

*The following material is based on a portion of the second edition of the text, **SOLD! A Professional's Guide to Real Estate Auctions**, (Copyright Stephen J. Martin and Thomas E. Battle, III, All Rights Reserved.) AuthorHouse.*

This material is provided to show how the client might look at auction marketing. It is important for you to have an appreciation for how the client views the industry and what thought-process is used in deciding to auction property.

ALTERNATIVE MARKETING SOURCES: UTILIZING THE AUCTION METHOD

Determining how best to assist a client in the reallocation of real estate assets requires some analysis of the property and the reasons for its sale. The real estate professional will ask a series of questions to determine how best to help the client. You will ask questions such as:

- How can I arrange a transaction that will provide the highest return to my client?
- How can I insure that my Clients property will receive the most attention in the market place?
- How can I arrange for the most expedient sale possible, while still controlling all the elements of negotiation except price?

The answer to these and other questions about how to service your clients real estate needs may be found in an alternative marketing method. This chapter discusses the use of one such alternative in detail, the auction method of marketing. In today's real estate market property owners often have a need for fast and efficient sale of their real estate assets. Real estate investors are placing more emphasis than ever before on the need for careful analysis of the true cost of holding and marketing property. With ever increasing frequency, smart real estate professionals are turning to a long-standing marketing alternative, the auction alternative. The nature of the real estate market requires quick, but commercially feasible action for both buyers and sellers. This atmosphere has fostered dramatic growth of the auction method of marketing as the preferred method of marketing or reallocating assets in many situations.

The auction method of marketing is now being used more frequently and we need to understand this dynamic part of the real estate industry since it will play an ever-increasing role in the marketing of real property assets.

The Auction Industry

To better understand this fast growing marketing concept we must first review some recent history, which shows the growth of the auction industry.

In 1980 over \$50 billion of real and personal assets were sold utilizing the auction method of marketing. Real property made up \$10 billion of this amount. By the end of 2009 it is estimated that over \$210 billion of assets will be selling annually utilizing the auction method including over \$95 billion of real property. The auction industry in this country consists of approximately 35,000 full time auctioneers with an estimated 24,000

selling real estate. Approximately 1,000 firms specialize in real estate and market over 70% of all real estate sold at auction in the United States.

The introduction of new techniques, computer technology and national referral systems has allowed the rapid growth of this element of the real estate industry. The auctioneers themselves have grown professionally over the last twenty years through the expansion of licensure, education, and specialization.

The Auction Marketing Institute (AMI) and the National Auctioneers Association have had a tremendous impact on the industry. The AMI Standards of Professional Practice and its certification programs have created new levels of auction marketing expertise in those who have earned their CAI designations. They have also developed certification programs for real estate professionals to gain knowledge regarding the auction alternative in Estate Marketing Specialization, Real estate and Auction Practice Administration.

Perhaps the most dramatic impact is due to the specialization of auction marketing firms. Real estate auction marketing firms have developed specific marketing techniques for categories of real property. For example, by specializing in real estate the firms have developed certain types of expertise that is required to market real estate at auction. Others have specializations in personal property.

Why select the Auction Alternative?

As a real estate professional your job is to provide your clients and customers with the best service possible. Many times that will mean utilizing alternative marketing methods to sell property.

Today's economy requires the timely marketing of a property before any of its equity value erodes. The on-going costs associated with holding the property during the marketing period of a typical negotiated sale may be extensive and can significantly reduce the actual return to the seller. Such items as mortgage Interest, taxes, insurance, maintenance, security, management fees and promotional expenses can all add up to a significant expense. We refer to such expenses as "holding costs" and owners are faced with such costs until the transfer of the property occurs. In some instances involving large properties holding costs can extend to over 20% of the value of the property in each year. With the concern for financial security and high return, property owners are reviewing these expenses closer than ever before.

Types Of Auctions

When is an auction an auction? That can be a difficult question to answer since there are different forms of auctions used to sell real estate. There are auctions that take place in the open or what are referred to as "public auctions" which allow for open and competitive bidding on the part of interested parties.

Attorneys, banks and trustees sometimes use "Sealed bid" auctions, which provide no opportunity for open competitive bidding, to sell property. Occasionally, an accelerated marketing firm might also use this process at the direction of their client.

By far the most common form of auction used in real estate is the public auction. There are three basic types of public auctions, which you, as a real estate professional, can employ to market your client's property. They are:

1) An auction "with reserve" which is when the seller reserves the right to establish a minimum opening bid, to accept or reject any and all bids, and even to withdraw the property at any time prior to the completion of the auction event. The Uniform Commercial Code, which controls the manner in which property being sold at auction may be advertised, indicates that an auction is "with reserve" unless otherwise stated. This provides the seller with total control over the sale, but may not be attractive to prospective buyers, the bidders, since they can not determine if the owner is really serious about selling the property. Even if the minimum bid is not reached, the auction may not have failed since it identified prospects for the property who may then be convinced to purchase the property through the negotiated sale method.

2) An "absolute auction" is one that is offered at auction without a reserve price. In an absolute auction the property will be sold, regardless of price, to the highest bidder. There is no minimum price determined before the property is offered. Under the Uniform Commercial Code, the seller may not withdraw the property after the opening bid has been received by the auctioneer on behalf of the seller, the property will be sold! This form of auction is very exciting for bidders and causes the best reaction in the market place since it creates the highest amount of interest in the property. Absolute auctions can bring higher prices than the property may have been sold for utilizing the private treaty method of marketing.

3) The "absolute auction with minimum opening bid" can allow the best of both the above, if used correctly and if it is allowed in your state. In this situation the seller sets a stated minimum opening bid, which is low enough to attract interest, but sets a floor on which to establish competitive bidding. In this type of auction the seller may not withdraw the property once the opening minimum bid has been reached, but can do so before the auctioneer has received such a bid. The advantage of this method lies in the seller's ability to set an opening bid, establishing that the property will sell once it has reached this realistic starting point. Auction marketing professionals usually recommend an opening minimum bid of no more than 40% of the anticipated market value of the property.

This method is used in situations where the seller is uncertain with the market reaction to the property. In some states the use of this hybrid method is not allowed due to a concern that the consuming public will not understand this form of auction marketing.

When To Use The Auction Method

Now that you have a basic understanding of the types of auctions that can be used to sell real estate, let's look at when to use this method of marketing.

The auction method of marketing is not right for every situation or property. The auction

method may be ideal for a highly desirable property with significant market potential. Such properties typically generate a number of potential buyers by any means, but a well-organized auction marketing program can generate significant market results in a short period of time. This is important due to the holding costs "discussed earlier in this chapter. In situations where the property to be sold has strong market recognition the auction method will attract the largest number of bidders who, because they know they have to make their decision on a given day, will attend and bid on the property. For example, some real estate developers have come to the realization that they can sell entire subdivisions on the very first day they are offered to the public rather than utilizing a lottery for interested parties to "win " the opportunity to pay the asking price for the lots or models being sold. The market determines the price and properties that are interesting to the market will bring top prices.

Second are facilities built for a special purpose. Properties of this type are usually hard to market utilizing the negotiated sale method. Many times the auction marketing professional, utilizing a target marketing plan, can facilitate the sale of these properties in a timely manner. Providing the seller with reduced carrying costs, by marketing the property quickly, is the prime reason for selling special built properties at auction. School buildings, post offices and industrial buildings frequently are sold at auction after a concentrated marketing campaign.

The third type of property situation, which may be suitable for auction marketing is agricultural property. For many years the auction method of marketing has been the main form of marketing farms, ranches and orchards. The auction method of marketing can usually accomplish this in as little as 60 days from the signing of the marketing agreement to the date of closing. Obviously, this can be a major advantage for the seller who wishes to sell such a property prior to the next planting season.

The fourth situation which lends itself to auction marketing involves the sale of both real and personal property. Situations involving closed industrial plants or commercial facilities with equipment, furniture and fixtures to sell. In this situation marketing the real property and the personal property together at auction makes a great deal of sense. The amount of exposure that the auction marketing campaign can provide both types of property will increase the likelihood of a good overall return to the seller. In addition, the ultimate buyer may have a need for both the equipment and the facility if there is an interest in operating the facility as an on-going business.

The combined sale of real and personal property at auction can also occur in residential situations. Many times an attorney representing an estate will need to sell the total assets of the client. A public auction of the home and its contents can provide an economical and speedy solution to the distribution of assets involved. It also provides a public record of what happened to the assets, the price paid and proof that there was competitive bidding for the goods sold.

Auctions are also ideal for situations requiring the public reallocation of assets. Many times a board or court ordered situation either requires or recommends the use of the

auction method to assure the openness of the transaction. A properly promoted public auction assures those involved that the transaction has been conducted in an open manner with all parties treated equally.

Advantages Of The Auction Method Of Marketing

As mentioned earlier, one of the prime reasons for utilizing the auction method of marketing is the speed of sale and closing. This method of marketing significantly reduces the holding costs associated with the property to be sold. The auction method of marketing also places the seller in control of the transaction. The seller establishes all the terms of the sale with the exception of the sales price. The date, time and place of the sale are all determined in advance. Many times even the date of the closing is determined prior to the sale taking place!

The auction method of marketing focuses full market attention on the property to be sold. This focus, on the subject property, allows for greater exposure to take place because marketing funds are expended in a condensed period of time. Many times the amount of funds expended on an auction marketing campaign will far exceed that allocated to a traditional negotiated sale. This focus also helps to eliminate the procrastination factor from potential buyers. It is a call to action for any interested bidder!

Studies have shown that buyers feel more comfortable, in competitive bidding situations, if they know they are among other legitimate bidders at an auction. In such situations potential buyers will participate in the auction bidding process with confidence. They feel that other bidders involved in the competitive bidding process confirm their judgment, as to the value of the property.

A well conducted auction marketing plan will create a situation which determines the "market value" on the day of sale through the competitive bidding process. The value determined at a well-organized and promoted auction will be the value of that particular property on that given day. Arguments can be made that such sales do not qualify as having determined market value. But if you look at the process you will see that it is what the market was willing to pay on that particular day. This is being proven at auctions through out the country every business day of the year.

An ancillary advantage of the auction method is that it can identify all the parties even potentially interested in acquiring the asset. Even an unsuccessful auction can lead to a successful sale through negotiation with the parties who indicated an interest while attending the auction.

How Can You Benefit From The Auction Method?

While the auction method of marketing will not be the ideal approach for every property it does present an ideal alternative tool to be used with situations that are suitable. The success of marketing properties quickly and efficiently will provide considerable goodwill with clients. The auction promotion provides the brokerage firm with considerable exposure at no, or very little expense to the firm. Such exposure can lead to new listing opportunities for the brokerage firm.

This marketing method also opens avenues for generation of commission revenues for brokers. Some of the opportunities include:

- 1) Co-op commissions for registering clients as bidders at the auction. Most auction firms have fee splitting arrangements with brokers who pre-register successful bidders and attend the auctions with their clients.
- 2) Referral situations occur in many real estate transactions, auction situations are no different. The broker who assists in obtaining an auction is normally entitled to a portion of the commission generated.
- 3) Joint venture relationships are common between brokerage firms and firms specializing in auction marketing. The parties determine what functions each will perform and establish their own policies as to when the auction method will be utilized. Some of these arrangements have been so successful that mergers have occurred between the joint venture partners.

Commercial Clients Interest In Auctions

One of the major reasons for the rapid expansion of the auction method of marketing is due to the increase in merger and acquisition activity in the last decade. Auctions were used successfully to both prevent and facilitate merger and acquisition activity by reallocating assets of companies. In the case of a takeover defense assets were sold quickly to raise cash from equity in existing facilities. In other cases assets were and are being sold to retire debt associated with the acquisition, which took place. In both situations sale-leaseback arrangements are common where the asset was critical to the on-going operations.

As a financial management tool, the auction method is used as an alternative in long term fixed asset reallocation through the sale for cash of fully depreciated assets. The auction method is also used in distress situations such as estate or partnership dissolutions. Auctions are also utilized to reallocate the assets of companies in bankruptcy.

Analysis Of Auction Opportunities

To determine the feasibility of the use of the auction method of marketing you should follow a simple analytical process similar to the one found in the chart given below. A number of questions need to be asked in this process relating to the market place, its acceptance of the auction method, the availability of the type of property to be sold, the need to sell and the speed at which a sale must be accomplished.

After this initial analysis is completed and a decision to reallocate the asset has been made the broker must analyze the following:

- 1) Compare the estimated sale price from the negotiated method with the estimated sales price achieved at auction.
- 2) Determine the holding period required for both methods of marketing through the date of closing.

- 3) Determine the aggregate holding and marketing costs for the holding periods determined above.
- 4) Estimate the net proceeds from each alternative. At this point a time value of money analysis will allow the broker to determine the best financial return to the client.

This analysis is then used in conjunction with the earlier list to determine the true feasibility of the marketing method to be selected.

What Next?

If the auction method of marketing is selected as the appropriate course of action it is necessary to select the right auction marketing firm. This selection is critical to the success of the sale. Selection should be done by obtaining proposals for auction services from multiple companies. The evaluation of several such proposals will provide information on the auction marketing firm to select for the project. Investors and titleholders should consider hiring a professional firm such as The GWENT Group, Inc. to guide them through the auction marketing path. In many cases, this additional assistance can be acquired at no additional cost to the property owner.

SUMMARY

In summary, auctions have grown in acceptance throughout the real estate market as an efficient and cost effective means of reallocating assets. It provides a viable alternative to the negotiated sale method of marketing real property. It is a marketing tool that works well in both good and bad economic situations. Brokers who consider themselves as progressive and leaders of the industry will be learning all they can about the auction alternative as an additional marketing tool with which to represent their clients.