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What price should you offer?

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

Once a buyer has defined the acreage and boundaries of the seller's property legally and on the ground and determined the nature of the seller's ownership, the question of offering price presents itself.

For most buyers, their thoughts on offering price are anchored in the seller's asking number.

That's not the right place for the buyer to be most of the time.

I've come to the conclusion over the years that most buyers do not need to buy most properties at which they make a purchase run. A buyer may need to buy some property at a particular time, but not necessarily a particular property. A buyer's level of need always depends on his BATTP—Best Alternative To This Purchase. The better a buyer's BATTP, the more negotiating power he's likely to have.

Buyers can choose among properties, particularly in a buyer's market.

If, as I believe, most property purchases are essentially discretionary and voluntarily from the buyer's point of view, it follows that buyers should have a formula for determining a property's right price from their perspective.

The formula that I've concocted is something like this: The right price for the buyer is based on his pre-offer research into the total net value of the property's disaggregated assets, together with an analysis of the buyer's resources available for purchase and his plans for the property.

The buyer must approach each property as a bundle of assets, some of which can be severed and sold, leased or used to generate income. These assets have value in the market that can be determined, but more important, the buyer assigns each asset a value to him.

When the total net value of the disaggregated assets falls short of the asking price, that number is the buyer's offering-price anchor. Or, it may be a signal to walk way…fast.

Here are several ways of looking at asking price and offering price.

A seller owns 500 acres that he's priced at $7,000 per acre, or $3.5 million. It has a main house, barn complex and a tenant's house in a far corner set back from the road. Two hundred acres are cropland, 100 acres are pasture and 200 are woods. The farm will convey with all mineral rights, and natural gas is a likely lease possibility in the future. The farm has various conservation-easement values, depending on what restrictions are imposed. It generates $30,000 a year in farm income.

Scenario 1: The seller hands the buyer an appraisal showing $3.5 million. The buyer commissions his own appraisal, which comes back at $3.5 million. The buyer makes the deal at $3.5 million.

Scenario 2: The seller hands the buyer an appraisal showing $3.5 million. The buyer immediately offers 20 percent less, or $2.8 million. They haggle. They settle for $3.25 million, which is $200,000 more than the seller had hoped for.

Scenario 3: The buyer investigates the property's assets before making an offer. He hires consultants to establish the discrete value of 150 acres of cropland, 50 acres of cropland plus main house and barn, 100 acres of pasture, merchantable timber on 200 acres of woods, future value of gas rights and conservation-easement values. He comes up with a total of $5 million. The buyer makes the deal for $3.5 million and sells $1.5 million in discrete assets for $2 million. The buyer is left with 350 acres, the main house and barn for $1.5 million. But he's in for some post-purchase surprises.

Scenario 4: The buyer investigates the property assets and liabilities before making an offer. Assets are valued at $5 million, but there are deductions for liabilities. A neighbor has fenced in 40 acres of pasture that is the seller's by deed. Other boundaries are disputed. The buyer faces a $25,000 survey cost, which does not guarantee resolution. Lack of resolution means he can't divide the property and sell the pieces he doesn't want. The merchantable timber worth $3,000 per acre can't be logged because it's sited on habitat for the federally endangered blue-eyed nosepicker, which also means no development. The cropland harbors an invasive species that the appraiser didn't know about which limits its value. The appraiser also didn't know about the noxious weed infestation in the pasture that reduces livestock gain by 25 percent. And 150 acres of open land are in a 50-year floodplain. Netted out the adjusted value is $2.1 million. The buyer submits all of his material to the seller, with the words that such matters need to be disclosed to all buyers who come after him. They settle at $2.35 million.

Scenario 5: The buyer is interested in the main house and only 300 acres. Assets are valued at $5 million with a discounted value at $2.1 million. The buyer pays $2.35 million and sells 200 acres, which includes the tenant's house and most of the floodplain. He treats the cropland and pastureland curing them of their afflictions. He sells the woods for $800,000 to a conservation group who promises to protect the nosepicker for ever. He leases the gas rights under 500 acres for $25,000 with a 12.5% royalty of net on future production. His lease includes a No-Surface Occupancy provision.

His sales are: 100 acres of woods, $800,000; tenant's house and 20 acres, $300,000; four 20-acre lots, $100,000 each, for $400,000. Net cost to buyer of purchasing main house and 300 acres, $2.35 million less gross sale proceeds of $1.5 million = $850,000, or $2,833 per acre including main house and barn complex.

I have seen each of these scenarios play out in what one of my college professors used to call "real life." It's useful to remember the words of Steven Cohen, head of The Negotiation Skills Company and author of Negotiation Skills for Managers: Price is what you pay; value is what you receive. (‼ HYPERLINK "http://www.negotiationskills.com/" ¶ www.negotiationskills.com┴)

A buyer must understand through pre-offer research what value he will receive, which then determines the price he's willing to pay and not pay.

Pre-offer research provides a buyer with the net value (gross value less discount costs for liabilities) of each asset. That approach and level of analysis helps the buyer develop a post-purchase plan. The combination of determining the net value of all the discrete assets on a particular property and developing a post-purchase plan leads a buyer to an offering price.

Once the buyer establishes the net value price of the property to him, he can then determine the intensity of his interest in a purchase and set an offering price that makes sense. It's not that hard to do, but most of us don't bother.