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LET THE BIDDING BEGIN: AMERICA FOR SALE- REAL ESTATE AUCTIONS

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I. Introduction:

You get a call from a client. The client owns or has a security interest in real property. The client may be a builder, developer, lender, lien claimant or even a bankruptcy trustee. The client's goal is to dispose of the real estate asset they own or use as collateral in a way that provides the highest value. The real estate auction with proper marketing support may be the most effective way to achieve your client's goals.

In Part I this article considers the growth in use of real estate auctions, making it the "trend" and an increasingly preferred method for marketing all types of real estate. Part II provides a description of the asset types that are suitable for auction sales; the typical reasons that underlay the decision to use an auction; the characterization of sellers who benefit most from choosing an auction; and two published business case studies providing a glimpse of the auction method in the context of real life situations. Part III of this article is a primer on the auction process. This section provides the basic terminology and describes the steps taken in a real estate auction. Part IV considers the role of the Seller's attorney as part of the strategic auction team. A review of the seller's attorney's role in drafting/reviewing both the listing agreement and the real estate sales contract and in dealing with closing and post closing issues provides a practical guide to this role.

GROWTH IN USE OF AUCTIONS TO MARKET REAL PROPERTY

Auctions are increasingly becoming the preferred method for selling real estate in the United States[1] and the U.S. may one day follow the lead of Australia and New Zealand where virtually

[1] See, Steven L. Good and Celeste M. Hammond, *Real Estate Auctions- Legal Concerns for An Increasingly Preferred Method of Selling Real Property*, 40 Real Prop. Prob. & Tr. J. 765 (2006) for analysis of legal concerns about using an auction to market real estate.

all residential real estate sales to individuals are by auction. [2] The National Association of Realtors (NAR) estimates that thirty percent of all real estate will be sold through auctions by 2010.[3] One sees the increasing use of auctions in statistics that indicate that between 2003 and 2006 auction sales of residential real estate increased by 39.2%; auction sales of vacant land and agricultural real estate increased by 33%; and auction sales of commercial and industrial real estate increased by 27.4%. [4]

The private auction of non-distressed real estate discussed in this article is to be distinguished from the forced sale in foreclosure. In an auction sale, the contract with the successful bidder does not need to provide for payment of all cash on the day of sale. Financing may be available, even from the auctioneer! [5] In contrast, at a foreclosure auction, sometimes called a "public auction", the successful bidder is likely to be the foreclosing lender which bids the amount due on the mortgage. The main purpose of the foreclosure is to extinguish the mortgagor's rights. [6]In contrast, a non-distress auction attracts a group of serious, qualified bidders and it may yield a price that is higher than what seller could get in a traditional sale through a broker.[7] This better result is due to the expansive marketing of a good auctioneer.

THE "AUCTION ADVANTAGE"

As counselor your role is to assure optimum monetization of the assets.[8] The costs of accomplishing the sale are a concern but a comprehensive view of costs may value positively the relatively short period before an auction sale which can offset management costs or a declining market. [9] The typical length of time to market by auction is six to eight weeks. Thus, seller's obligation to pay taxes, insurance, interest on debt secured on the real estate, security, and repairs is time limited. The owner may save three to six months of such costs by using the auction. [10] This may be especially important when the real estate is not being used by the seller or producing income. [11]

However seller's attorney needs to understand the auction process to provide the client with advice and to participate in formulating the strategy once the decision to use the auction has been made.

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[2] Id., fn. 7 citing Christopher J. Mayer, *Assessing Performance of Real Estate Auctions*, 26 REAL ESTATE ECON.41,42 (1998).

[3] *See*, Harold D. Hunt, *Going Once, Going Twice, Sold*!, TIERRA GRANDE, July 2002, available at http://recenter.tamu.edu/pdf/1565.pdf (last visited June 17, 2008).

[4] Steven L. Good, "Real Estate Auction Industry Overview," prepared for ABA Section of Real Property Probate & Trust Law, April 27, 2007, Washington D.C. Power point on file with author.

[5] Anthony Fitzgerald, *Real Estate Auctions Popular with Both Sellers and Bargain Hunters*, 25-7 ABIJ 16 (September 2006).

[6] *See*, Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Non Judicial Foreclosure Act*, 53 DUKE L.J. 1399 (2004). The authors discuss the inadequacies of the auctions held pursuant to foreclosure; these include the inadequacy of the successful bid as compared with fair market value.

[7] *See*, Fitzgerald, *supra* note 5.

[8] *Id.*

[9] *See*, Nelson & Whitman, *supra*, note 6 at 1416.

[10] *See*, Fitzgerald, *supra* note 5.

[11] *See*, Nelson & Whitman, *supra* note 6 at 1416-17.

II. Variety of Real Estate Assets to Be Sold Using the Auction Method

A. Properties suitable for real estate auctions

All categories of real property can be effectively sold by the auction method. User properties, including industrial, commercial and office, may come up for sale as surplus property of a corporation. Investor properties including apartment buildings and rental housing, shopping centers, and net leased commercial properties may lend themselves to sale by auction. In the residential category, houses, condominiums, townhouses, and trophy estates have all been sold successfully at auction. [12] Because the auction can be structured to meet the requirements of the seller, auctions can benefit from a creative approach. Thus, portfolios of surplus properties owned by a corporation[13] or portfolios of developer properties consisting of units in various stages of development[14] can be sold by auction very effectively, especially when combined with the bidding in the alternative feature. [15]

B. Reasons underlying the use of auctions

1. Property not easily valued

Properties that are not easily valued or that are difficult to appraise benefit from an auction sale. The auction by its nature sets a deadline and a date certain for valuation. [16] Reasons why properties may fall into this category include: market volatility, economic business cycles, rising cost of financing, supply and demand of the property type or a combination of these factors.[17]Properties in overbuilt markets may be suitable for an auction because these properties can be showcased through the extensive marketing which a good auction company provides. Even for properties offered in a soft market, an auction may be advisable. Moreover, because the seller can insist on a minimum bid, include a secret reserve amount that must be attained before the bid is binding on seller and even cancel the auction, sellers have more control of their destinies by using an auction. Sellers and their attorneys should realize that whatever the auction type, a seller has a right to withdraw the property or cancel the auction any time prior to the bidding. [18]

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[12] See, e.g., Good, supra note 4 (list of the types of properties commonly sold at auction).
[13] See, *infra* discussion text II D 1 (Alcoa and Newell-Rubbermaid auctions).
[14] See, *infra* discussion text II D (United Homes Portfolio auction).
[15] See, *infra* discussion text II B 4.
[16] *See*, Hunt, *supra*, note 3; Steven L. Good & Margot B. Weinstein, *The Auction Advantage: Innovative Corporate Real Estate Portfolio Sales*, CORP. REAL EST.LEADER, Mar. 2005 at 54-58.
[17] *Id.*; see also, Good & Hammond, supra note 1 at 770.
[18] *See*, Good & Hammond, *supra* note 1 at 783. This cancellation right in the seller should also be appreciated by bidders/buyers and their attorneys. Yet, at least one court has ruled in favor of purchaser and auctioneer and against seller, holding that "this withdrawal of authority must be clear and unequivocal." *Kinmon v. J.P.King Auction Co.*, 276 So.2d 569, 570 (Ala. 1973).

2. Seller wants to control timeline

The auction occurs on a certain date of sale, in contrast with the traditional broker facilitated sale in which the seller waits for an offer. Controlling the actual date of the sale may be important to a seller for income tax planning purposes or for meeting other deadlines.[19] In fact anytime when 'time is of the essence' an auction should be considered. [20] The aggressive, intensive marketing done by an experienced auctioneer should indicate to the seller before the auction date the identity of the likely bidders and whether it may be advantageous to delay the auction for a better market or to negotiate a sale directly with one of the registered bidders rather than to actually conduct the auction.

The auction seeks to bring serious buyers who prefer the focus an auction requires. Because the time frame for the auction sale is shorter, usually within 90 days of seller's entering into the contract with the auctioneer, than for a traditional market sale, properties with high carrying costs (debt service, maintenance expense, property taxes, utilities and insurance) are suitable for sale by auction. Finally, unique or extremely expensive properties lend themselves to the auction method because such properties take longest to sell.[21] By using an auction, the seller determines the timing of the sale. If the auctioneer does not find a market of bidders, the seller can cancel the sale up until the moment when the bidding begins.

3. Seller needs release from traditional liability/needs appropriate buyers

If the seller requires release from environmental, structural or other liability because of the condition of the property or a special role of the owner, the ability to sell without any warranty, "as is, where is" may make a sale by auction preferable to a regularly conducted sale.[22] The qualification and pre registration of bidders by the auctioneer insures that serious capable bidders participate in the auction. Typically, the bidder must bring in a certified check for at least 10% of the bid. And, normally seller pays no commission because of the "buyer's premium" which requires the buyer to pay 4-8% of the successful bid.[23]

4. Bidding in the Alternative is desired

The auction process allows for bidding of the parts as compared with bidding of the whole. Good & Wolff present an example in their article on using auctions for sale of real estate assets owned by fiduciaries. "…[A]ssume a vacant 450 acre land parcel located in a very desirable suburb comes up for sale. If it is marketed conventionally, the fiduciary is required to deal with buyers as they present themselves. Often times any given buyer may want only 10 or 20 acres at a given time putting the fiduciary in the precarious position of having to decide whether to split the property up and sell it piecemeal, not knowing how the sale of the smaller parcels will ultimately effect the value of the entire property. In an auction setting, the property can be

[19] *See*, Good & Hammond, *supra* note 1 at 770.
[20] *See*, Fitzgerald, *supra* note 5 listing circumstances where having to meet a deadline may make the auction approach advantageous: "probate sales, trust, bankruptcy, divorce, inheritance, and partnership dissolution sales."
[21] *See*, Hunt, *supra* note 3.
[22] *See*, Fitzgerald, *supra* note 5.
[23] Id.

divided in advance of the auction and buyers can be given the choice to bid on any offered sub-parcel, any group or combination of sub-parcels or on the property as a whole. [24]

5. Portfolio of properties to be sold simultaneously

Sellers who own multiple properties can structure the auction sale to market all of the properties at once and yet set up bidding so that the seller can evaluate the range of offers for individual properties and compare them with the bids for the entire portfolio. Examples of suitable portfolios include surplus properties owned by a corporation[25] and unsold developed properties owned by a residential builder. [26] By requiring bids to be irrevocable for a set period of time, typically seven business days following the last property's bidding this objective can be achieved.[27] This goal is not achievable by conventional marketing because sellers must respond to buyers for individual properties or the entire portfolio on the buyer's time schedule. This "lack of context in knowing where the entire portfolio of properties stands in the marketplace" [28] is the basis for an unfavorable comparison between conventional marketing and auction marketing of portfolios. Additionally, the marketing costs can be spread among the multiple properties. A single auction may include a single owner of multiple properties in one geographic area or in different locations. Such an auction may even be of multiple owners. One of the main advantages of the auction method when a skilled real estate auctioneer is involved is having the auctioneer recommend the best format for selling such properties.

A related approach is the "bidder's choice" strategy which can be used effectively in the auction of a portfolio of real estate properties. It encourages the bidder to bid up to its limit in each round of bidding to protect selection of their most preferred properties.[29]

C. Special types of sellers

1. Fiduciaries

There are advantages to fiduciaries who sell real estate through auctions.[30] The Uniform Prudent Investor Act or similar rules affect fiduciaries, requiring diversification among others that may

[24] Steven L. Good & Wallace J. Wolff, *Real Estate Auctions: A Prudent Disposition Strategy for Fiduciaries Owning Real Estate*, ABA TR. & INVESTMENTS, Nov./Dec. 2005, at 40.
[25] See, Margot B. Weinstein & Steven L. Good, *A Multi Case Portfolio Analysis of Alcoa & Newell Rubbermaid: Exploring the Use of Auctions to Sell Two Significant Portfolios of Non-distressed Properties*, presented at American Real Estate Society (ARES) conference Santa Fe, New Mexico, April 2005.
[26] See, Margot B. Weinstein & Steven L. Good, *Auctioning the United Homes Portfolio: A Case Study*, presented at American Real Estate Society (ARES) conference Florida 2006 (paper on file with the author); See, e.g. Steven L. Good & Alan R. Kravets, *Representing Sellers In Residential Real Estate Auctions*, Vol. 9 The Compleat Lawyer 43 (1992) (discusses the North Fork Bank auction of 90 properties, spanning a 70 mile radius in a single auction. Properties included single family homes, individual sites for developing luxury homes on lots costing up to $375,000 plus 50+ subdivision home sites suitable for tract housing. "Virtually the entire portfolio sold at auction for just under $6 million in 55 days.").
[27] *See*, Good & Hammond, *supra* note 1 at 771.
[28] Good & Weinstein, *supra* note 14, make this observation about the limitations of regular sales for portfolios as compared with auctions.
[29] See, *infra* text II D 2 discussion, *Bidder's Choice Cap Rate Auctions: A New Strategy for Selling Real Estate Portfolios.*

persuade a trustee, executor or other fiduciary to sell a real estate asset. The traditional method of selling real estate has drawbacks, especially for hard to value properties. Using an auction meets the requirement of arm's length transaction even when one or more of the beneficiaries is interested in buying the real estate. [31]

Other advantages of using the auction to sell real estate owned by a fiduciary include that the seller structures the transaction that it wants and the market of bidders reacts (or not). This avoids getting an offer with unacceptable contingencies such as the condition of the property. Also, the auction process permits bidding in the alternative [32]

All of these characteristics of the auction are likely to enhance the final price, the goal of the auction process. A report of an owner who had resisted selling his real estate for years, in spite of brokers' trying to get a listing is published in the American Bankruptcy Institute Journal. [33] After the death of that owner, the trustee of his trust received several offers of $2.9 million. Yet, the absolute auction that was held yielded $3.5 million, or 21% more than the offers under the conventional process!

2. Debtors in bankruptcy

For debtors in bankruptcy owning real estate assets for which there are secured creditors, an auction may be much preferred to lifting the stay and allowing a forced sale in a foreclosure action. The amount available to the secured, as well as unsecured creditors, in the bankruptcy is likely to be greater than through a foreclosure sale.[34] This higher price is due to differences between the two types of sales. The marketing to attract bidders to the auction is very different from the limited audience legal notices of a foreclosure sale. The key of the successful auction is in getting good attendance at the auction. In the foreclosure situation, the only bidder is likely to be the lender. Moreover, in the auction, financing may be available for the successful bidder. In fact, the closing may be delayed 30 days to permit the buyer to obtain such financing.

The *legal* case study which the author is developing with the assistance of Steven L. Good and Margot B. Weinstein demonstrates how the auction can be an effective method for selling such bankruptcy assets – a large portfolio owned by United Homes, a residential developer. It consisted of 320 properties evenly distributed around suburban Chicago, Scottsdale and suburban Grand Rapids, Michigan.[35] Barry Chatz, attorney for the unsecured creditor committee, concluded "We were looking to maximize the prices for the properties offered and reach their ultimate markets in a short term timeframe by reaching all of the potential buyers and given the fact that the ULI portfolio contained a large amount of properties, and that many of these properties were located in markets that people were interested in buying properties, we did just that." [36]

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[30] For excellent discussion, see Good & Wolff, *supra* note 22.
[31] See, e.g., John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?* 114 Yale L.J. 929, 953 (2005).
[32] See *supra* text II B 4 for discussion.
[33] See, Fitzgerald *supra* note 5.
[34] Id.
[35] See, Weinstein & Good, *supra* note 26 (A parallel business case study on the same facts).
[36] Id.

Most buyers at residential auctions are those who plan on occupying the houses themselves. As consumers they are afforded consumer protections such as rights to rescind, protection of required disclosures, etc. The experience is that auctions mirror the market for the properties involved. The process merely is speeded up because of the perceived urgency the auction creates.

D. Case Studies of Real Estate Auctions Provide Real Life Contexts for Understanding the Auction Advantage

Business case studies of a variety of real estate auctions have been written up by teams made up of real estate professors and players in the auction industry.[37] Since 1925 when the Harvard Business School began to publish them, business case studies of actual business situations have been widely used by business schools to provide students with a context in which to learn basic business principles. In some ways the business case study parallels the use of the ubiquitous 'hypothetical' in law school classrooms. However case studies may be more effective than hypotheticals because they involve real life, often well known, scenarios or stories in which the players have faced issues that require resolution, providing students with a chance to test their book learning and to provide advice to their clients or customers.

Legal case studies for law school courses in real estate transactions seem like a possible next step in the development of teaching materials. The author is writing her first legal case study about a private real estate auction of non-distressed real property: United Homes Portfolio. Joining her in this project are Steven L. Good and Dr. Margot B. Weinstein who developed the business case study upon which the legal case study in based. The auction of the United Homes real estate portfolio arose out of a Chapter 11 bankruptcy of the residential real estate developer/debtor. The business/economic facts in the business case study provide the backdrop for the bankruptcy and the auction sale of the real estate assets under Section 363 of the Bankruptcy Code. Interviews with Richard Lauter of Freeborn & Peters (attorney for debtor); Barry Chatz of Arnstein & Lehr, LLP (attorney for the Unsecured Creditor Committee); and Ronald Barliant of Goldberg Kohn Bell Black Rosenbloom & Moritz Ltd. (formerly the Bankruptcy Judge who supervised the case of United Homes) provide a unique view of those involved from the law side of the auction. Appending the bankruptcy court docket to the legal case study will make it into appropriate materials both for advanced real estate transactions and for bankruptcy courses. It responds to the new goals of legal education to bridge the gap between law school and practice.[38]

Two business case studies

1. Surplus corporate real estate

[37] *See, e.g*. Marcus T. Allen, *Auctioning the Lazy H Ranch: A Case Study* Vol. 6 J. of Real Estate Practice and Education No.2 p. 269 (2003);, Margot B. Weinstein, Steven L. Good, Kenneth L. Stanley & Mark H. Bezik, *Alcoa's Real Estate On Sale: Auctioning Non Distressed Properties*, American Real Estate Society (ARES) 2007; Margot B. Weinstein & Steven L. Good, *A Multi-Case Portfolio Analysis of Alcoa & Newell Rubbermaid: Exploring the Use of Auctions to Sell Two Significant Portfolios of Non-Distressed Properties*, American Real Estate Society (ARES) 2005; Margot B. Weinstein, Steven L. Good & Jeffrey D. Fisher, *Bidder's Choice Cap Rate Auctions: A New Strategy for Selling Real Estate Portfolios*, American Real Estate Society (ARES) 2008.
[38] See, The Mac Crate Report of the ABA Committee on Accreditation of Law Schools and Admissions to the Bar.

Dr. Margot Weinstein and Steven Good are authors of "A Multi-Case Portfolio Analysis of Alcoa & Newell Rubbermaid: Exploring the Use of Auctions to Sell Two Significant Portfolios of Non-distressed Properties" which they presented at the 2005 American Real Estate Society (ARES) Conference.[39] The research study investigated and compared the use of auctions to sell two large portfolios by successful companies in the United States. These portfolios contained considerable industrial, warehouse, and manufacturing properties including both improved and vacant properties that were sold within sixty days of each other. The portfolios consisted of 19 surplus properties in 12 states totaling over 4.1 million square feet of manufacturing facilities and over 500 acres of vacant industrial land. Good and Weinstein used the multi-case study as the methodology to analyze the two portfolios and compare the results. This approach allows " the researchers to deal with a full variety of evidence – documents, artifacts, interviews, and observations. (Yin 1994; Smith, 1990)" [40]

Although case studies of this sort are developed for the education of students, commercial real estate attorneys and other players in real estate auctions can learn by reviewing sections of the paper describing the marketing approach which responded to the clients' priorities of selling all the properties by year end and getting the best price. Interestingly, Alcoa required "open participation with the current broker representation in place" and a marketing budget of $600,000.[41] All but one property sold by the auction method[42] and a second property was removed from the auction by the client because "the business unit that owned it changed its mind and decided to keep it prior to receiving any bid."[43]

For Newell Rubbermaid the priority was to sell all the surplus property by year end or as soon as possible. The marketing budget was $230,000 and included over $100,000 in print and electronic media advertising and direct mail to 35,000 potential bidders. [44] The identification of each property's zoning and permitted uses was the initial step in the marketing. "The elasticity of the zoning use enables SG&C[auctioneer] to plan a marketing campaign by identifying prospects who can utilize each property." Properties with a more restrictive zoning required a more targeted marketing approach (direct mail), including end users like investors with tenants in tow. [45]

Good and Weinstein report that individual "properties in the portfolio sold well. One environmentally challenged property sold for $20.00." In that instance Newell Rubbermaid acknowledged that the costs to remediate exceeded the value of the property. A second functionally obsolete property sold two weeks after the auction for $12,000 but the client was pleased because the costs of repairing the roof was in the million dollar range and carrying costs were high. Those costs were not likely to be offset by a higher bid in a conventional sale.[46]

Exhibits 1 and 2 to the case study are the information for the respective Alcoa and Newell Rubbermaid portfolios. These exhibits are in the form of a chart listing each property in the

[39] Santa Fe, New Mexico, April 2005. The author has the case study on file.
[40] Id. at p. 14.
[41] Id. at p. 19.
[42] Id. at p. 19 (and auctioneer had made this assessment to the client before taking on the auction).
[43] Id.
[44] Id. at p.20.
[45] Id.
[46] Id. at 21.

portfolio, the auction format, the property type and size, and the offering method to be used. Exhibits 3 and 4 list the properties in each portfolio, the property address, whether or not an auction of the property occurred, the high bid and the total purchase price. This sort of information should prompt "students and practitioners to start the process of inquiring and learning about selling non-distressed commercial properties via the auctions."[47]

2. Bidder's choice cap rate auction: a new strategy

A team of highly respected academics and Steven L. Good, the auctioneer who was involved in the auction, prepared a business case study of a very creative approach to selling a real estate portfolio.[48] This was used to sell a portfolio of 71 income producing manufactured homes communities across 15 states. The portfolio was owned by Affordable Residential Communities (ARC) a publicly traded REIT. ARC had decided to optimize shareholder value and increase profitability by focusing on strategic markets. Therefore, the decision was made to sell off surplus properties to save on costs. ARC had used Sheldon Good & Company in the past several years and was optimistic about using the auction method. The auction would be open outcry with the new feature of the "bidder's choice" based upon cap rates, rather than the fair market value of the properties. The seller appreciated the ability to control the timeline and to get exposure with investors likely to be interested in this investment type.

Rather than bidding a dollar amount for a specific property, bidders indicated what capitalization (cap) rate that they were willing to pay. If a bidder were the winner of the round, it could choose one or more properties to purchase at that cap rate. "So with each round of bidding, the winning bidder (which we will see … is the bidder with the lowest cap rate) can choose as many properties that they want to purchase at that cap rate. Then bidding is repeated for a second and as many additional rounds of bidding are necessary until all the properties are sold."[49]

According to the academic literature cited in the case study, "a bidder's choice maximizes the revenue to seller when bidders are risk averse (which they normally are) because there is a greater chance that an adversary is bidding for the property a particular bidder wants. That is, the bidder does not know if the other bidder(s) will choose the property they want or a different property because there is more than one property that could be chosen."[50]

The use of cap rates is common basis for appraising the value of incoming producing real estate, although it is a new approach for auctions. The case study includes a useful description of the manufactured home community and the sources of income from ownership.[51] Thus, it is relevant for the investor who is considering this type of ownership.

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[47] Id. at pp 22-25.
[48] Margot B. Weinstein, Steven L. Good, & Jeffery D. Fisher, *Bidder's Choice Cap Rate Auctions: A New Strategy for Selling Real Estate Portfolios*, presented at the American Real Estate Society (ARES) conference April 2008 in Captiva Island, Florida. Author has a copy in her file.
[49] Id. at p. 9 (discussing the novel approach introduced by Jim MacDonnell, executive managing director of Sheldon Good & Company in Colorado).
[50] Id. at p. 12, (citing Goeree, Plott and Wooders, "Bidders' Choice Auctions: Raising Revenues Through the Right to Choose," California Institute of Technology Working Paper, 2003).
[51] Id. at pp. 5-7 (rents from tenants paying for the use of the site (pads) and the common area which may include recreational facilities; rental of park owned homes and interest income on notes received for seller financing).

Bottom line, this case study shows the creativity that is possible when a seller works with an experienced, sophisticated auctioneer in developing a strategy. For example, Jim Mac Donnell of Sheldon Good & Company is credited with developing at least one other innovative auction strategy- the lease at auction of vacant office space in large office parks.[52]

III. Understanding the Auction process

A. Auction formats

1. Open outcry

At open outcry auctions, bidders gather at one time and in one place to bid. This works particularly well when price is the main consideration. [53] It is the most frequently used format.

2. Sealed bids

A sealed bid auction may be preferred when one buyer may be prepared to bid a price much higher than all the other bidders, when price is not the sole objective, where bidding in the alternative for different sales terms or where all bidders are not equally desirable or qualified.[54]

3. Sealed bid convertible

A hybrid, sealed bid, convertible auction format may be most effective for a portfolio of properties. It starts as a sealed bid and converts to an open outcry bid auction during the pendency of the auction process. [55] Good & Weinstein discuss the auction of "19 surplus properties in 12 states totaling more than 4.1 million square feet of manufacturing facilities and over 500 across of industrial land" to show the effectiveness of this combination. [56]

B. Auction Strategies/Deal Structure

1. Without reserve/no minimum = absolute auction

In the absolute auction the real estate is guaranteed to be sold regardless of the outcome of the bidding. Consequently, this type of auction sparks the most excitement among bidders and generally generates the highest prices. Unless the seller withdraws the auction before the bidding begins, always an option for the seller, the seller has made an offer that becomes

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[52] Id. at fn 2.
[53] Good & Hammond, supra note 1 at 778.
[54] Good & Weinstein, *supra* note 16 at 58.
[55]See, Good & Weinstein , *supra* text II D 1 (discussion of auction of Alcoa and Newell Rubbermaid.).
[56] See, Good & Weinstein, *supra* note 16 at 58.

irrevocable once the bidding begins.[57] This contrasts with the reserve auction which is considered to be merely an invitation by the seller to the bidders to make an offer.

2. Without reserve/subject to minimum bid

At the minimum bid auction, the auctioneer will only accept bids above the minimum price which is announced at the beginning of the auction.[58] This amount should be disclosed in all advertising of the event.

3. With reserve

An auction is presumed to be "with reserve" unless it is represented to be otherwise![59] While there is no minimum bid, the seller reserves the right to accept or reject the highest bid according to the terms, conditions and timing of the auction. [60] Most often the seller does not disclose the reserve amount. If the undisclosed amount is bid, the seller may owe a commission to the auctioneer but is under no obligation to enter into a real estate sales contract with any bidder.

It is not surprising that absolute auctions attract the greatest number of bidders and that auctions with reserve reduces the number of bidders. This likelihood is due to fact that bidders may not be willing to spend the time and money performing due diligence and attending the auction only to have the seller reject all bids.

C. Auction Methodology

The discussion of the methodology employed once the decision has been made to use an auction to sell real property, presupposes that a knowledgeable auctioneer, described as "a unique professional that is both a real estate expert and an auctioneer, capable of marketing and selling particular real estate to a capable buyer at a price acceptable to the seller"[61] is involved from the beginning.

The auctioneer and its staff are responsible for a range of activities before the auction is held. It is only with this professional preparation that the auction will meet its goal of yielding the highest price. Therefore, choosing the auction company is an important aspect of strategy. "Experience, ability to market the product, the corporate structure, the length of time in business, the accounting and administrative capabilities" [62]of the auction company should be evaluated carefully by seller, and seller's advisors.

Typically, the auctioneer provides analysis of the property type as a first step in developing a strategy. Obviously, determining the type of property is important in analyzing the market, i.e.,

[57] See, Good & Hammond, *supra* note 1 at 777.
[58] See, Hunt *supra* note 3 .
[59] See, Good & Hammond, supra note 1 at 777. See also U.C.C. sec 2-238 (2005) (Discussing reserve and without reserve/absolute auctions. Subsection 3 indicates that a sale is with reserve unless it is explicit that the auction is without reserve). Although the Uniform Commercial Code does not apply to sales of real estate, courts have applied it by analogy to real estate auctions. Id. At pp. 809-810.
[60] See, Good & Hammond, *supra* note 1 at 777.
[61] Id. at 779.
[62] Alan R. Kravets, *Going, Going Gone! Real Estate Auctions in the 90's*, PROB. & PROP., May-June 1992,38, 40.

the bidders who would likely attend the auction. Once the property category and location are clarified and the likely bidders/market determined, the auctioneer will come up with a suggestion of the type of auction and a marketing plan. Here the seller is relying on the expertise of the auctioneer to steer the seller to the optimal auction method.

IV. Seller's Attorney- Part of the Strategy Team

A part of the decision to market real estate by auction requires the seller and the seller's attorney to appreciate and understand that strategy is needed for a successful auction. "Simply stated, the basic strategy of the auction process is to have as many bona fide potential bidders as possible in attendance at the auction."[63] The seller's attorney is part of the strategy team.

A. Listing Agreement between Seller and Auctioneer

To begin with the attorney becomes involved in negotiating the contract with the auctioneer. It is a form of listing agreement. [64] This document will structure the relationship between the seller and the auctioneer and should include all of the terms of the relationship[65] (see III A and B above for decisions to be made regarding auction formats and deal structures). The contract between the seller and the auctioneer is an exclusive listing agreement that is more complex than the conventional listing agreement. In contrast with the conventional listing contract, the auction contract "contemplates a defined and structured time line that is not easily changed once set." [66] Minimally, it should include:

*Name of the legal title holder
*Legal description of the real estate
*Duties of the auctioneer
*Compensation of the auctioneer
*Duties of the seller (obtaining survey, title report, and personal property included in the sale)
*Length of time for the auction contract
*Whether the auction will be reserve, minimum bid or absolute
*Items required to meet local, state and federal law
*Seller's expenses
*Marketing plan (including references to advertising, times for showings to prospects and location and time for the auction itself)

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[63] Steven L. Good & Sheldon Gottlieb, *Real Estate Auctions: A Guide for the Seller's Lawyer*, 2 PROB & PROP.41 (1988).
[64] In most jurisdictions the auctioneer is a licensed broker. The auctioneer may also be required to have an auctioneer license. *See,* Good & Hammond, *supra* note 1 at 802-805.
[65] See, Good & Gottlieb, *supra* note 16 at 43 ,"Perhaps the most important element is a clear determination of the services to be provided by the auctioneer….Beware the auctioneer who 'gets the business' and then contracts out the various key functions (e.g. open houses and marketing.)"
[66] Good & Hammond, *supra* note 1 at 779.

*Contemplate the bidder's information packet (including the real estate sales contract to be used, financing information, terms of the auction, information about expenses of ownership of the property). [67]

Like real estate brokerages, real estate auctioneers can provide financing and title services *via* captive related companies.[68] If there is such an expectation between seller and auctioneer, it should be spelled out in their contract.

B. Drafting or Reviewing the Real Estate Sales Contract

A significant difference between the auction sale and a regular sale through a broker is that the real estate sales contract which seller and the successful bidder will enter into is drafted entirely by the seller![69] That contract is prepared by the auctioneer and is part of the bidder's kit package.[70] The bidder understands it will sign this particular real estate sales contract if it is the successful bidder. In contrast with the usual contract, there is no negotiation between the seller and the buyer. Thus, seller's attorney should draft or review that contract as part of the negotiations with the auctioneer. Seller and its attorney should address financing of the sale by seller or others, earnest money and other aspects of the transaction.

Even here strategy is important. If the terms of participating are too burdensome and too pro seller, bidders may stay away from the auction or feel anxious about becoming bound to a one sided sales contract.[71] Experienced auction attorneys offer a "frame of reference for seller's lawyer…[I]f the buyer brought the contract to his or her lawyer's office, the lawyer could say: 'It's a fair contract. As long as you have the money and are prepared to close on the purchase, the contract will protect you.'"[72]

Such a commercially reasonable contract will include seller's providing title insurance and an accurate survey. Seller should eliminate title and survey defects *before* the pre-auction package is delivered to registered bidders.[73]While reasonable default provisions should be included, there should not be any contingency, nor should seller be required to make any representations or warranties.

C. Closing and Post Closing Issues

Because the successful bidder is buying the real estate "as is" and because the title and survey matters have been resolved before the real estate sales contract is even executed, there should be a minimum of issues for seller's attorney at closing and afterwards. Still, it is recommended that

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[67] See, Good & Kravets, *supra* note 26 at 45 as cited in Good & Hammond, *supra* note 1 at 779.
[68] Good & Hammond, *supra* note 1 at 775.
[69] Good & Hammond, *supra* note 1 at 772.
[70] The bidder's kit will provide information about the property, a copy of the proposed sales contract, a recent title insurance commitment , a survey and such other information appropriate for the particular type of property and the degree of due diligence needed to entice potential buyers to bid at the auction. See, Good & Gottlieb, supra note 16 at 42.
[71] *See*, Good & Gottlieb, *supra* note 16 at 42.
[72] Good & Kravets *supra* note 26 at 46.
[73] Good & Gottlieb, *supra* note 16 at 43.

the seller's attorney be available at the auction itself to answer questions and to make sure that the real estate sales contract is actually signed. Requiring the second highest bidder to remain after the auction until the contract is signed and the earnest money is deposited is recommended.[74]

V. Conclusion

In today's volatile marketplace which makes valuation of real estate difficult, owners need to understand all the possible methods of selling their real estate assets. A real estate auction may be the best approach for certain situations and for certain properties and owners as described in this article. In their role of advisor/counselor, attorneys for a variety of clients which own real estate assets may be called upon to provide advice about using the auction method for selling that real estate. Hopefully, those who have read this article will understand the auction basics and appreciate when an auction could be a beneficial alternative for such clients.

[74] This requirement should be made clear to bidders in the bidder's package.

Program Description: You are an owner, lender, lien claimant or bankruptcy trustee. How do you dispose of your real estate asset or collateral and obtain the highest and best value for it? Is the real estate auction with proper marketing support a viable option? This program will provide a practical approach to using real estate auctions as a way to dispose of real estate assets.