When does market value stop and price takes over? - by John Rynne

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At a recent seminar I attended, a discussion ensued about market value and price. Someone brought up the point that market value should not be defined, as such, in an exceptionally “hot” market where there are bidding wars going on. This phenomenon is brought about by an imbalance of supply and demand. This is a rare occurrence in Upstate New York, northwest and west central New England for non-residential properties. Although it does have some applicability for the single family and small multiple family home market. It is more common in the New York and Boston Metropolitan areas who have a fuller spectrum of non-residential sales activity.

A common definition of market value is “the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

1) Buyer and seller are typically motivated;

2) Both parties are well informed or well advised;

3) Both acting in what they consider their own best interest;

4) A reasonable time is allowed for exposure in the open market; and

5) Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto, and the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.”

If there is unusually high demand due to historically low interest rates, a highly desirable location or a low supply due to lack of listings, high building costs, or stringent zoning laws, prices may climb dramatically. When does market value stop and price takes over? All appraisers know that sales price and market value are not necessarily identical. This is similar to the concept that cost does not necessarily equal value. One of the key phrases in the last paragraph for the definition of market value is “assuming the price is not affected by undue stimulus.” For example: A national chain for wireless phones is in a business expansion mode with a limited time window for such an expansion.

They may violate the market value principle which states “assuming the price is not affected by undue stimulus.” In order to comply with their business strategy, they may pay more than market value by contacting property owners who were not previously stimulated to sell but the wireless company was stimulated to buy. This violates the premise of market value in two ways:

A) No undue stimulus and

B) Buyer and seller typically motivated to sell.

These violations of the market value definition can present a large contrast between market value and price. It is difficult to discern the difference because some markets have a relatively large sample of these corporate driven sales. They may apply to drug stores, gas stations, fast food, etc. It should be noted a relatively large percentage of these sales involve assemblages. This can be an indicator that the sale is more dependent upon price than market value. If there is enough frequency of these corporate driven sales, the difference between market value and price becomes smaller. In Upstate New York, it may apply to certain parts of Jefferson Rd. in Henrietta, Erie Blvd. in Dewitt, Wolf Rd. in Colonie, and along Rte. 9 in the Mid Hudson. This can be expanded to strong commercial areas on Long Island, Rte. 1 in Connecticut, etc. which may be near major interchanges.

In many commercial locations there is not as many strong demand generators. Therefore, market value and these corporate stimulated prices can be substantially different. This carries over to market rents and non-market corporate rentals. Some appraisers consider the differences attributed to business enterprise value (BEV) or going concern. For example, a wireless phone national outlet with a long-term lease put together by a corporate driven expansion policy may have very large difference between market rent and corporate contrived rent. I appraised a vacant drug store in which the corporation bought out the lease and the property was now unencumbered by that above market lease. The market rent that the fee simple owner was able to get was $10 per s/f. The rent with the previous national tenant was $25 per s/f. This clearly showed the difference between market value and price. In conclusion, the difference of market value and price is caused by some basic violations of the market value definition previously cited.

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