SCHWARTZ *Report*

DIRECT: 302-234-5202 • OFFICE: 302-239-3000
www.charlieschwartz.com

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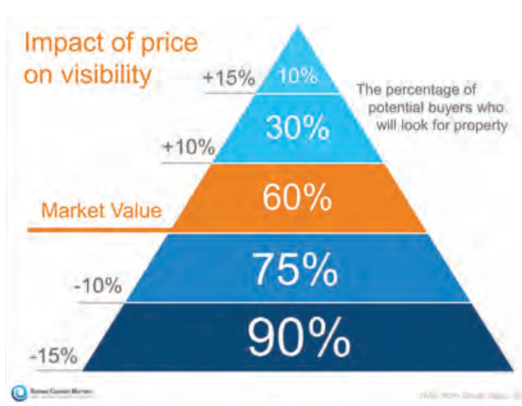
Too Much Weight Stops the Freight II

Winston Churchill closed one of his radio addresses in the darkest days of 1940 with a biblical admonishment for his countrymen: "Arm yourselves and be ye men of valor and be in readiness for the conflict…" This may be a dramatic way to open. It certainly seems so, but while selling real estate is not like surviving the London Blitz; it does have plenty of the harder aspects of conflict resolution. I have the growing sense that the market is ripe for an adjustment, perhaps a dramatic one. This will set up the need for arming ourselves with heretofore little needed or perhaps yet to be learned conflict resolution skills. Among them are proper pricing before going on the market or, after failing that test, the timely and effective price reduction.

For a combination of reasons, the pace of market activity in our region may already be losing some steam. Foremost among them is that we are now facing the highest rate of all item inflation since 1981 which appears to be gaining a life of its own. As prices rise, dollar wages cease to match real wages and purchasing/borrowing power evaporates. Eventually, every consumer will seek to get ahead of rising prices and a wage/price spiral akin to what we saw in the 1970's may erupt. Stagflation looms.

The Federal Reserve, which is charged by Congress with maintaining price stability, has a surprisingly bare medicine chest when it comes to treating run-away inflation. It can either feed a cold or starve a fever. In the case of inflation, starving that fever means a rise in prevailing interest rates to a sustained level above the rate of inflation for a significant period of time until the fever is broken. We saw this with Paul Volcker's term as Fed Chairman in the early 1980's. In the meantime, a lot of things get broken along the way. Mortgage rates will rise, and median sale prices and days on market will reverse trends.



I have frequently characterized real estate as a commodity market, which, like any other, is susceptible to the vagaries of the laws of supply and demand. Localized as each real estate market may be, they each respond via price to changes in supply or demand. Successful pricing is more difficult in a transitioning market. That's because pricing signals are not as clear. Sellers tend to become infected with the need to build "negotiating room" into their initial list price. The classic statement to prepare their agent for this strategy is: "If it doesn't sell, we can always come down later." The proper response to this self-destructiveness is that there is no later. Targeting a market clearing price in a transitioning market depends more on getting below what's for sale now, and ahead of what's about to come on the market. The best potential buyers are those who are already in the market. Therefore, a property with a compelling price is half sold because it speaks to their immediate interest. They have been house hunting, some for months, and have already picked over the existing inventory using their unique criteria for price, size, location, etc. Furthermore, they have painstakingly qualified themselves, not only for financing purposes, but are on the top of their game when comparing price to value. A successful seller must entice the educated buyers currently in the market. Failing that, they will have to wait for another group to come along who have likewise educated themselves as to value which may now be at a lower level. This can only cost time and money. The market is not always kind but it is never wrong.

Taken to its extreme, the built in negotiating room strategy may cause the property to become invisible to the would-be buyers because it may be priced outside the range in which they are looking. Worse than being invisible to the market is the pin ball

Cont. from pg. 1

effect where a property with less to offer than its competitors will cause potential buyers to bank off it and go over to something which demonstrates a better value. Remember, the buyers are in tune with what value means to them. In effect, what this "negotiating room" will do is to help someone else sell their home.

The bottom line is that the higher a seller prices their home above its true market value, the less potential bidders will want to take it seriously. Less potential bidders equals less demand which means a lower eventual selling price. See the nearby chart depicting the impact of price on visibility. A far better strategy is to resolve this negotiating conflict up front by pricing properly from the beginning which may even increase the chances of bringing in multiple offers. Over pricing leads inevitably to a longer time on the market, and usually a lower eventual selling price which certainly does not work to a seller's advantage.

My father had a stable of pricing parables that he would trot out as needed. One of my favorites was used on a retiring Penn Central engineer. When the question of building in some negotiating room arose, Dad said that value is like the pulling power of one of those big engines. The inference, which was left unstated, was that no matter how much horsepower an engine can generate, eventually putting too much weight on will stop it. With the sale of your home the price is the weight, a burden which should not be too much to overcome. In short, too much weight will stop the freight.

Patterson Schwartz Real Estate
Charles E. Schwartz II, CRB
7234 Lancaster Pike, 100A
Hockessin, DE 19707
302-234-5202
Fax 302-234-5212
cschwartz@psre.com
www.charlieschwartz.com