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The Auction Advantage

Accelerated marketing gains traction in today's troubled market.

by Paul A. Lynn, CCIM, and Gordon Greene, CCIM

During the last 24 months, sold and closed commercial real estate transactions have been in short supply, while unsold properties seem to have increased exponentially. The last cycle in which CCIM practitioners experienced a somewhat similar market was the late

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1980s and early 1990s. During those years, large property portfolios were timely and effectively sold by the Resolution Trust Corp., banks, and private sellers through real estate auction programs that came into vogue. While negotiated transactional sales were few or nonexistent, auctions and accelerated marketing programs established current true market value in a competitive bidding environment.

Today, decreased values and foreclosures of commercial assets are pervasive once again as a result of the credit crisis. As banks, institutional lenders, and private and corporate sellers expand their real



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A closeout of 32 remaining condos in Villas at the Barrett Lakes in Atlanta grossed \$3.2 million at auction.



estate-owned or workout situations, the question arises: How can we move these properties off our books on a timely basis at market prices?

Real estate auction marketing can be an effective alternative to the more-static negotiated sales marketing model. Open outcry real estate auctions and other types of accelerated marketing techniques can be efficient methods for the timely sale of most commercial real estate assets. In recent years a number of CCIMs and other real estate professionals have become involved in open outcry auctions or sealed bid sales as their traditional negotiated sales volume has declined. These auction programs have helped clients extricate themselves from difficult-to-sell properties.

Why Auctions Work Today

Auctions offer sellers two factors that are missing from the traditional negotiated sales process: a set time frame and control over the sales process. Particularly in today's market, many properties are experiencing limited or negative net operating income and sellers are supporting properties out-of-pocket each month. Tenant bankruptcies are causing unanticipated high vacancies or lead tenants already have vacated properties. Other buildings may be in or subject to pending foreclosure or bankruptcy, or a lender already may control the property and needs to get it off its books.

Even if the traditional transaction market was functioning properly, such properties would be difficult to sell. But in today's market, brokers and sellers come up against issues of financing, valuation, and lack of comparable sales. For example, how do you value properties with high vacancies, low or negative net operating income, or no comparable sales? And while it may be relatively easy to find a buyer, can the buyer find financing?



Offered without a reserve, the auction of the 130-room Morgan Hotel in Charlotte, N.C., generated 178 prospect inquiries from 26 states, 52 due diligence packages purchased by prospective bidders, and 20 bidders at the auction from 10 states. The final sales price on the property was more than \$6.8 million (\$51,500 per key) to a Chinese group from Chicago. The property had been appraised prior to auction by the sellers in a range of between \$4.5 million and \$5 million.

The auction process eliminates many of these concerns by giving the seller control over the sale. In the auction process sellers control the following factors:

- timing of the sale, usually 60 to 90 days;
- structure of the offering;
- financing through either an assumption, structured seller financing, or committed third-party financing;

- predetermined purchase and sale agreement: to make buyers comfortable with bidding and the purchase, the seller must make the contract fair and commercially reasonable;
- property on an as-is, where-is basis with limited warranties; and
- closing in 30 to 45 days from the date the contract is signed.

Seller's Costs

There are some differences in seller costs in an auction program versus traditional marketing. With an auction sale, a normal six- to 18-month marketing program is compressed into six to eight weeks. To accomplish this, an intense marketing and public relations campaign is required to present the property to all potential buyers, get them to on-site inspections, and eventually have them attend the auction event to bid. These high-profile marketing expenses are a seller's cost and often are paid to the broker/auctioneer in advance of the actual auction date. These costs can range between 0.5 percent and 1.5 percent of the property's value. For a large property or portfolio, a stand-alone auction for a specific seller is structured with the marketing costs paid by that seller. Alternatively, a number of sellers with small properties can be combined into multi-property, multi-owner auctions where all sellers share the required marketing expenses.

Buyer's Premium. A unique opportunity an auction provides is the ability to use a buyer's premium, which offsets some or all of the seller's auction transaction costs. The buyer's premium is an additional amount that is added to the high bid price to determine the total contract price the buyer will pay to the seller at closing. The agreement between seller and broker/auctioneer provides the particular percentage of the buyer's premium that is paid to the broker by the seller at the close of escrow.

What Happens When a Property Doesn't Sell at Auction?

Sometimes a property is in a shallow market, the auction bid is not quite at an acceptable level, or the property is bid aggressively but the seller cannot mark the property to market for some internal accounting reason. Then it is necessary to negotiate a post-auction deal. The auction program invariably identifies in 60 days one or more serious prospects; it's only a question of determining the issues that need to be negotiated. It could be financing, environmental issues, or just a little more time to close. Options such as seller

financing should immediately be put on the table to close the deal.

In some cases, the property has no depth of market and the seller needs to consider alternative options. These can include waiting a few more years, substantial price reduction, additional leasing, construction changes, property cleanup, or possibly giving it back to the lender. Sellers need to be realistic: An auction does not change market dynamics, but it can help to expedite timing for understanding current conditions and making decisions.

In an active and aggressive bidding environment, the buyer's premium is perceived by bidders almost as a sales tax and can lead to higher net proceeds for the seller. Specified buyer's premium can range from 3 percent to 10 percent of the bid price and is an accepted part of the auction process.

The buyer's premium allows the seller to increase the gross sales price and is a way for the seller to transfer transaction costs onto the buyer. When implemented properly, the seller's total effective transaction costs (marketing expenses plus commission) can be less than that of a traditional brokerage sale.

Broker Compensation

Many CCIMs and other brokers have formed alliances or work with real estate auction companies. Others are looking at auctions as a way to expand their business and income opportunities. Since the process for auctions and traditional sales are different, it makes more sense for those without auction expertise to develop a partnership with an experienced national and/or

regional auctioneer to expand the potential for success and represent clients effectively.

Some of the areas where CCIMs and brokers can earn fees from auctions include:

- referring clients or properties to auctioneers for sale;
- representing buyers in purchasing an auction property and receiving a buyer's brokerage fee;
- acting as a local designated broker for an out-of-state auctioneer;
- assisting an auctioneer at open houses; and
- working with the auctioneer at an auction event.

Interestingly, during the last 30 years in the real estate auction business only about 15 percent to 20 percent of auction buyers have been represented by buyer brokers. Earning a commission as a buyer broker is easy: Don't let the opportunity pass you by.

Changing Auction Technology

EBay and other online services have increased the visibility of all auctions,

including how they are perceived and conducted. Online real estate auctions, when combined with live open outcry real estate auctions, are taking on more prominence; however, if not implemented properly these events can prove to be unsuccessful.

While many products can be sold easily in online auctions, real estate by its nature is unique and individual. No two parcels of land, buildings, or locations are exactly the same; each has its own particular characteristics. Thus, due diligence is an extremely important part of the auction process. Technology programs, such as the CCIM member service STDBonline, are very helpful in preparing due diligence materials.

Most importantly, auctioneers rely on new technology today to publicize auctions and target potential bidders. In the past the most effective means of advertising auctions to buyers was local newspapers, the *Wall Street Journal*, and direct mail. However, with the lower circulation of print media and increased postal mailing costs, electronic media is now more effective. Useful formats to reach potential buyers include commercial information exchanges such as LoopNet, CoStar, and CCIMNet; targeted e-mail blast services; Web sites; banner ads; targeted cable services; and radio. In addition, potential buyers can access detailed due diligence materials on password-protected Web sites. At the auction event, Web simulcasts of live auctions bring buyers from anywhere in the world into the active bidding.

In a marketplace where value is uncertain and sales are slow, auctions demonstrate where market equilibrium should settle. The high bidder gets his purchase price reinforced by the fact that other buyers are willing to pay just \$10,000 or \$25,000 less than the winning bid. Auctions provide the full transparency certain situations require, such as in probate or trust sales. Bankruptcies and corporate portfolio sales can be accomplished more effectively in auctions than in traditional negotiated sales. Auctions may be the best valid forum to find today's true market value for many properties. ■

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Real estate auction sales differ somewhat from traditional brokerage sales. Find out some of the points that define the auction process.

Accelerated Sales Strategies

Auction With Reserve. This program offers the property subject to the seller accepting or rejecting the high bid placed at auction. This type of auction is not a very strong calling card; purchasers are likely to believe that the auction is no more than a traditional negotiated sales technique and that the seller may just be seeking a free appraisal for the property. With no certainty of guaranteed sales, the final prices realized can be lackluster. This technique can work for governmental agencies and financial institutions, as the supposition of prospective bidders is that an institutional seller definitely means to sell the assets.

Auction Without Reserve Subject to a Stated Minimum Bid. This strategy requires some careful analysis and knowledge of buyer psychology. The minimum bid figure should clearly demonstrate the opportunity for an excellent purchase by a bidder. Often it is at a level at which the seller would prefer not to sell the asset, but at which many serious bidders perceive substantial additional value and would bid beyond that value in a competitive bidding environment. Typically when recommending a minimum bid, auctioneers anticipate an uptick in bidding of 50 percent or higher.

Auction Without Reserve and No Minimum Bid. This strategy sends a clear message to the marketplace that the seller means to sell the asset. It frequently attracts the highest number of serious prospects and leads to the best possible price. It can be used effectively with an asset or group of assets with good depth of market and high transparency, such as condominiums. The illusion of a bargain is a definite component of this process. With a property of substantial appeal it can be the best marketing vehicle.

Live Open Outcry Auction. This approach is most effective when there are multiple buyers. By bringing them into the same venue at the same time, a competitive bidding condition will be created that will produce the highest price for the seller.

Sealed Bid Sale. This strategy is most effective for properties with only a few potential buyers and the possibility there could be great disparity between what those buyers would bid. In essence the sealed bid is a private sale but buyers tend to be concerned about what to bid.