



The advantages of real estate auctions: Why condominium developers should sell by auctions

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As the market has continued to transition over the past several years, the auction model has continued to gain popularity as an effective method of marketing and selling real estate throughout the country. Real estate auctions were commonplace in the late 1980s and early 1990s when owners and lenders sought more compelling and efficient methods to move large inventories of unsold properties.

Today, the fastest growing segment of the real estate auction business, nationally, is the residential sector, with a particular focus on residential condominiums. It is evident that condominium developers turn to more outside-the-box marketing strategies—such as auction programs—in markets like these.

But should developers sell condominiums by auction in other types of markets too?

The Conceptual Advantages

First and foremost, the auction is essentially a marketing strategy that focuses the market's attention on the subject property, virtually immobilizing the marketplace with respect to the sale of competitive product. This is exceptionally significant in a market where supply of the specific type of asset is high (which is certainly true of residential condominiums today)—but important in any type of market. Second, the auction creates a deadline, forcing prospective purchasers to act immediately. This is also extremely important when supply is high, leading purchasers to believe that there is no urgency and prompting them to continue to wait for sellers to reduce asking prices. This is one of the most difficult obstacles for sellers to overcome in a buyer's market and the deadline associated with the auction helps give sellers back a certain degree of leverage with respect to this point.

By focusing the market's attention on the subject property and creating a deadline, a properly implemented auction program accelerates the sales process, thereby eliminating the prolonged carrying costs associated with conventional sales programs. This is relevant in almost every situation and in any market, particularly so with respect to develop-for-sale product, such as condominiums, where the developer's profit or equity often lies in the last 10-20% of units.

Dollars and Sense

So what kind of sense does an auction program make financially?

In an auction, the net cost of a transaction to a developer is usually less than that of a conventional sale. First, most of the costs of sale (essentially, the commissions) in an auction are transferred to the purchaser through the buyer's premium, a customary practice in the auction business whereby the winning bidder pays a certain percentage over and above the winning bid price. Second, a comprehensive and intensive marketing program will generate sales at market price on an accelerated basis, saving the seller significantly in the long term on the costs associated with extended marketing programs that may last for many months or years (depending upon the

geography of the property and the number of units to sell, among other things).

Moreover, an auction allows developers to sell multiple units to individual purchasers simultaneously—for example, a developer can sell 30 condominiums to 30 individual purchasers all at once. This essentially allows developers to execute bulk sales for retail pricing. This is a tremendous advantage over the two more common alternatives available to developers, each of which has major disadvantages:

(a) engaging in conventional marketing programs where units are sold individually is unnecessarily time-consuming (meaning high carry costs and high opportunity costs) and

(b) conducting bulk sales of a number of units to a single purchaser will invariably generate a significant discount (which no developer wants).

In fact, a developer may actually realize a higher internal rate of return (IRR) if the developer, at the outset, pro formas and actually executes a sale by auction of multiple units on an accelerated basis—even if the auction prices are below market. Consider a new model—one where developers actually spent just a few months marketing and then at once selling out an entire development that they spent years conceiving and building. Is that so far-fetched?

If an accelerated model can reach buyers more effectively and focus their attention on a particular offering—and generate a high volume of sales at or near market pricing—why shouldn't developers use auctions to sell condominiums in any market?

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