What Buyer Intentionally Pays the Highest Price?

Michael H. Leifer, Esq.
Palmieri, Tyler, Wiener,
Wilhelm & Waldron

Michael F. Waldron, MAI
Waldron & Associates, Inc.

What Buyer Intentionally Pays the Highest Price?

- Seriously, does this Buyer really exist?
- Anyone…?

What Buyer Intentionally Pays the Highest Price?

- Correct – No Buyer intentionally pays the highest price.

- Therefore, in a broad sense – the market may not be directly applicable to the highest price standard.

What Buyer Intentionally Pays the Highest Price?

In the Eminent Domain context, we have a Constitutional requirement to provide compensation for the taking of private property –

Cal. Constitution, Article 1, Sec. 19

"Just Compensation"

THE CONSTITUTION

- California Constitution, Article 1, Sec. 19

"Private property may be taken or damaged for a public use only when just compensation, ascertained by a jury unless waived, has first been paid to, or into court for, the owner."

ARTICLE 4
Measure of Compensation for Property Taken

§1263.310 Fair Market Value.

"Compensation shall be awarded for the property taken. The measure of this compensation is the fair market value of the property taken."

ARTICLE 4
Measure of Compensation for Property Taken

§1263.320 "Fair Market Value" Defined.

"(a) The fair market value of the property taken **is the highest price** on the date of valuation that would be agreed to by a seller, **being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing**, **each dealing with the other with full knowledge** of all the uses and purposes for which the property is reasonably adaptable and available.

(b) The fair market value of property taken for which there is no relevant, comparable market is its value on the date of valuation as determined by any method of valuation that is just and equitable."

SYNONYMS FOR "HIGHEST"

Uppermost, maximum, peak, top, utmost, premier, record, supreme, Greatest (above-average), extraordinary, elevated, extreme, prohibitive, abnormal, excessive, above what is usual, topmost, ultimate, astronomical.

Astronomical = exorbitant, excessive, sky-high, huge, enormous, vast, immense, prodigious, through-the-ceiling.

Fair Market Value / Market Value

Contrast Fair Market Value with other definitions, specifically Market Value – "most probable" price

History

Let's look back at the economic theories that attempted to define wealth, value and the markets.

History

Mercantilism – an economic policy designed to promote wealth through the trading of goods and services to maximize the exports of a nation in return for accumulating monetary reserves.

…the gold standard.

History

Physiocracy – an economic theory developed by 18th Century Enlightenment French economists who believed wealth was derived solely from the value of land agriculture or land development. Agricultural production, not gold, was identified as the source of wealth, and land was cited as the fundamental productive agent.

…the agri-base standard.

History

Classical School – expanded and refined the physiocratic tenets, formulated a theory of value that attributed value to the cost of production (Adam Smith).

…expands the agents of production.

History

Adam Smith (Wealth of Nations 1776) – considered value as an objective phenomenon. By virtue of its existence, an item was presumed to possess utility. Scarcity also added exchange value to goods. The "natural price" of an object generally reflected how much the item cost to produce. Classical theory has influenced the Cost Approach.

…utility and scarcity fundamental value generators.

History

Karl Marx – challenged the Classical School, claiming that all value is the direct result of labor and that increased wages would lower capitalistic profits. Marx envisioned an inevitable struggle between the social classes – resulting in a violent political upheaval.

…labor is key.

History

Austrian School – marginal utility – critical of both Classical School and Marx theories. The central concept of marginal utility limits value to the utility of and demand for the marginal, or additional, unit of an item. Thus, if one more unit than is needed or demanded appears in a given market, the market becomes diluted and the cost of production becomes irrelevant. Value is regarded as a function of demand, with utility as its fundamental precept. Marginal utility is the theoretical basis of the concept of contribution.

…a blending of supply and demand.

History

Alfred Marshall – synthesized supply-cost considerations of classicists with the demand-price theory of marginal utility – forming contemporary value theory.

* Marshall maintained that market forces tend toward equilibrium where prices and production costs meet.

…Marshall makes sense of it all.

History

Utility-demand considerations operate in the limited span of a given market. In the short term, supply is relatively fixed and value is a function of demand. Cost-supply considerations, however, extend over a broader period, during which production flows and patterns are subject to change. Marshall believed that a perfect economic market would eventually result, and that price, cost and value would all be equal.

…the three approaches in perfect unison.

Marshall – first economist to consider the techniques of valuation, specifically the valuation of real estate. Credited with identifying the three traditional approaches to value – market, reproduction/replacement cost, and capitalization of income.

APPRAISAL OF REAL ESTATE
14^{th} Edition

- Factors of Value

"The economic concept of value is not inherent in the commodity, good, or service to which it is ascribed. **Rather, it is created in the minds of the individuals who make up the market**. The relationships that create value are complex, and values change when the factors that influence value change.

APPRAISAL OF REAL ESTATE 14th Edition

- Typically, four interdependent economic factors create value:
  - utility
  - scarcity
  - desire
  - effective purchasing power

All four factors must be present for a property to have value. The four factors interact in the marketplace to influence the relationship of supply and demand."

VALUE

- Value – created in the minds of the individuals who make up the market.
- Relationships that create value are complex.
- Value changes when the factors that influence value change.

INTERDEPENDENT ECONOMIC FACTORS

Four interdependent economic factors create value:

- utility
- scarcity
- desire
- effective purchasing power

DYNAMICS OF VALUE

"The principles of anticipation, change, supply and demand, competition, and substitution are fundamental to understanding the dynamics of value."

Appraisal of Real Estate, 14th Edition

DYNAMICS OF VALUE

Anticipation - the perception that value is created by the expectation of benefits to be derived in the future.

Change - the result of the cause and effect relationship among the forces that influence real property value.

DYNAMICS OF VALUE

Supply and Demand - in economic theory, the principle that states that the price of a commodity, good or service varies directly, but not necessarily proportionately, with demand, and inversely, but not necessarily proportionately, with supply.

DYNAMICS OF VALUE

Competition - the level of productivity and amenities or benefits characteristic of each property considering the advantageous or disadvantageous position of the property relative to the competitors.

DYNAMICS OF VALUE

Substitution - the principle that states that when several similar or commensurate commodities, goods or services are available, **the one with the lowest price attracts the greatest demand and widest distribution**. This principle **assumes rational, prudent market behavior** with no undue cost due to delay.

- Accordingly, a buyer will pay no more for one property than for another that is equally desirable.
- Contrary to highest price standard.

DYNAMICS OF VALUE

- The dynamics of the market are fluid, constantly in flux.

- Perceptions, forces, supply, demand, level of productivity, amenities and benefits of each characteristic in the context of other competitive properties, and ability or inability to substitute a similar property. All affect value and consequently price paid for a particular property.

DYNAMICS OF VALUE

- The one with the lowest price attracts the greatest demand and widest distribution.
- In the end, a buyer will pay no more for one property than for another that is equally desirable.
- The market is economically predisposed to seek the lowest price – not the highest price.

Are your colleagues concerned about the law?

Yes, but – really concerned about USPAP, what does the textbook say?

- USPAP provides for these sophisticated complexities -

You have the Jurisdictional Exception, where if any applicable law or regulation precludes compliance with any part of USPAP - only that part becomes void for that assignment.

- You are required to identify the exact definition of market value and its authority.

CREDIBLE & FAIR

You/We want to be credible and fair, but “Fair Market Value” is not necessarily credible or fair.

- It's not a fair price.
- It's not a credible price.
- It's the highest price — which is the only price that is fair.

CREDIBLE & FAIR

Credibility comes with doing a proper analysis, impartially.

It's a game of mediocrity, middle of the road, averages, midpoints, and lowest price motivation.

WE AVERAGE OUT OF FEAR

Why — we don't want to be perceived as being unfair or unreasonable.

CONSTITUTIONAL MANDATE

We know the Constitutional mandate:

<u>Just Compensation</u> - to be measured by:

<u>Fair Market Value</u> which is:

<u>The Highest Price</u>

SYNONYMS FOR "HIGHEST"

Uppermost, maximum, peak, top, utmost, premier, record, supreme, Greatest (above-average), extraordinary, elevated, extreme, prohibitive, abnormal, excessive, above what is usual, topmost, ultimate, astronomical.

Astronomical = exorbitant, excessive, sky-high, huge, enormous, vast, immense, prodigious, through-the-ceiling.

SYNONYMS FOR "HIGHEST"

- In relation to "fair," "just," highest has a negative connotation.

READING IN REVERSE

But that's reading it in reverse.

The building blocks to just compensation - should understand what comes first:

1) the highest price is
2) fair market value, which is
3) just compensation

APPRAISERS OPINIONS

Appraisers formulate opinions based upon . . .

- Evidence in the market.
- That evidence is the sales.
- The sales are facts.

APPRAISERS OPINIONS

What appraisers do with these facts is critical to developing an opinion of value.

- Choosing the relevant facts.
- Weighing the facts.
- Analyzing the facts.
- Concluding to an opinion based upon these facts

APPRAISERS OPINIONS

- All facts are being gathered from a market that does not promote paying the highest price, in fact, generally the opposite.

MOST PROBABLE

Market is probably pretty good for "most probable" price.

Really — what are we doing . . . . ?

We are applying a most-probable price market to a highest-price requirement.

Let's take a look at those all-important market participants, Mr. Seller and Mr. Buyer, who are sometimes assisted by others . . . Mr. Broker, Mr. Banker and Mr. Appraiser.

MARKET CONDITIONS ADVISORY

CALIFORNIA ASSOCIATION OF REALTORS®

MARKET CONDITIONS ADVISORY
(C.A.R. Form MCA, Revised 11/11)

1. MARKET CONDITIONS: Real estate markets are cyclical and can change over time. It is impossible to predict future market conditions with accuracy. In a competitive or "hot" real estate market, there are generally more Buyers than Sellers. This will often lead to multiple buyers competing for the same property. As a result, in order to make their offers more attractive, some Buyers may offer more than originally planned or eliminate certain contingencies in their offers. In a less competitive or "cool" market there are generally more Sellers than Buyers, often causing real estate prices to level off or drop, sometimes precipitously. The sales price of homes being sold as foreclosures and short sales is difficult to anticipate and can affect the value of other homes in the area. Brokers, appraisers, Sellers and Buyers take these "distressed" property sales and listings into consideration when valuing property. In light of the real estate market's cyclical nature it is important that Buyers understand the potential for little or no appreciation in value, or an actual loss in value, of the property they purchase. This Advisory discusses some of the potential risks inherent in changing market conditions.

2. BUYER CONSIDERATIONS:

A. OFFERING PRICE: AS A BUYER, YOU ARE RESPONSIBLE FOR DETERMINING THE PRICE YOU WANT TO OFFER FOR A PROPERTY. Although Brokers may provide you with comparable sales data, generally from information published in the local multiple listing service, you should know that the reporting of this data is often delayed and prices may change, up or down, faster than reported sales indicate. All buyers should be sure they are comfortable with the price they are offering or the price they are accepting in a counter offer. You should be aware of and think about the following: (i) If your offer is accepted, the property's value may not increase and may even decrease. (ii) If your offer is accepted, you may have "Buyer's remorse" that you paid too much. (iii) If your offer is rejected there can be no guarantee that you will find a similar property at the same price. (iv) If your offer is rejected, you may not be satisfied that the amount you offered was right for you. Only you can determine that your offer was reasonable and prudent in light of the property and your circumstances.

MARKET CONDITIONS ADVISORY

3. SELLER CONSIDERATIONS:

As a Seller, you are responsible for determining the asking price for your property. Although Brokers may provide you with comparable sales data, generally from information published in the local multiple listing service, you should know that the reporting of this data is often delayed and prices may change, up or down, faster than reported sales indicate. All Sellers should be sure they are comfortable with the asking price they are setting and the price they are accepting. There is not, and cannot be, any guarantee that the price you decide to ask for your property, or the price at which you agree to sell your property is the highest available price obtainable for the property. It is solely your decision as to how much to ask for your property and at which price to sell your property.

SELLERS WANT TO SELL

Most sellers want to sell/obliged to sell.

But why?

-often something wrong

-with the property or personal circumstances

SELLERS MAY TAKE LESS

A Seller may take less when:

- a less complicated transaction
- no contingencies
- all cash
- quick close (time is money)
  (may not be reflected in price/value)
- personal connection –
  seller may prefer a certain buyer - relationship
- not well-informed
- not knowledgeable

SELLERS MAY TAKE LESS

A Seller may take less when:

- broker favors certain buyers
- broker blows it - doesn't present best offer - lots of paperwork/review
- pocket listings - not widely marketed
- for sale by owner
- divorce/partner dissolution
- death
- age
- disability

SELLERS MAY TAKE LESS

A Seller may take less when:

- financial distress
- litigation
- REITS
- Pensions/Limited Partnership
- 1031 Exchanges
- Sale/Leasebacks

FORCED TO DISCOUNT

<u>**Forced to Discount**</u> - The final price is likely not the lowest or the highest:

- multiple sellers (some with competing interests)
- profit seekers at less than max

These are just a few considerations which likely reflect something less than the highest price.

FORCED TO DISCOUNT

- Even if the Seller is seeking to achieve the highest price possible, the Buyer is seeking to pay the lowest price possible.

WHAT ABOUT THE BUYER?

- Buyer is doing his/her own thing.
- Oftentimes each party is represented by a broker.
- Are these parties really… “each dealing with the other with full knowledge…”?
- How much is lost in translation?
- Buyer and Seller really don’t deal with each other.
- They each have their own unique circumstances.

A GRAND SLAM!

In order for these market sales to be reliable indicators, the Seller would have to score 100% every time, a grand slam every time!

uppermost	record
maximum	premier
peak	supreme
top	topmost
utmost	ultimate

A TRUE CONUNDRUM

Buyer is seeking to pay the lowest price, all things being equal.

A true conundrum –

Required to opine the highest price derived from a market that is geared otherwise:

What do we do?

A TRUE CONUNDRUM

- Afford greater weight to highest indicators
- Cost approach in upper context may be the most definitive of highest price
- Upward adjustment – highest price adjustment
- Literally reach the highest price among comparables
- Are listings meaningful? – prohibitions

A TRUE CONUNDRUM

But this may not be sufficient when considering the deficiencies of the market.

There is no basis for diverting from the highest price standard.

OLE ADAGE

Ever hear the ole adage:

> "I would rather have a fast nickel than a slow dime"?
>
> "Your first offer is your best offer."
>
> "Bird in the hand…"

Many market participants, including brokers, are motivated by these general observations.

A quick sale at a reasonable price is better than holding out for a higher price for an uncertain period with additional market risk.