, condition, convenience of layout, etc. – are not generally looked at hard.

I've also found that appraisals rarely dig deeply into material defects that affect the property's usability, such as a crawlspace that's too low to the ground, or ground that's too steep for operating equipment, or land that's unproductive for various reasons.

A market that's either in rapid decline or rapid ascent requires an appraisal derived from pending sales, not ones that are as much as six months old.

I've seen a seller commission simultaneous appraisals from three different appraisers and then set his asking price as the average of the three. If, of course, a seller is willing to lean on one appraiser, he's also willing to lean on three to get to the number he wants.

The average-of-the-three approach is a practical method for establishing the value of estate property where one heir wants to buy out the interests of the others—and everyone is looking for a fair-to-all way of doing so.

Tax-assessed value (TAV). In recent years, tax-assessed values lagged selling prices with most types of rural property. For that reason, buyers often used TAVs as a starting point in negotiations, forcing sellers to dismiss them as unrealistically low. With sales slowing, the situation could easily reverse, with TAVs of record showing unrealistically high values.

TAVs are based on formulas that reassessment appraisers use across the board. Very little, if any, digging into quality-of-asset considerations occurs. The TAV method provides a way of comparing the value of one parcel with its neighbors since the methodology is applied to all equally, but TAVs don't tell a seller or buyer much about the value of any particular property once its researched assets and researched defects are netted out.

Online home-value sites. I ran through a number of these sites. None provided any valuation of my current rural residence, a house that has been standing for almost 100 years, on a street with a numbered address. I concede for the record that Blue Grass, Virginia is not in the thick of things.

I plugged in my childhood home in Pittsburgh…and got wildly varying results, a low of $84,500 to a high of $154,000. The sites could not agree on the number of bathrooms and most recent sale date. Others may have better luck with sites such as Eppraisal, Real Estate ABC, Zillow, Yahoo, Home.gain, cyberHomes; PropertyShark and HouseFact.

Home-Price Indexes. These efforts -- Federal Housing Finance Agency House Price Index; Purchase-Only; Radar Logic (25 metro areas using price psf); S&P Case-Shiller U.S. National Home Price Index; NAR Median Sale Price; LoanPerformance House Price Index; and Integrated Asset Services IAS360 National Index -- are not very useful for rural properties for various reasons, mainly dealing with different approaches and different data bases. (Carl Bialik, “Only One Person Knows a Home’s Value: Its Buyer,” Wall Street Journal, November 21, 2008 at ‼ HYPERLINK "http://online.wsj.com/article/SB122722235538745845.html?mod=residential_real_estate" ¶ http://online.wsj.com/article/SB122722235538745845.html┴ .)

Each provides a trend that shows percent gain/loss plotted against time, and they don’t agree. Since January, 2000, four show about a 50 percent increase and two show a 75 percent increase. All show a decrease over the last couple of years, but the steepness of the decline differs. Taken together, they give a seller a sense of price direction.

So what’s a seller to do?

First, property does not have an objective dollar value until a buyer buys it. Every other number is speculation, to one degree or another.

Second, the various approaches described above will provide a range of value estimates, hopefully narrow enough to be useful. A seller can narrow the range by throwing out the low and the high numbers, then averaging the remainder. The seller might consider this number his estimated working value (EWV), in terms of which he sets his asking price.

Third, the settlement, or sale, price should be more related in the seller’s thinking to the EWV than to the asking price.

Fourth, sellers should understand that familiarity breeds overvaluation. The longer a seller has owned a place and the more emotionally invested he is, the more dollars he thinks its worth.

No universal formula exists for a seller to determine his property’s EWV, asking price or settlement price. EWV is the result of pulling together as much data-hardened information as possible and using experience and judgment to come up with a good-enough value estimate, given the seller’s circumstances. Asking price is a matter of tactics, and settlement price is often a matter of circumstances.

When a seller has only one buyer, his choice is to make a deal or keep the property. If holding is not an option, the seller has to make the best deal he can. In that circumstance, a seller does what he has to do. The decision is forced upon him by circumstances, so there’s not a lot of agonizing.

When a seller has flexibility and holding power, he should make a good-faith effort to figure out his EWV. It makes setting an asking price and a settlement price much easier. When a buyer is close to the seller’s EWV, it’s time to make a deal.