

The Business Cycle and Buying a Home

Recession and Expansion

There are times when the economy is brisk and everyone feels confident about his or her prospects for the future. As a result, they spend money. People eat out more, buy new cars, and...they buy new homes. Then, for one reason or another, the economy slows down. Companies lay off employees and consumers are more careful about where they spend money, perhaps saving more than usual. As a result, the economy decelerates even further. If it slows enough, we have a recession. During such a time, fewer people are buying homes. Even so, some homeowners find themselves in a situation where they must sell. Families grow beyond the capacity of the home, employees get relocated, and some may even find themselves unable to make their mortgage payment - perhaps because of a layoff in the family.

Supply and Demand

When the supply of available houses is greater than the supply of buyers, appreciation may slow, and prices may even fall, as happened in the early eighties and the early to mid-nineties. If you are lucky enough to purchase a home during a slow period, you can be reasonably certain the economy will begin to show strength again. At times, real estate values may even surge drastically. In many regions of the country, this is precisely what occurred in the late eighties and nineties. Should You Try to "Time the Market"? One problem with attempting to time your purchase to the business cycle is that no one can accurately predict the future. Another challenge is that interest rates are generally higher during a depressed market and income may not be keeping up. For that reason, fewer people can qualify for a home purchase than in more prosperous times.

Why You Should Not Wait

Plus, this strategy generally works best for first-time buyers. People who already have a home usually need to sell it in order to buy their next one. If a "move-up" buyer wants to buy a home during a depressed market that means they usually have to sell one during the slow market, too. If a seller wants to sell his home to take advantage of a "hot" market when prices are fairly high, they generally have to buy their next home during that same hot market. It tends to equal out. Finally, the business cycle can change over time. Since 1983, we have had two fairly long expansions with only a slight recession in between each. You would not want to wait nine years to buy a home, would you? You could miss out on a substantial amount of appreciation by waiting, and end up paying much higher prices.

Determining Your Offer Price

When you prepare an offer to purchase a home, you already know the seller's asking price. But what price are you going to offer and how do you come up with that figure? Determining your offer price is a three-step process. First, you look at recent sales of similar properties to come up with a price range. Then, you analyze additional data, such as the condition of the home, improvements made to the property, current market conditions, and the circumstances of the seller. This will help you settle on a price you think would be fair to pay for the home. Finally, depending on your negotiating style, you adjust your "fair" price and come up with what you want to put in your offer.

Comparable Sales

The first step in determining the price you are willing to offer is to look at the recent sales of similar homes. These are called "comparable sales." Comparable sales are recent sales of homes that compare closely to the one you are looking to purchase. Specifically, you want to compare prices of homes that are similar in square footage, number of bedrooms and bathrooms, garage space, lot size, and type of construction. If the home you are interested in is part of a tract of homes, then you will most likely find some exact model matches to compare against one another. There are three main sources of information on comparable sales, all of which are easily accessed by a real estate agent. It is somewhat more difficult for the general public to access this data, and in some cases impossible. Two of the most obvious information sources are the public record and the Multiple Listing Service.

Comparable Sales in the Public Record

The most accessible source of information on comparable sales is the public record. When someone buys a home the property is deeded from the seller to the buyer. In most circumstances, this deed is recorded at the local county recorder's office. They combine sales data with information already known about the property so they can assess property taxes correctly. Provided there have been no additions to the property, the information available from the public record is usually correct regarding sales price, square footage, and numbers of rooms. This makes it easy to use the public record as a source of data for comparable sale information. Accessing the data is another matter, at least for the general public. Realtors can generally look up this information through title insurance companies. The title companies either compile the data directly from the county recorder's office or purchase it from other companies. One problem with the public record is that it tends to run *at least* six to eight weeks behind. Add another four to six weeks for the typical escrow period and you can see the data is not current. The most current information is the most valuable.

Comparable Sales in the Multiple Listing Service

Most of the public is aware that the Multiple Listing Service is a private resource where Realtors list properties available for sale. Recently, the public has been able to access some of that information on such sites as Realtor.com, MSN HomeAdvisor, and others. Once a property is sold and the transaction has closed, the selling price is posted to the listing in the Multiple Listing Service. Over time, it has become a huge database on past sales, containing much more information on individual homes than can be gleaned from the public record. This information is only available to real estate agents who are members of the local Multiple Listing Service. Your agent will provide you with this data to help determine your offer price.

Comparable Sales – Pending Transactions

The most valuable information would be the most current, of course. A sale last week has more validity in helping you determine a purchase price than a sale from six months ago. The problem is that there is no actual record of the sales price until the transaction is completed. The information is not available in the public record because no deed has yet been recorded. Neither is the information available in the Multiple Listing Service. Once a property is sold, it becomes a "pending sale" and all pricing information is removed from the listing. Prices are not posted until it becomes a "closed sale." This protects the seller in case the transaction falls apart and the property is placed back on the market. It would give an unfair advantage to future potential buyers if they already knew what price the seller had been willing to accept in the past. However, if a Realtor has a reason to know the sales price, they can usually find out through professional courtesy. Also, some real estate brokerages post sales information on a transaction board in their office.

Other Factors Influencing Your Offer Price

Gathering and analyzing information from comparable sales helps to establish the range of prices you should consider when making an offer to buy a home. More weight should be given to the most recent sales, but even so, you need to do a bit more analysis before setting upon the price you will offer. That is because you also need to consider the condition of the property, improvements, the current market, and the circumstances behind the seller's decision to sell. How Property Condition Affects Your Offer Since you have toured the property you are interested in, you should know how it compares to the general neighborhood. All you have to do is put the home in one of three categories - average, above average, or below average. When evaluating a home's condition, there are a number of things you should consider. Structural condition is most important - items such as walls, ceilings, floors, doors and windows. Then paint, carpets, and floor coverings. Pay special attention to bathrooms and bedrooms and whether the plumbing and electricity work efficiently. Look at the fixtures, such as light switches, doorknobs, and drawer handles. The front and back yards should be in reasonably good shape. The missing ingredient will be information on the condition of the homes from your comparable sales list. Provided you chose the right agent to represent you, they will have actually visited most of those homes and be able to provide key insights.

How Home Improvements Affect Your Offer Price

Even when comparing exact model matches within a tract of homes, you should note whether the previous owners have made any substantial improvements. Cosmetic changes should be largely ignored, but major improvements should be taken into account. Most important would be room additions, especially bedrooms and bathrooms. Other items, like expensive floor tile or swimming pools should be taken into account, too, but should be discounted. A pool that costs \$20,000 to install does not normally add \$20,000 in value to the home. Rely on your agent to give you guidance in this area.

How Market Conditions Affect Your Offer Price
A hot market is a "seller's market." During a seller's market, properties can sell within a few days of being listed and there are often multiple offers. Sometimes homes even sell *above* the asking price. Though most buyer's want to get a "deal" on a home, reducing your offer by even a few thousand dollars could mean that someone else will get the home you desire. A slow market is a "buyer's market. During a buyer's market properties may languish on the market for some time and offers may be few and far between. Prices may even decline temporarily. Such a market would allow you to be more flexible in offering a lower price for the home. Even if your offered price is too low, the seller is likely to make some sort of counter-offer and you can begin negotiations in earnest. More often than not, the market is simply "steady," or in transition. When a market is steady, no real rules apply on whether you should make an offer on the high end of your range or the low end. You could find yourself in a situation with multiple offers on your desired house, or where no one has made an offer in weeks. Transition markets are more difficult to define. If the economy slows unexpectedly, as it did in the early nineties, people who buy on the high end of a seller's market (like the late eighties) could find their home loses value for several years. So far, no one has proven reliable in predicting when markets change or how good or bad the real estate market will become.

How Seller Motivation Affects Your Offer Price

Truthfully, it is rather rare that a seller's motivation will dramatically affect the price of a home, but it is often possible to save a few thousand dollars. The most common "motivated seller" is someone who has already bought his or her next home or is relocating to a new area. They will be under the gun to sell the home quickly or face the prospect of making two mortgage payments at the same time. Since that can drain a bank account quickly, most sellers want to avoid such a situation and may be willing to give up a few thousand dollars to avoid the possibility. There are also family crises that can motivate a seller to make a quick deal.

However, when you see a real estate ad that mentions, "divorce," "motivated seller," "relocation," or something to that affect, beware. Although the facts may be true, that does not necessarily mean the seller is motivated to make a quick and costly sale. Most likely, the ad is more designed to generate phone calls and leads rather than sell the home. However, there are times when a seller is truly distressed, willing to make a quick sale and sacrifice thousands of dollars. With the seller's permission, the listing agent will post this information along with the listing in the Multiple Listing Service. They may also inform other agents during office and association marketing sessions or by flyers sent to other real estate offices. Provided this information has been made generally available to Realtors, your agent should know when a seller is truly motivated and when it is just "puff" designed to illicit interest in a property. The exception is when an agent is selling a home they have listed themselves or selling a home that was listed by another agent from their own company. In such a situation, the agent may be acting as an agent for the seller, or as a "dual agent," representing both you and the seller. In such a situation, they cannot legally provide you with information that would give you an advantage over the seller.

The Final Decision on Your Offer Price

Comparable sales information helps you to determine a base price range for a particular home. Adding in the various factors like property condition, improvements, market conditions, and seller motivation help determine whether a "fair" price would be at the upper limit of that range or the lower limit. Perhaps you will feel a fair price is outside of that price range. The "fair" price should be approximately what you are willing to agree on at the *end* of negotiations with the seller. The price you put in your offer to *begin* negotiations is totally up to you and depends on your negotiating style. Most buyers start off somewhat lower than the price they eventually want to pay. Although your agent may provide advice and guidance, you are the one who makes the decision. The price you put in the offer is totally up to you.