

Understanding Voluntary Real Estate Auctions



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They don't work like ordinary sale and purchase transactions, so make sure you know the rules well in advance.

NOT A SINGLE DAY seems to pass without multiple newspaper articles and media interviews relating to the current real estate marketplace. Commentators continue to discuss the subprime mortgage debacle, the ever-upward spiral of mortgage foreclosures, and the seemingly ever-downward movement of home prices and new home starts. Layoffs by national home builders, new projects placed on hold, condominium projects largely unsold, and other symptoms of a weak real estate market dominate the conversations of developers, lenders, investors, and others alike. Within this less-than-friendly environment, there has been a steady uptick in auction sales. This article is intended to address issues that are pertinent to real estate auctions generally, to purchasers at such auctions specifically, and to the role that may be played by legal counsel in representing or counseling buyers at voluntary real estate auctions.

THE AUCTION MODEL OF REAL ESTATE SALES • The auction model has in the past, at least in the United States, been applied most often to involuntary sales (tax sales and mortgage loan defaults), but rarely to voluntary sales of either residential or commercial properties. Standard traditional practices involved a licensed

real estate broker securing a listing contract to advertise, show, and sell a real estate parcel in return for a commission of anywhere from five to seven per cent, although both higher and lower commission rates have not been uncommon.

As the real estate market has cooled in many parts of the country, with prices stagnant or still sagging, and “days listed” growing steadily, interest in a different model for real estate sales has increased significantly — the auction model has emerged as a viable alternative to the traditional broker listing method. This is not to say that the real estate broker is losing a segment of the traditional market, but that some real estate brokers now utilize the auction model as either the exclusive method for their sales or as a vehicle for a segment of their listings.

This is also not to say that real estate auctions are the new kid on the block. Auction sales have been around seemingly forever. In the United States, auctions have been used to sell properties in foreclosure and for non-payment of taxes and other lienable claims. Never before, however, have so many properties been auctioned not as a consequence of court order or as a result of an owner’s inability to cover the obligations of ownership. While the property owner’s decision to choose the auction method of sales will most likely depend upon such factors as expected selling price, costs of sale, quickness of sale and settlement, sale where pertinent of multiple properties on one day (developer’s close-out), the finality of the auction may make up for other expected or even unexpected shortcomings. On the other hand, however, a buyer at auction might be no better off than a gambler at the craps table, not knowing how, when, or why to bet. An understanding of the “game” is a necessity for any bidder at a real estate auction, and an absolute necessity for the winning bidder.

HOW REAL ESTATE AUCTIONS WORK •

Real estate auctions will fall into one of three dif-

ferent types: reserve, without reserve (or absolute), and minimum bid:

- In a reserve auction, the seller “reserves” the right to accept a bidder’s offer by having a pre-set, ordinarily undisclosed, minimum price. Should the bid meet or exceed the undisclosed minimum, the seller is then obligated to accept the highest bid;
- When a property is auctioned “without reserve,” the highest bid, regardless of how low, forces the sale;
- A pre-determined minimum bid auction allows the seller to set a reserve price that is disclosed to the bidders in advance of the bidding process. The auctioneer is not authorized to accept a price below the advertised minimum bid. (An advertised minimum bid auction could be transformed into a sale “without reserve” upon a seller’s agreement to modify the terms of the auction. This might occur when a set minimum bid has been inappropriately identified or when a seller simply wants or needs the finality of the sale even at a bid price lower than that which had been expected to be exceeded. A review of the auction “rules” may shed some light on whether this transformation is permitted.)

Clarify What Will Happen If

The Auction Fails

While a seller may not secure an expected sale price but nevertheless be required to complete the sale, a failed auction will not only fail to generate the expected sale but may also result in out-of-pocket cost to the owner/seller. The owner’s contract with the auction company should state whether or not the owner will be responsible for reimbursing the advertising and related costs to the auction company should there be no successful bidder. The contract should also identify whether the auction company is entitled to cost reimbursement in addition to the “buyer’s premium,” or commission (whether the commission is paid by seller or buyer).

Know The Rules In Advance

A prospective bidder should secure from the auction house or company all of the rules pertinent to the auction process. These rules will be those formulated by the auction house and may not be governed by or subject to any state or federal regulation. In other words, in the absence of confirmation by a bidder's own legal counsel that state and federal laws designed to protect buyers from certain real estate practices or conditions of the real estate itself are applicable to the auction purchase, a bidder should assume that the rules of the auction and the terms of the proposed real estate contract (along with any designated addenda) are the only considerations in effect.

Rules Of Rescission Might Not Apply

An example of how a bidder without legal counsel or knowledge may mistakenly rely upon non-applicable statutory protections is demonstrated by rights of rescission that are afforded under a number of states' real estate statutes. A standard term in the contract that will be signed by the successful bidder will provide for a waiver of such statutory rights of rescission. *See, e.g.*, New Jersey's three-day right of rescission available to purchasers of residential real property.

Integration Clauses Might Render Important Documents Useless

Another aspect of a standard contract covering the sale of auctioned real estate relates to whether any documents other than the agreement of sale shall survive the transfer of title. In connection with its pre-auction property analysis, the auction company will typically do a physical inspection of the premises, a title search confirming ownership as well as the existence of all liens and encumbrances, including easements and restrictions of record, and may generate reports regarding the property. The sales agreement may however contain a merger or integration clause by which the seller and buyer

agree that all prior statements, documents, representations, and agreements are merged into the agreement of sale and the deed of conveyance and do not survive the closing. State law may address the enforceability of an integration clause, especially when the prior agreement or representation is found to be fraudulent. *See*, for example, the ongoing issue under Pennsylvania real estate law whereby a residential seller is obligated to complete a seller disclosure statement answering some 16 questions relating mostly to the physical condition of the premises. Pennsylvania precedent holds that a prior misrepresentation is merged into the deed and does not survive the closing on the sale. *See LeDonne v. Kessler*, 389 A.2d 1123 (Pa. Super. Ct. 1978).

Successful Bidder's Obligation Not Contingent On Financing

While one or more mortgage brokers or lenders are generally invited by the auction company to attend the auction, the presence of these financial resources in no way predicates the sale upon the successful bidder securing a mortgage loan. Auction sales are ordinarily cash sales, with the successful bidder being required to make a substantial deposit immediately following the sale. The proposed agreement of sale, which should always be subject to inspection before the auction, will invariably contain a provision that states that the successful bidder's/buyer's obligation to complete the purchase is not contingent upon financing. The auctioneer may, as part of the auction rules, require that a prospective bidder bring a cashier's or certified check (made payable to the bidder) to the auction in order to bid. In the event the bidder is successful, the cashier's check would be endorsed over to the auction company as agent for the seller.