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Record pricing belie: Market priced for perfection - by Daniel Calano

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Perhaps some of you have gone to an art auction with the intention of purchasing a modestly priced painting, by a sometimes well-known painter. Let's say the artist routinely commands about \$5,000 for a painting, and you anticipate paying that amount, perhaps a little more, because you like it more. The bidding starts and works its way up to \$5,000, you're still in the hunt, and you either get the painting or miss it by an extra thousand you weren't willing to go. It's more or less market value for that particular artist's work, and the sale has borne it out.

There is another side to the art world as well. In a recent Wall Street Journal article, an art writer focused on the complete unpredictability of new hot artists who have caught the eye of well-off collectors. The author focused on a young African woman, who moved to L.A. to pursue her work. She began selling paintings in a range of \$3,000. That was her works "market value," until a collector/gallery noticed her art and began to promote it. Within a few years, she now sells paintings for \$3 million. Suddenly, there is no predictable market price, and buyers rushed into speculative realms, never previously imagined. Why? Because the buyer could afford to, and they'd decided they wanted something, regardless of price.

Have you noticed this phenomenon in high-end real estate? I emphasize "high-end," because it is the marketplace for that level buyer. Way back down in the middle end, residences are still "priced for perfection," with lots of sales made to lots of people, with lots of data analysis. Sellers, buyers, and brokers can fairly well predict what a property will sell for. If the typical comparable properties sell for around \$500,000, so will many others that look like it.

Back to the art analogy, there can be the same phenomenon in high end housing that occurs with the artist suddenly "found" to be desirable. Some of this phenomenon leads to bid wars, where properties sell for, let's say, 50% more than expected. Some of it leads to speculative pricing, where sellers put their property on for twice what the market would lead them to anticipate. You can see record-breaking pricing every day in the advertising section of the big newspapers, or in the glossy brochures of the high end sellers. The Wall Street Journal creates a weekly section called "Mansion," where previously unobtainable prices are discussed as perfectly reasonable, in recent record cases going over a \$100 million.

These recent sales belie the notion that there is a market price for all types of real estate. The highest sale always belies all of the previous comparables, by definition. At the very high end, the difference can be as high as tens of millions more than previously achieved or currently anticipated. It may never happen again, or it may be setting a new bar.

The Boston area is not known for its flamboyance, despite the fact that there are wealthy areas that have routinely commanded high prices. Recently, however, there is a spate of record listing and selling prices, followed by new higher record asking prices. In Boston, condominiums for example, where high prices used to be between \$1,000 - \$1,500 per s/f, prices are now routinely asking and getting over \$3,000 per s/f, which increase came in a relatively short time frame. As another example, in Cambridge, where the top residential price ever had been \$10 million, and comparable sales might suggest high end pricing at \$4-\$5 million, some new, clearly desirable properties will be listed according to brokers at \$12 million and above.

If you think about it, a person who can afford an \$8 million house, can also afford a \$10 million house, or a \$15 million house. It is not the extra million or so that is troublesome, particularly if the property is extraordinary. I relate a story often of a Nantucket buyer who was looking at a property asking \$25 million and asked a real estate friend whether the house was worth it. Before the friend could answer, the buyer said something like, "It isn't about the money, you understand. I just don't want to be perceived as overpaying."

Pricing is determined by a sometimes amorphous notion of what someone will be willing to pay. That "someone" may not necessarily be a predictable market participant. It's been more than a few times where I have consulted on value, told the client what the comparables would suggest, but ended with a caveat: Don't be surprised if it sells for 50% more. It happens.

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