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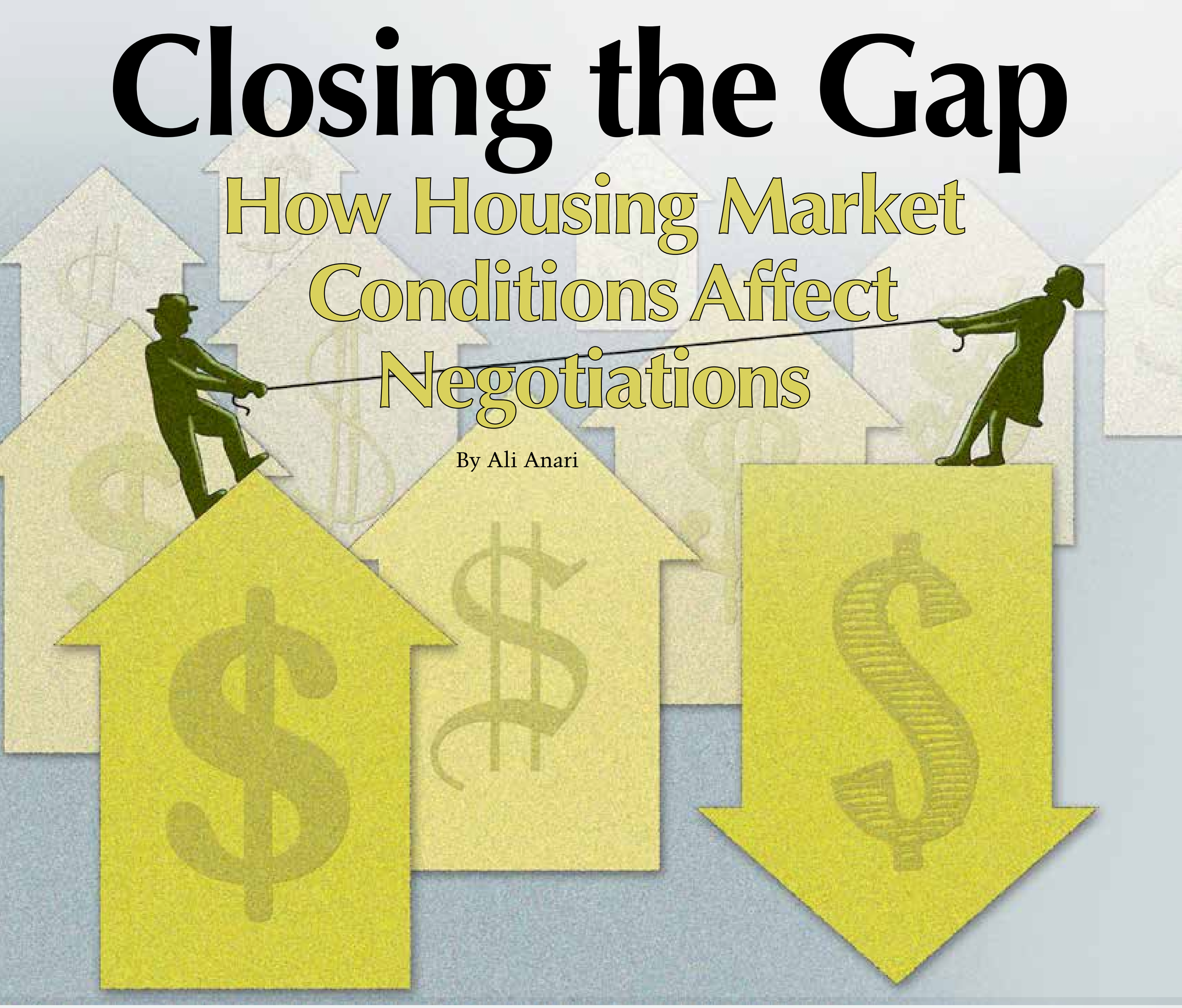
Closing the Gap

How Housing Market Conditions Affect Negotiations

By Ali Anari



"There's always room to negotiate," real estate agents are fond of saying. Research shows that's true because the final sales price is usually less than the original asking price.

A research project at the Real Estate Center studied the relationship between changing housing market conditions and both list and sale prices. The research finds that the larger the "for-sale" inventory, the larger the "spread" or difference between sale price and list price. That is, market conditions, as measured by months of inventory of homes for sale, affect the gap between list and sale prices.

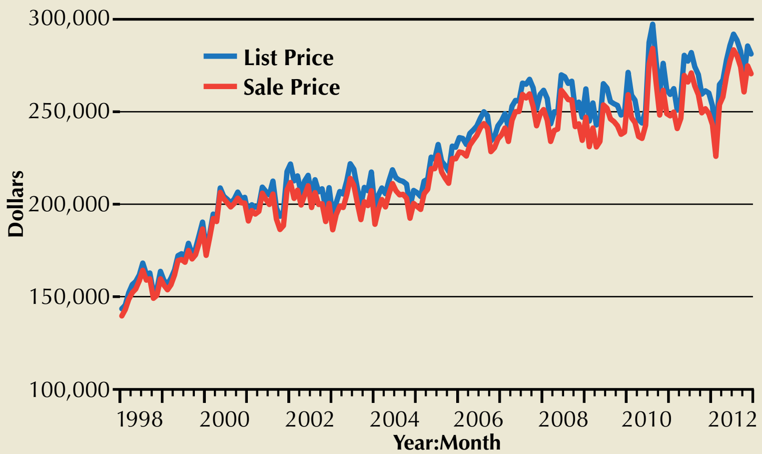
The dataset used for this project consisted of 15 years of housing sales data (1998–2012) compiled from the Multiple Listing Service (MLS) for the Austin metropolitan area.

List Price/Sale Price Gap

When a house is listed for sale, the list price/asking price is set by homeowners and their agents. The actual sale price is determined by local housing market conditions and willing buyers and sellers. When housing demand exceeds supply in a local market, sale prices can be close to or even exceed list prices. By contrast, when the number of home sellers exceeds that of homebuyers, sellers may have to reduce their asking prices to increase the likelihood of a sale. These market conditions are commonly known as a seller's market or a buyer's market.

Because sellers seek to maximize their asking prices while buyers want to minimize the costs of buying homes, a gap often exists between asking prices and sale prices due to

Figure 1. Austin Residential Market Average List Price and Average Sale Price 1998–2012

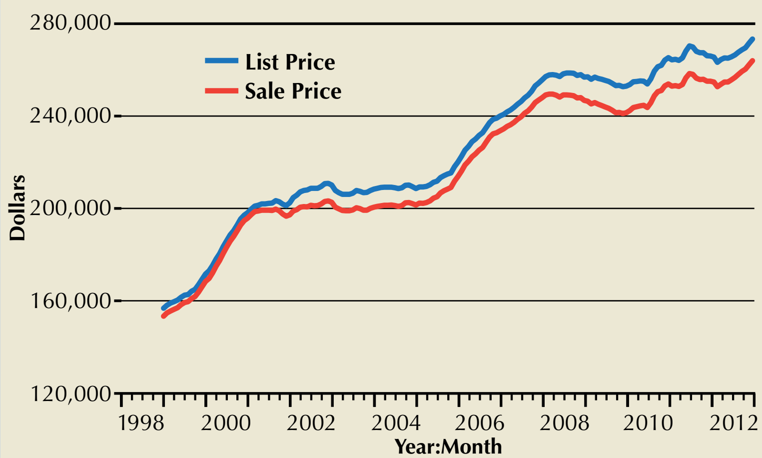


Source: Real Estate Center at Texas A&M University

(1) market conditions, (2) buyers', sellers' and agents' knowledge about home sales transactions and housing market conditions and (3) how buyers, sellers and their agents use market information to attain their objectives. Knowledgeable and reliable real estate agents can help homebuyers and sellers narrow the list price/sale price gap.

The difference between the initial list price of a house and the final sale price is the spread, just like the difference between a bid price and an ask price in the stock market. Because of changing market conditions, the spread between average list prices and average sale prices in local housing markets widens or narrows over time. Although the sale price for an individual home can be more or less than its list price, national averages show average sale prices have been less than average list prices.

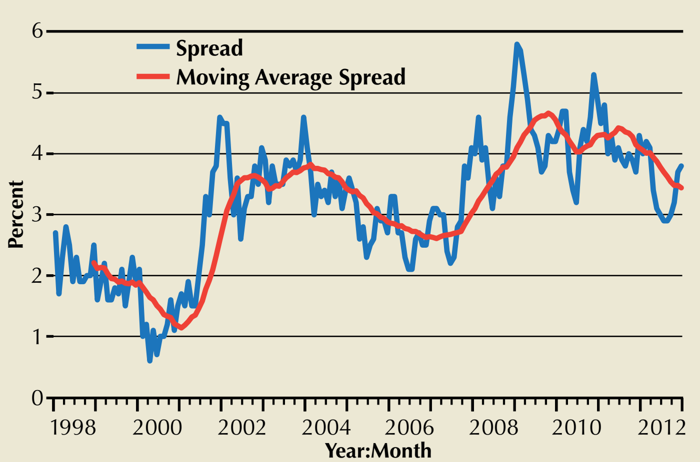
Figure 2. Austin Residential Market Moving Averages of List Price and Sale Price 1998–2012



Source: Real Estate Center at Texas A&M University

In Austin's housing market, the average list prices were higher than average sale price in all months from 1998 through 2012 (Figure 1). Both exhibit monthly seasonal variations with peaks in summers and troughs in winters. Adjusted for seasonality, the 12-month moving averages of list and sale prices show changing spreads between list and sale prices (Figure 2). The spread narrowed in 2006 and 2007 and widened after 2008. During the period studied, the average list price of homes sold in Austin was $225,892 compared with an average sale price of $218,522. Over the past 15 years, the average sales price was 96.7 percent of the average list price, and the average spread was 3.26 percent.

Figure 3. List Price/Sale Price Spread as Percentages 1998–2012



Source: Real Estate Center at Texas A&M University

Average percentages of the list price/sale price spread as a percentage of list price are shown in Figure 3. Because of seasonality in list and sale prices, the average spreads also exhibit seasonal variations.

The moving average of the spreads fell from 2.2 percent in December 1998 to an all-time low of 1.1 percent in January 2001. The moving average of the spread increased to more than 3.8 percent in February 2004, in the aftermath of the dot-com bubble bursting. In the nationwide housing market rebound of 2005–07, the spread trended downward until November 2006, when it fell to 2.6 percent. The downward trend was reversed in 2007, and the Great Recession of 2009 forced sellers to reduce the prices of their homes for sale by more than 4.6 percent in October 2009.

Implementation of a number of Federal Reserve policy initiatives, as well as the Housing and Economic Recovery Act of 2008 and the American Recovery and Reinvestment Act of 2009, decreased the average list price/sales price spread from November 2009. The spread fell to 4 percent in June 2010, but the impact of the policy measures did not last long; the spread climbed to 4.4 percent in June 2011. Since then, the spread has been trending downward.

Home Price Discounts and Months of Inventory of Homes

Months of inventory	1	2	3	4	5	6	7	8
Price reduction, percent	0.79	1.41	2.03	2.65	3.27	3.89	4.51	5.13

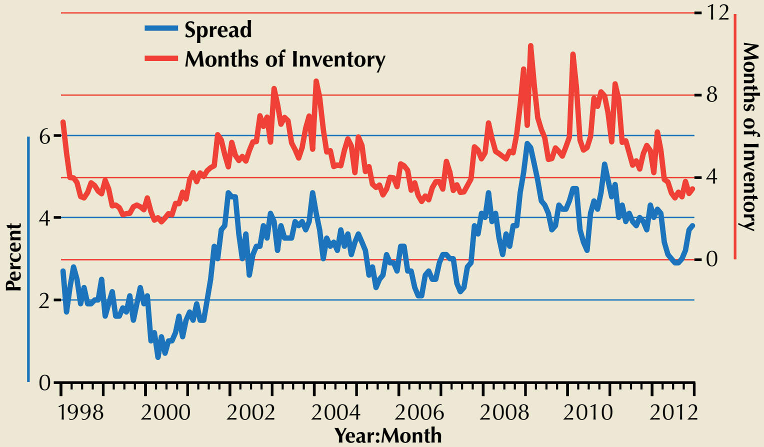
Source: Real Estate Center at Texas A&M University

Spread, Months of Inventory

Changes in average list price/sale price spread reflect changing local market conditions. The number of months of inventory is an appropriate measure of local housing market conditions, as it illustrates the relative supply and demand for homes. Months of inventory is calculated by dividing the number of homes for sale at the end of a month by the number of homes sold in that month. This metric summarizes the supply and demand of the local housing market.

Figure 4 shows average percentages of the list price/sale price spread (blue line, left axis), and averages of months of inventory (right axis, red line) of homes for sale in the Austin area. The months of inventory averages are computed by dividing the number of homes for sale at the end of each month by moving averages of monthly home sales. The average spread and the average month of inventory move in the same direction.

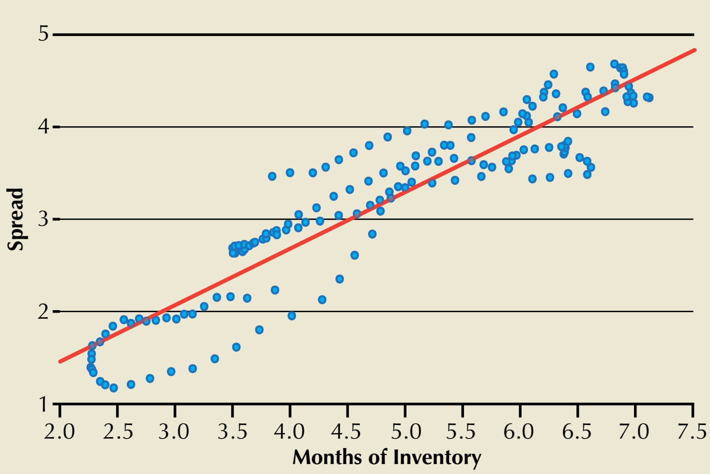
Figure 4. Austin Residential Market Home Sale Price Reduction and Months of Inventory 1998–2012



Source: Real Estate Center at Texas A&M University

A scatter diagram of the spread and months of inventory quantifies the relationship between list price/sale price spread and months of inventory (Figure 5). The computed trend line shows that as the inventory of homes for sale gets larger, the spread gets larger too. That is, as the inventory of homes increased in Austin, home sellers had to offer a larger discount to list price. The table shows the average spread associated with months of inventory of homes for sale. This discount from list price to sale price increased 0.62 percent for each one-month increase in inventory of homes for sale.

Figure 5. Austin Residential Market Home Sale Price Reduction and Inventory



Source: Real Estate Center at Texas A&M University

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THE TAKEAWAY

Finding the "right price" for a home for sale is not an easy task, but homebuyers and their agents can make more informed decisions by paying attention to the relationships between list prices, sale prices and inventory of homes for sale.

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The Real Estate Center at Texas A&M University is the nation's largest publicly funded organization devoted to real estate research. The Center was created by the Texas Legislature in 1971 to conduct research on real estate topics to meet the needs of the real estate industry, instructors and the public.

Most of the Center's funding comes from real estate license fees paid by more than 135,000 professionals. A nine-member advisory committee appointed by the governor provides research guidance and approves the budget and plan of work.

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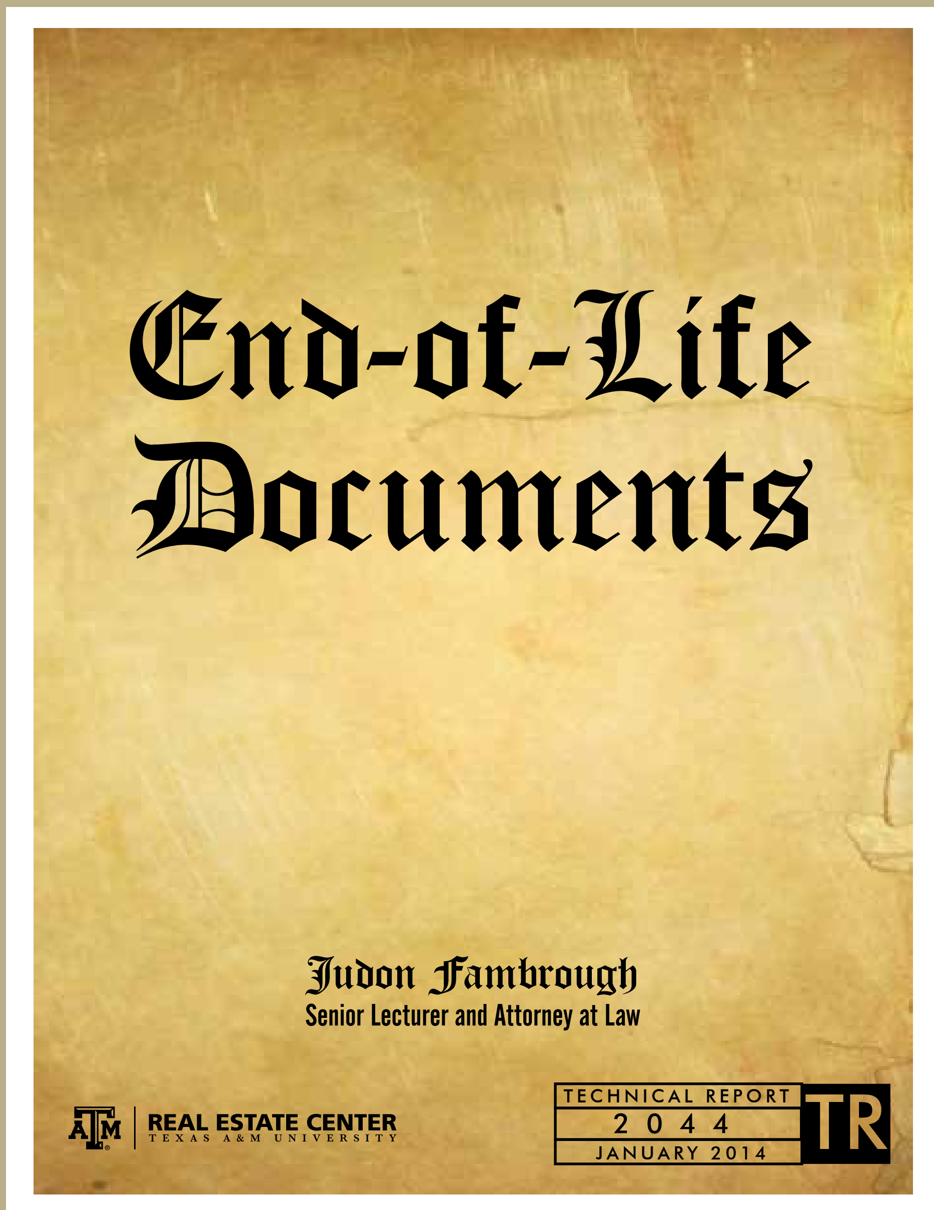

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