

The Auction Process and Commercial Real Estate



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By John Haney

The real estate market has changed considerably in the past year. The residential market saw it first, and now the commercial and industrial markets are well into a market that is spiraling downward. For those of us who are in the business of marketing real estate, we realize that as the landscape changes around us, we must change and evolve with it.

Now more than ever, alternative sales strategies are essential for brokers. One alternative strategy that should be on the list is the auction.

The auction is one of the oldest methods of marketing. Its roots trace all the way back to the ancient Roman Empire. In more recent times, auctions have been used to sell everything from fine art to classic cars to real estate.

Auctions work off of a simple premise: They determine the true market value of an asset today, based on the terms and conditions of the sale.

There are two main types of auctions:

- **Reserve Auction** – The seller typically has the right to set a minimum selling price for the property. In other words, the seller has the right to accept or reject the high bid.
- **Absolute Auction** – The property will be sold to the last and highest bidder, regardless of price, with no minimum or reserve bid.

Each method has unique benefits. The major benefit of the reserve auction is that it allows the seller to “protect” the property if the bidding does not meet or exceed expectations. The absolute auction benefits from drawing the most excitement and urgency from the market. If potential buyers in a market know that the property will be sold at whatever the market will bear, then more potential buyers will attend the auction and bid on the property.

One of the questions that real estate brokers ask me most often is “How does my client benefit from an auction?” There are five main benefits to the client.

Auctions Create a Competitive Marketplace

The auction method of marketing creates a form of competition that cannot be duplicated by traditional methods. The market value of the property is reinforced by each bid. This affirmation of value encourages other participants to continue bidding. Within all of us is a tremendous need to win, and the auction process creates an atmosphere of competition that is unique.

The auction brings all interested parties to one place at the same time for a single purpose: to determine who will pay the most for the property. At that point, another benefit of the auction process comes into play: All interested parties are concentrated on making a decision. Getting an interested person to act can be the most difficult thing for a broker to do, especially in the current market. The auction method takes that obstacle out of the equation.

In this age of instant gratification, the auction method provides an almost immediate forum for both the buyer and seller to conduct business.

Auctions Maintain Control

The timing of the sale and the terms of the auction are established by the seller. The buyers are bidding based on a common set of terms and conditions. In effect, the seller controls the form of the sale, and the buyers determine the value of the property based on those terms.

This is perhaps one of the top benefits to our industrial clients. Many times, they are only willing to

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convey surplus real estate under certain conditions and restrictions. For instance, the industrial seller may wish to restrict the future use of the property, and certain environmental indemnifications may be necessary. For an auction, the seller’s counsel can create a uniform purchase and sale agreement that will be provided to bidders. The bidders, in turn, can review the document ahead of the auction and bid accordingly. The buyer will purchase the property knowing any and all restrictions on it.

Provide Immediate Results

Auctions allow the seller to determine the date of the auction and the closing. The seller can then plan how to best use the proceeds of the sale. Will it be reinvested into a new venture or held over into the next fiscal year? The seller has complete control of the timing. Many of the Fortune 500 companies with which we work have

realize the potential here. By being able to set definite timelines for disposing of surplus property, funds from the sale of real estate can be used in long-term planning.

Recently, we sold 27 properties for a regional supermarket chain. The properties ranged from retail pad sites to development tracts to big box stores. The chain had embarked on an ambitious program of replacing older stores with new ones and reducing its overall real estate holdings. Part of the chain's new plan also called for refreshing many of its existing locations. It auctioned off the 27 sites in order to fund the refreshing program.

The chain wanted to sell the assets as late in the calendar year as possible and still close before January 1st. The auction was held on November 15th and the terms of the auction called for a 45-day closing. At the auction, the properties brought a total of \$12 million, and all deals were closed by December 30th. The proceeds from the auction were used to start the refreshing campaign at the beginning of the year. In this case, the management converted nonperforming assets into liquid cash to fund a new venture and accomplished it on the most ideal of timelines. In the traditional market, it may have taken two to three years to successfully sell and close all of these properties.

Another important consideration is the time value of money. This principle holds that a dollar received today is worth more than the same dollar

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to be received at a later date. The auction method quickly provides liquid capital that can be used immediately for other goals. The traditional sales method has little ability to capitalize on this principle. While real estate may never be as liquid as stocks or securities, the auction method increases liquidity significantly.

The auction can increase cash flow in two ways. First, the holding cost of the property is eliminated. The auction will terminate expenditures such as interest, taxes, and maintenance. Second, there is the cost of lost opportunities. It is important to consider the investments that can be lost while your equity is tied up in unproductive properties.

Include a Tailored Promotion Package

One of the strongest advantages of the auction method is a promotion that is specifically created for the property. The advertising campaign will normally include print media advertising, Internet advertising, signs, custom-printed brochures, e-mail blasts, direct mail, and telemarketing.

An intensive advertising campaign in the weeks leading up to the sale notifies the potential bidders of the upcoming auction and also excites and motivates the potential bidders to participate in the process.

Most auction companies will also provide a due diligence package that provides the bidders with all of the most requested information on the property.

This can include taxes, zoning, utilities, environmental reports, surveys, title commitments, and, perhaps most importantly, the purchase and sale agreement that will be executed on auction day. The importance of the due diligence package cannot be stressed too much. It is important to remove as many unknowns as possible about the property so that bidders

can make an informed purchase decision at the auction. Bidders who are bidding with confidence are also likely to bid higher.

Create Motivational Excitement

Auctioneers use their experience and expertise to create excitement and motivation at a public auction.

Professionally trained auction ring persons apply continuous motivational pressure on the buyers to gain every dollar possible. This sense of excitement works to create the psychology of impending sale, which is so critical to the success of an auction.

It is the interaction of these five components coupled with a well-trained, seasoned auction team, that make an auction one of today's most successful methods of marketing real estate.

The commercial and industrial broker must have the right tools. Knowing what strategy will best fit your clients' needs and when to implement an alternative sales strategy can make the difference between success and failure. 