



Auctions maximize REO sales values: Examining efficient disposition strategies for lenders

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One of the ways banks and other lenders seek to sell real estate is through the auction. In fact, the real estate auction is a format successfully used by all types of real estate owners, including private, institutional, governmental and corporate owners, to achieve their disposition objectives.

Essentially, the strategy consists of an accelerated and structured program, including a comprehensive marketing program that culminates in a sale of the asset(s). The seller sets the terms of sale, including those of the actual purchase and sale agreement as well as the timeline, in advance, creating a level playing field for all buyers to compete. Properly implemented, auction programs can be very effective.

REO portfolios continue
to expand due to
market conditions

The chief factors in this incredible national real estate market that continue to serve as catalysts for the growth of REO portfolios include: (a) the tight credit markets, (b) the nation's housing slump, (c) the pending expirations of the fixed periods on a plethora of mortgages (such as the three and five-year adjustable rate mortgages originated during the middle and latter parts of this past decade), providing for lower, fixed payments for borrowers during the first few years of loan repayment periods, and (d) the increasingly high level of residential inventory (including condominiums, single-family homes and townhouses) that developers simply cannot move in line with their pro formas. Lenders on various asset classes have already begun to amass much larger portfolios on their books than they anticipated—and the commercial market still has not been affected to the extent many believe it ultimately will be.

Auction focuses market's
attention on the subject property

Lenders proceeding with the auction strategy will benefit from numerous advantages with which conventional methods of sale simply cannot compete. While the deadline inherent in the auction process creates a sense of urgency and forces buyers to act, the inevitable corollary is an advantage that is perhaps even more impressive: the auction focuses the market's attention on the subject property and immobilizes activity with respect to the sale of competitive product.

This advantage is extremely important, particularly in a buyer's market like this one, characterized by high inventory (i.e., many choices for buyers) and a lack of a sustainable motivation to buy (due to financing difficulties, expectations of further market value depreciation, etc.).

Auction establishes
property value without
setting a ceiling on price

Not only will a competitive bidding process yield the highest price for the seller on an accelerated basis, it may actually cause the property to trade for a premium. Indeed, the auction process will establish a value for the subject property without ever setting a ceiling on price. This works especially well for properties that are unique or difficult to value. Through conventional marketing—particularly in a down market—it is extremely unlikely that an asset will trade above its asking price, which is usually the starting point for negotiations. Conversely, in an auction, bidding begins below market value and stops at the point when no one is willing to pay more. Once again, that point may be higher than the asking price the seller would have set in a conventional sales program.

Portfolio auction yields retail prices on timeline normally associated with bulk sale

Finally, and perhaps most importantly for a lender seeking to execute a portfolio sale, is the fact that bulk sales ordinarily yield a discount for the seller. A properly conceived auction marketing campaign for an REO portfolio will provide for custom-tailored, individualized marketing and sales programs for each asset within the portfolio. The timeline of the marketing programs and auctions for the individual assets within the portfolio will coincide, but each of the assets should be treated individually to maximize value.

Most importantly, that means each property must be offered for sale individually (versus as part of a bulk package), as this will more likely produce higher/retail pricing for the seller. Thus, in an auction, the net result to the lender/seller is the execution of a portfolio sale at prices more often expected to be realized on an individualized/retail sale, and achieved on a timeline more often associated with a bulk sale. This is the best of both worlds: higher prices on a faster timeline.

These attractive competitive advantages inherent within the auction process help lenders (and other sellers) seeking to sell portfolios of real estate efficiently. The ability to market, sell and close entire portfolios of property using structured sales, where lenders can control the timing and terms of the process, creates a uniquely ideal yet very practical approach for lenders seeking to maximize value for their REO portfolios. Thus, the auction arena will continue to experience significant growth in this market.

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