

REAL ESTATE AUCTIONS: THE NEW METHOD TO SELL REAL ESTATE

by Lawrence F. Sherman
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An auction is a sale concluded by an increase of bids over a reservation price. Something is finally sold to the person who makes the highest bid. Auctions are a viable way to successfully complete real estate exchanges; a quick way to unload unwanted but valuable real estate; an often emotional event that brings together many buyers; and a risky but often lucrative sales technique for the buyer and/or seller.

Auctions previously were viewed as a way to dispose of distressed properties. However, as the economy changed, financing complexities increased and liquidity became more of an issue. Real estate auctions now have become an accepted and profitable way for the real estate person to do business.

Auction Terms

Auctions can be defined by property ownership and property quantity.

Stand Alone Auction (also called Single Product/Single Owner). This is the most expensive type of auction because its costs cannot be spread over many properties. Only a single building or residential development is offered, e.g., the developer's portion of the housing units in a subdivision. The advantage of this type of auction is that it can be initiated at any time without input from other parties.

Single Ownership/Multiple Property Auction. This type of auction also can be initiated at any time, because it still only involves the single owner. Here, the single owner's portfolio of properties is auctioned, and the costs are spread over all of the properties.

Multiple Owner/Multiple Property Auction. This type of auction is popular because it includes many different types and sizes of properties which enables the auction costs to be shared among many property owners.

Auctions Can Be Defined By Their Rules Of Sale
Absolute Sale Auction (also called Absolute With No Minimum Bid). Properties at this auction will be sold regardless of the prices bid. These auction rules produce the most risk for the seller, but they generally attract more buyers, which can lead to higher prices.

Stated Minimum Bid Auction (also called Absolute With a Minimum Bid). Properties at this auction will

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be sold only if the prices bid are higher than the minimum bid specified by the owner. It is not necessary for the owner to notify the bidders of the required minimum. If bidding fails to reach the minimum, sellers often approach the highest bidder and offer the property at the minimum bid price.

Confirmation by the Seller Auction (also called Reserve). Properties at this auction are sold only if the highest bidder has reached or surpassed the reserve amount specified by the owner. The reserve is not necessarily communicated until the bidding is completed. To make the reserve auction more popular, an incentive can be offered to compensate the high bidder if the seller rejects that bid. Auction promotional materials which do not specify the type of auction usually are reserve auctions.

Auctions Can Be Described By Their Rules Of Bidding

Public Auction: Buyers get together in a room and bid against each other until someone wins. This is the most common form of auction.

Sealed Bid Auction: Bids are mailed in; the buyer is notified by return mail of his high bid.

Spot Bid Auction: Buyers bring secret bids to the auction site where the auctioneer announces the winning bid.

Negotiated Sales: Written and telephone offers are taken by the auctioneer before the auction date. The highest offer is accepted on the auction date.

The sale price at an auction is known by two other names: knockdown price, because at the conclusion of the sale the auctioneer's hammer is knocked down; and strike price, because at the conclusion of the sale the item is struck from the auctioneer's list.

Who Holds Auctions?

The easy answer to this question is the auction companies. These companies provide important services to the property owner before, during and after the auction. A reputable auction company will have marketing strength, an understanding of real estate auctions and the local real estate market, the ability to provide financial and legal services (pre and post auction), proven attention to auction day details and a sensitivity to buyers who are unfamiliar with auctions. The auction company pays all promotion and advertising expenses and has fees similar to those of real estate brokers.

It is the property owner who provides the auction company with the product to sell. The reasons the owner is selling the property and the property itself determine whether an auction is the best way to part with the property.

In addition to private property owners, developers, probate, estate and tax sales, there are many government agencies with real estate to sell at auction.

- *The Resolution Trust Corporation (RTC):* The RTC holds a broad array of properties including vacant land, industrial parks, single family homes and apartment buildings. The RTC holds property that has been collected from liquidated financial institutions, such as banks. Good buys are available on many of the RTC properties.
- *The Federal Deposit Insurance Corporation (FDIC):* The FDIC also has a broad array of properties, since a failed financial institution's assets will go to either the FDIC or RTC, depending upon the legal circumstances.
- *Fannie Mae and Freddie Mac:* Primarily single family homes are held by these agencies. Some good deals are available, but unlike the RTC, these agencies are not under the same pressure to sell.
- *Department of Housing and Urban Development (HUD):* Lower class housing is HUD's specialty. Good buys are available for investors to purchase, fix up and resell.
- *Department of Veteran's Affairs:* These properties are slightly worse than HUD properties. Good deals are available, but be prepared for extensive renovation.
- *General Services Administration:* This agency encompasses a hodgepodge of properties and services.
- *Farmers Home Administration (FHA):* The FHA has some great deals if you are persistent. However, in order to effectively utilize their services, you probably will have to move to the country.
- *Bureau of Land Management:* This agency is strictly for the adventurous who want to capitalize on the federal government's urge to give away odd land at \$5 an acre or less.

Why Are These Auctions Held?

Property is sold through auctions to accomplish inventory clearing with expediency. Inventory can consist of just one single family home, a condominium complex, five shopping centers, or any other combination of REO (real estate owned).

Any owner of property can participate (sell) in an auction. Any potential purchaser of real estate can participate (buy) in an auction. Some properties do not lend themselves to auction sales, and some buyers should not use auctions as a medium for property purchases. Sellers should avoid auctions if their property cannot be offered in the standardized, pre-established package that auctions provide, or if they are unable to accept not controlling the property's sale price.

Auctions are primarily used for properties which:

- a. must be sold (forced liquidations or the owner just cannot afford to spend any more for carrying costs).
- b. are unique and desirable (prospects bid against each other, raising the strike price).
- c. are built specifically to sell at auction. The auction medium is often used by developers.

Auctions are held because they provide advantages to the seller.

- Auctions are the fastest method of converting real property into cash. The advantages of speedy sales are:
 - a. Carrying costs, such as interest and maintenance charges, can amount to more than 30% of an unsold property's value each year; time is important in real estate transactions.
 - b. When property values are failing, an auction sale is likely to be much more profitable than an individual broker sale at some unspecified time in the future.
 - c. Where speed is desirable, property involved in divorces, settlement of wills and other legal commitments can be auctioned advantageously.
- Property is sold as is at auctions; the seller is not liable for unknown problems with the property once the sale is completed.
- Auctions permit the property owner to know that on a certain date his property will be sold.
- Auctions create interest in the area; nearby properties often will sell once the auction sales are completed.
- Auction attenders must provide registration information about themselves; this provides a list of prospects for the real estate owner and/or broker after the auction is concluded.
- Auctions can be used as a valuation tool.
 - a. When property prices are uncertain (such as in a new residential development in an area undergoing rehabilitation), an auction of some properties in the development can help the owner determine realistic prices for the remaining properties.
 - b. Property that has remained unsold for a long period of time can either be sold or at least revalued by placing it at auction. This is useful for brokers trying to convince clients that their listing price is much too high.
- Auctions create a sense of urgency; buyers cannot go home to think it over or just wait patiently for the price to fall.
- Auctions freeze out nearby properties; buyers tend to review the properties to be auctioned before they will make any other buying decision. Often, buyers will wait until after the auction is

completed before considering any real estate purchases.

While there are some difficulties with auctions, their popularity continues to grow.

- Since buyers usually have to pay cash for property purchased at auction, they must often procure financing in advance of the auction date.
- Auction companies charge a fee. The auctioneer also gets a typical settlement fee of 1% or 2 % if no one reaches the minimum bid.
- The sales price is not controlled by the seller but by the buyer.
- Auctions can harbor dishonesty. Before the auction, be sure to check the track record of the auction company.

Psychological Tricks

At an auction, the seller has numerous advantages. In order for the auction buyer to compete successfully with the auctioneer, who is appointed by the seller, the buyer needs his own bag of auction tricks. The kind of buyers who should not attend auctions are those who will not take the precautions described here. Buyers of auction property can uncover bargains, but in order to improve the odds for success as an auction buyer, the following precautions are strongly recommended:

- Always know the real estate value of what you are buying.
- Never get auction fever.
 - a. Take a break from the auction when you realize you are afraid to take a break because you might miss something.
 - b. Take a break from the auction when you forget to look at the index card in your hand that shows your maximum bid.
 - c. Take a break from the auction when you begin to feel light-headed or when you realize you are staring at the auctioneer and nothing else.
- Always inspect the property before the auction.
- Always read the conditions of sale before attending an auction.
- Never forget that an auctioneer is a salesman, and he has something to sell you. The auctioneer will use everything in his power for you to make a higher bid.

There are techniques to counteract the practiced expertise of the auctioneer.

- a. Counter the auctioneer's enthusiasm.
- b. Make a few very low bids. It throws off the auctioneer's timing and slows down the auction.
- c. Set your limit. Write your limit down and do not bid past it.

Be warned: It is very easy to catch auction fever. Those people who think psychological tricks are

unnecessary will likely be the very people who need them the most.

Before The Auction—Buyer's Viewpoint

To ensure a successful auction experience, the buyer must take action before the auction. Using the psychological tricks, described here, requires advance planning. Before the auction date the buyer must complete a property inspection so the property can be valued correctly and the maximum bid determined. It is not possible to accurately choose a maximum amount to bid without seeing the property.

It is prudent to hire a certified property inspector to accurately value the properties in which you are interested. Before hiring the property inspector, inspect the properties yourself. Eliminate properties which do not meet your needs; this decreases the number of properties you pay the inspector to review.

Examine the property at its least advantageous times of day, e.g., when residents are home from work. How much parking is available? Does the neighborhood appear safe?

Observe the exterior of the property. If the exterior does not meet your standards, don't waste your time looking at its interior.

- Is the property located near a toxic waste dump, polluted river or other undesirable entity?
- Review the overall noise level of the area. Is the property too close to a freeway or main street? How much traffic passes by the property?
- How private is the property? What are the neighbors like?
- How is the property situated? Is it at the bottom of an incline where flooding could occur?

Evaluate the property's proximity to local amenities: shopping, public transportation, fire stations, recreational and cultural facilities, religious institutions, schools and hospitals.

- Examine the roof. Are the shingles warped? Do the gutters need repair?
- What is your overall impression of the property? Would you want to live or work there? Could reliable tenants be easily found?

Both residential and light industrial properties should be evaluated, as described here, but answers to the questions can result in differing values. For example, extremely close freeway proximity would be an asset to a light industrial property but a deterrent to the purchase of a residential property. If your review of the exterior property produces serious doubts about the property, go to the next property. If the exterior review provides acceptable results, proceed to review the interior.

- Are the floors level? Solid? Carpeted? Carpeting may be used to hide defects.
- Check the walls and ceiling for stains and peeling. These can indicate water damage and/or leaks. Don't forget the attic and basement.
- Check the water pressure. Turn on the shower and sink, then flush the toilet. Does the shower or sink water flow decrease significantly?
- Look for infestation. Termite infestation can practically destroy a property's value. Bring a flashlight to look for signs in corners and other dark areas.
- Make a list of needed repairs. Calculate what these repairs will cost.

In addition to the property inspection and corresponding valuation, the prudent buyer has additional responsibilities.

- Find out about the property's legal status. Tenants can be difficult to eject from the property. Some sellers are allowed to redeem the property back from the buyer for up to two years after the sale, depending upon the legal circumstances. Know the correct dollar amounts of all encumbrances.
- Check the time, location and date of the sale. Check the properties that are to be sold. Keep checking on these items right up to the morning of the sale. There are often changes and postponements up to the last minute.
- Be prepared with financing. Auctions often expect the strike price to be paid on auction day, not weeks later when you have arranged financing. Before the auction, consult with a professional regarding the best way to manage auction financing. On auction day, the high bidder will sometimes need to pay only a down payment or earnest money, rather than the full strike price. Before the auction check on the specific details regarding payment. There is no standard down payment at auctions.

Before The Auction—Seller's Viewpoint

Having decided to sell a property at auction, the seller chooses a reliable auction company. The seller should be aware that the property to be auctioned will be off the market for approximately six weeks: three weeks for the auction company to plan and prepare for the auction and three more weeks for advertising, promotion, publicity and inspection. Closings take place up to eight weeks after the auction date.

Before The Auction—Realtor's Role

Auctions are another way for realtors to collect commissions. The realtor can register his prospect with the auction company (only simple paperwork is required), take his registered prospect to the auction

and encourage him to bid, and then collect a commission from the auction company, whether or not the prospect buys. Each auction company has its own rules regarding commission payments; realtors should contact local auction companies for these rules.

After The Auction

After winning the property at auction, the usual practice is endorsement of the cashier's check brought to represent the down payment, earnest money or full strike price. The auction company will provide instructions regarding when and where the closing will occur. It is prudent to have your attorney work with the auction house to prepare the closing paperwork. Never use the seller's attorney for this purpose.

When the closing occurs on the day of the auction, bring your attorney along to ensure that all the paperwork is properly concluded. If you cannot bring your attorney, sign all documents with this conditional clause: "This document subject to review by my attorney." If the auction house balks at this clause, do not buy the property.

Whatever the terms, expect to complete all the usual steps for buying any kind of real estate, such as having the site surveyed and a title insurance policy in hand, by the closing date.

Buyers who remain attracted to a property they did not win at the auction still can hope to eventually purchase it. Most auctioneers keep a list of the unsuccessful bidders for each property. Unsuccessful bidders often put a request for "Right of First Refusal" in writing to the auctioneer the day after the auction. If the winning bidder cannot buy the property or utilize the buyer's remorse law to change his mind, the individual with the right of first refusal will be next in line.

Conclusion

Auctions are no longer used only to dispose of distressed real estate properties. Although auctions are not suitable for every real estate transaction, they have become an increasingly popular choice among many real estate buyers and sellers. As long as real estate buyers and sellers take precautions to ensure reasonable, timely and profitable auctions, they should continue to grow in popularity, sophistication and attendance throughout the coming years.

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