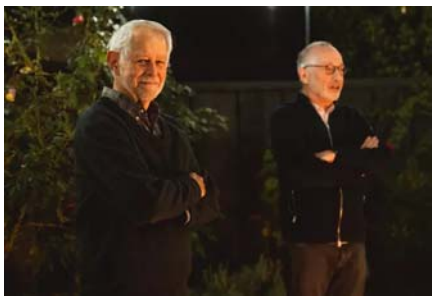
# Want To Make More Money? Listen To These Nobel Prize Winners And Bring Transparency To Your Sales Process

**19 October 2020** | Mike Phillips, Bisnow London (https://www.bisnow.com/author/mike-phillips-103547) (mailto:mike.phillips@bisnow.com)

When you sell a piece of real estate, are you using the process that will get the highest price possible? The work of two U.S. academics who last week won the Nobel Prize (https://www.bisnow.com/tags/nobel-prize) for economics suggests you almost certainly aren't.



Stanford University (https://www.bisnow.com/tags/stanford-university)'s Paul Milgrom and Robert Wilson won the prestigious prize for their work on auction theory and how the design of auctions can be changed to maximise the price paid for an asset. (https://www.nobelprize.org/prizes/economic-sciences/2020/popular-information/) A close look at their research suggests the way real estate is typically sold in the U.S. and UK is not designed to get the highest price possible. And those weaknesses in the property sales process, in particular the lack of transparency, could be holding the growth of the sector back.

"In the past, property has benefitted, and some players in the industry have benefitted, from it being an opaque market," Income Analytics chief executive Matthew Richardson said. "But if you ask the big global investors with experience in the equity and bond market what they want now they are looking at real estate, what they say is liquidity and transparency. But the kind of asymmetry of information you have in real estate supports a world where when you buy and sell, you are just running around a prehistoric forest trying to whack anything you can with a club."

Real estate investors and sales brokers might not think the study of auctions applies to them, but it does. Milgrom and Wilson's work deals with the complications that arise from selling assets that have a common value, a kind of intrinsic value based on something like cash flows, but also a private value — the way a particular asset might be worth more to one person than another. That sums up succinctly most commercial real estate transactions, where each asset is unique, but is also valued based around market norms.

And even when they don't entail bidders putting their hands in the air, commercial real estate investment sales typically operate as slow-motion auctions. Potential buyers put forward their offers over multiple rounds of bidding, and then, in general, the highest bid wins if the seller thinks the bidder has the money and expertise to complete the deal.

Two elements of Wilson and Milgrom’s work highlight how these auctions are badly designed and one word sums up both parts: transparency.

The winner’s curse is a well-known phenomenon in the financial world. If you have paid more than anyone else for an asset, you may well have overpaid — no one else thinks it is worth as much as you. If you try to sell it again one day, there might not be anyone out there willing to pay what you did, and you might make a loss. Wilson and Milgrom’s research shows that fear of the winner’s curse leads bidders to pay less than what they think an asset is worth to avoid overpaying.

One way around this is to give as much information as possible to people or companies looking to buy an asset. That can include providing information to the bidders about what other people are willing to pay, perhaps by sharing anonymised general levels of other offers.

But in a typical real estate sale, bids from potential buyers are submitted blind, even after the initial round of bidding.

“You might be asked to sharpen your pencil and told if you increased your bid you would have a better chance, but you’re never sure if that’s just the vendor or their agent pushing to get a better price when they don't really have someone on the other side,” Soller Capital Management Chief Investment Officer Matthew Webster said.

“In some cases you will have a situation where it is an advantage as a seller, because you have someone come in willing to pay a lot more than anyone else based on a personal desire rather than fundamentals, but that isn’t very common. In most cases the buyer second guesses what other people might be willing to pay and avoid the winner's curse.”

“If you are bidding blind, you might be paying far too much, so you hold back on what you bid, which means the market becomes dysfunctional,” Acuitus Chairman Richard Auterac said. Auterac’s bias is clear — he has been a commercial real estate auctioneer for more than 30 years — but he makes the point that an English auction, the technical term for a traditional live auction of progressively higher public bids, is a good mechanism for price discovery.

The second point real estate should take from Milgrom and Wilson’s work relates to transparency in the amount of information sellers give to buyers. Their research (including delving into residential property auctions) found that the less a buyer knew about an asset, the less they were willing to pay. So the more information about an asset a seller can provide, the higher price they will get.

“Price is essentially a function of risk; the less you know, the greater the risk, so the less you will pay,” Richardson said.

This may sound obvious, but it is not something commercial real estate has necessarily taken on board.

“When you get into the data room on a property sale, the level of disclosure you get is often woeful,” Richardson said. “It is essentially caveat emptor, and up to you to pick things up during due diligence. You will ask a seller, why didn’t you mention X, and they will say, you didn’t ask.”

In a previous role as head of European research at Fidelity, he worked deals where the seller didn’t disclose issues around zoning, the condition of a property and even the fact that someone else owned a strip of property between the building being sold and the street.

“There is a school of thought that if you tell people everything, you show them the warts, and that might put buyers off,” Auterac said. “But I think it just puts off the people who were trying to buy on the cheap. In general, more transparency is beneficial.”

Webster believes the sale of nonperforming commercial real estate loans could particularly benefit from better disclosure.

“Because of the nature of the loans, people are terrified of buying something and then coming across something they didn’t know about,” he said. “So the data rooms are put together with as much information as possible, in a uniform way, to try to overcome that fear.”

He adds that when bidding on NPL portfolios, buyers are asked to provide a breakdown of the price they would be willing to pay for each individual asset, not just the portfolio as a whole. That way the seller can analyse if it will get the best price selling the portfolio whole, or breaking it up and selling smaller portfolios to individual buyers who may put a higher price on some assets than their peers. There is already some real-life evidence transparency in this type of sale will bring in more money — auctions designed by Milgrom and Wilson of broadband, 3G and 4G spectrums allowed governments in the U.S. and UK to recoup tens of billions of dollars for assets they used to essentially give away for free.

Why has the commercial real estate investment market not embraced change? For Auterac, it is about keeping the sector a closed shop, for various reasons.

“Previously, you had a small number of brokers and institutions that controlled the market, and you knew that if you sold to someone, they would complete the transaction,” he said. “Then you had a whole raft of new investors come in, and that relationship starts to break down.”

How can we get to a more transparent system? Regulation and technology may be the answer.

“Real estate typically runs a mile when you mention regulation, but I think it would benefit from being a regulated marketplace,” Richardson said. “In equities and bonds there are different levels of disclosure, but essentially it is regulated as to what you need to disclose, and that isn’t the case in real estate.”

On the technology side, a lot of people are still trying to work out how blockchain might play a role in real estate, but a permanent ledger of every aspect of a piece of real estate could provide buyers the kind of transparency and disclosure that would allow them to make an informed decision on pricing. Auterac also pointed out that something as simple as standardised leases would remove some of the idiosyncrasies that surround real estate assets, and would make them easier to underwrite.

Technology can also provide a more transparent bidding platform.

“The industry could definitely benefit from having more of an automated system that would allow you to see what bid prices are coming in from other bidders,” Webster said. “Not who they are, but the pricing.”

Auterac believes if real estate is to ever become more than a niche asset class, the sales process needs a significant overhaul.

“If you are serious about being a major part of the financial markets, then you need that greater transparency,” he said. “It may not happen overnight, but it will have to change.”

*Contact Mike Phillips at mike.phillips@bisnow.com (mailto:mike.phillips@bisnow.com)*

See Also: Owners On This 270-Yard Stretch Of London Road Look For £1.4B Of Debt (/london/news/office/owners-on-this-270-yard-stretch-of-london-road-look-for-14b-of-debt-106360)

Related Topics: Nobel Prize (https://www.bisnow.com/tags/nobel-prize), real estate auctions (https://www.bisnow.com/tags/real-estate-auctions), Commercial Property Auctions (https://www.bisnow.com/tags/commercial-property-auctions), Matthew Richardson (https://www.bisnow.com/tags/matthew-richardson), Acuitus (https://www.bisnow.com/tags/acuitus), Income Analytics (https://www.bisnow.com/tags/income-analytics), Soller Capital Management