How To Figure Out What a House Should Sell For

How We Decided The Price of Our Last 5,000 Listings

Notes from the class given by Russell Shaw on June 20, 2014.

In the private Facebook group “Arizona Real Estate Agent Forum,” Jeff Sibbach posed a question on June 1, 2014 about how agents price homes. The post got over 70 comments and led to Russell Shaw volunteering to give a class on how he figures out what a home should sell for without ever using price per square foot. Below are my notes from the class and my best understanding of what Russell said. **Thanks so much for the class Russell!**
John Wake

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Takeaways

1) Always calculate the months supply in the subject property’s neighborhood before pricing the house.

2) You don’t need to use price per square foot to correctly price a house.

The Problem - Price per Square Foot is Largely Misused

“The most common thing you see agents do is they take right off the MLS sheet average price per square foot for the neighborhood, take the number of square feet in the subject property and multiple and come up with a price. Now the odds of that being correct are about the same as Zillow being correct.”

Russell did not fiddle with price per square foot and he took thousands of listings himself.

No one teaches new agents how to price homes. They hear about price per square foot and it’s deadly information. They’re bound to misuse it.

The problem is they’re not qualifying it enough. Only use price per square foot to calculate the difference in value between house A and house B, if you know how to comp it out right. You need to plus/minus for the 3rd car garage, plus/minus for a pool, plus/minus for the fireplace, plus/minus for a tile roof. That would be great but most agents don’t have enough experience to do that. They don’t have enough information. They don’t have enough skills to do it.

“And I actually don’t think they need to do it and I’m going to tell you why.”
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The Rules

- When defining the neighborhood for calculating months supply and pulling comps, NEVER cross a busy street.

- When comping out a house, NEVER compare a 1-level home to a 2-level home and vice versa. There is no adjustment that can be made to make them comparable.

- When comping out a house, NEVER compare houses that have more than a 20% difference in size. The bigger the house, the lower the price per square foot, all other things being equal, and there is no formula to correctly adjust for it.

Why Months Supply

Russell told the story of how he was brilliant at accurately pricing homes in the early 2000s but in late 2004 he got dumb and by early 2005 he was a moron. :) He learned to be comfortable saying, “I don’t know,” he learned the importance of months supply and how to correctly price houses.

‘I don’t know how to look at comps until I know the months supply.’

The months supply will give you the key to what’s happening in the neighborhood. You can learn to see a little bit around corners.

A correctly priced listing is one that a buyer will pay that amount of money for TODAY. If no one will come and buy it, it’s not the right price.

The most important thing to figuring out the market value of a house is being able to calculate months of supply for any neighborhood. This is true whether you are on the buy side or sell side.

How to Calculate Months of Supply

The months supply (absorption rate) is more important than coming up with the comps because the comps will only be valid in relation to the months supply.

To Calculate Months of Supply for a <u>City or Zip Code</u>

Months Supply = Number of Active Listings / Number of Sales in Last Month

However, looking at the months of supply for a city or zip code is meaningless because there are such huge variations within a city or zip code - one neighborhood can be a lot hotter or colder than another nearby neighborhood.

To Calculate Months of Supply for a <u>Neighborhood</u>

Remember Rule #1. When selecting the neighborhood, NEVER cross a busy street.

When working in neighborhoods there usually won't be many sales per month and the number of sales can fluctuate wildly from one month to the next (0 sales one month and 3 the next). To get a better idea of the market velocity he looks at the number of sales over the last six months in the neighborhood and divides by six to get the average number of sales per month over the last six months.

Months Supply = Number of Active Listings / (Number of Sales Last 6 Months / 6)

This system will work accurately with as little as one sale per month.

If you only walk away with one thing today, learn to do that.

Balanced Market or Not

Once you know the months supply for a neighborhood you know the market velocity.

6 Months Supply = Balanced Market (No pressure on prices to move up or down)

Six months supply is always a perfectly balanced market. It doesn't matter when or where, there's no price movement either way when you have six months supply.

8 Months Supply or More = Favors Buyers (Downward pressure on prices)
4 Months Supply or Less = Favors Sellers (Gentle upward pressure on prices)

(These do not apply to the luxury market where it's normal for the months supply to be much higher. During a later discussion, Russell mentioned that luxury homes could be defined as homes priced north of roughly $1 million.)

Months supply is more important than the comps because the months supply tells you whether you should price the home ahead of, behind or in-line with the comps. The months supply tells you which way the market is moving and the market velocity.

“In a rapidly rising market, I can price any house ahead of the comps and sell it. In a rapidly declining market you can’t sell any house for what the comps have sold for.”

Recent Changes in Market Velocity

To see if the market has changed over the last six months, calculate the months supply using the average number of sales over the last **3** months and compare it to the months supply you calculated earlier using the average number of sales over the last **6** months. See if there’s a difference.

Also look at the number of Pending listings to look for changes in market velocity.

Comping Out the Subject Property

First Russell’s staff pull the IMAPP tax info on the subject property.

Next they pull ALL Active, Pending, Sold, Cancel and Expired in the neighborhood in the last 6 months. He wants to see the Cancelled and Expired because they show clearly what will not work.

They usually search 6 months back, by subdivision and by book (and they NEVER cross a busy street).

The problem at this point is often too much data or too little data.

It there are too many listings they will run it again with an additional criteria. In the example he handed out, the first run had 46 listings which was too much.

The second run was for the Past 6 Months, Subdivision, Book and they added 2-level homes only since the subject had 2 levels. This cut the list of Active, Pending, Sold, Cancelled and Expired to 14 listings.

Too Few Comps

If you get down to 3 or 4 Active, Pending, Sold, Cancelled and Expired, you're just guessing. You don't have any data. In that case, go back in time (and mark the old ones in red). Go back a year.

"I'm very comfortable telling people I don't know. I don't know what your house is worth."

"If I have crappy data or conflicting data I never want to make an assumption on a series of one comp that matches. Is it high? Is it low? Was it a hardship sale? Is it a mistake?"

"I want to see a pattern."

At The Table

Russell's staff prepare the comps report and he never looks at the comps until he arrives at the house! He never looked at comps beforehand and he had 2 to 3 listing appointments per day.

In this case, he would give the seller the printout of all 46 listings and the shorter list of 14 listings. From then on in the presentation he would focus on the shorter printout, in this case of the 14 listings of 2-story houses.

The Neighborhood Market

First he would calculate months supply in front of the seller and explain 6 months means balanced market and so on.

Going over the handout, 'We have 5 actives and 3 solds in six months. So I'm going to divide 3 by 6 and I come up with one-half sale per month. I divide that number into 5 (divide 0.5 into 5). That looks like 10 months supply. A 10-month supply says there is an over abundance of inventory.'

The current supply would last 10 months at the current absorption rate. Could the absorption rate change? Yes! It could all of a sudden speed up or slow down. 'I'm not saying where the market is going, just where the market is today.'

"So, this would say I can't price this home way above the comps in this neighborhood. It won't sell. That's what I found out, it won't sell. I've got to price it in line or slightly below the comps to get it to sell." He's not covering the price yet with the seller, just the market.

Finding the Comps

Next he goes through every single line of the Active, Pending, Sold, Cancelled and Expired listings report with the seller.

‘I’m going to hand out a list just like this to the seller so we both have them and explain that we don’t cherry pick three comps to show them, like we’re sandbagging them or something. Here’s all the data that matches this description.’

He doesn’t take the big homes out of the list beforehand. He goes down the list with the seller and says this listing means nothing because it’s too big, too small or whatever.

‘I want to go right down the list and if this looks like it would be a better house than theirs, I’m going to show it to the seller and say but this one would sell for more than yours. Yours is worth less than that and tell them why. And get their point of agreement for each one.

“Your’s would be more than this one, less than that one, more than this one, less than that one, pretty close to this one. That kind of thing.”

When they see a listing that is approximately the same size, they know it’s about the same product.

We’re going to take every single house that is approximately the same size as the subject and put an equal sign by it or a greater-than sign (will sell for more than their house) or a less-than sign (will sell for less than their house).

We’re finding the houses most like theirs so we can plus/minus, plus/minus those houses and bracket the seller’s house on price.

He’s trying to figure out which listings to pull out the full plano on.

Pricing the Comps

Russell has with him the full ARMLS printout for every listing (not given to seller).

He pulls out the ARMLS printout for a similar-sized comp and plus/minuses it - plus/minus so many dollars for the 3rd car garage, plus/minus for a pool, plus/minus for the fireplace, plus/minus for a tile roof, and so on.

He does that for all the similar-sized listings to create a price bracket for the seller’s house.

Then he adjusts the price for the market velocity (months supply).

I Don't Know

"Am I that clever to go, 'No it's $350,000 not $360,000.' I just tell them I don't know. Here's what I know. If we're not getting market activity as brisk as the market is, the market is telling us lower the price. So if we get in a couple of weeks and we don't have an offer, I'm going to tell you you should change the price."

'I don't want to pretend I have the answer. I don't pretend to know why.'

"I just tell them the truth. It's not a sales technique."

How Much Overpricing Will You Allow?

'If someone is really nice, I might let them overprice it as long as they won't get mad at me for not selling it right away.'

When to Change the List Price

'A properly price listings would get an offer written, on average, after 10 showings. I don't think of listings having a long shelf life. If we get 10 showings a month, we're on target. Although holidays will skewer those numbers.'

"Normally, speaking I want to see at least 10 showings in a month. If I'm not getting 10 showings or more then we have a price issue."

'It's not a sales technique, we're telling them this is the deal. If they say they're not that motivated that they don't want to lower the price if there are few showings, that they're willing to wait, I go "Okay, I just wanted to make sure you knew."'

If you're running way under 10 showings, you're fishing with your bait out of the water. You're overpriced.

How Overpriced?
No Showings = Minimum 10% overpriced
Showings but No Offers = Minimum 5% overpriced

Those numbers work every time.

Other Tips

Sellers kind of like being “closed” but buyers hate it.

Buyers do not want to be pressured. EVER!

Oddly enough, repeatedly trying to close a seller makes them like you as an agent because they want someone who’s a go-getter.

The fact that you can never pull that closing stuff on a buyer is irrelevant.

Narrow price band when working with buyers.

Get buyers to narrow their price range to what they’re really likely to end up paying. If they were looking in a narrow range like $95,000 to $105,000 price range, all they have to do is pick the house they like best and they’ve picked the house that gives them the most bang for their buck.

When you buy on Amazon you don’t look at price per something, you just looking at which one’s the best deal. That’s all you have to do with a house when the price range is narrow.

Calculating the waterfront or golf course premium when you don’t have recent comps.

Russell got a question about how to price a waterfront lot in Arrowhead when there are few or no recent waterfront comps.

In that case, you can calculate the waterfront lot premium in the neighborhood by finding waterfront homes that sold more than 6 months ago and comparing them to non-waterfront comps that sold within 90 days of each of the waterfront houses. Find about three to get the waterfront premium.

Listing presentation tip.

Put yellow pad on the table and say, “I’m here applying for a job so let me ask you some questions. What are you looking for in an agent.” Write down everything they say.

Then repeat back what they said, ‘Do I have it right that you’re looking for an agent that X and Y and Z?’

What do THEY think is important? It doesn't matter what you think is important.

If it turns out they're looking for something you don't do (for example, open houses every Sunday) and you know we won't get the listing (and you know you don't want the listing), you don't need to price it out or continue the listing presentation.

On the other hand, now that you know what the sellers are looking for in an agent, you can tailor your presentation exactly to what they think is important.

BTW, the #1 complaint against Realtors is they don't return phone calls.

How Russell Declines High Priced Listing

"If we price it too high, you'll cancel and get mad at me so I'll save you the time and let you get mad at me now."