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## Auction Purchases Of Commercial Property: Bidders Beware

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Law360, New York (May 20, 2014, 1:41 PM ET) -- Auction sales of real estate are nothing new, and over the course of the Great Recession, auctions in the foreclosure context became an inescapable fact of life for both the commercial and residential sectors in most of the U.S. What is relatively new, though, is the sustained use of the auction format in an online setting.



Kate Lewis

The advent of large online property auction platforms with sophisticated search features allows prospective purchasers to easily discover sellers and properties all over the country that they might never encounter otherwise — and with a little digging and luck, find some great deals.

One reason that the auction process is attractive to purchasers is that it streamlines much of the laborious process of identifying and negotiating a deal. However, a consequence of that streamlining is the loss of some leverage that purchasers often take for granted in a traditional commercial property sale.

Here are some legal and business pointers for a would-be bidder to consider when seeking out that diamond in the rough.

### Plan for a Front-Loaded Transaction

A standard commercial property sale acquisition has certain familiar rhythms. First the purchase and sale agreement is negotiated. Then there is a time period, often a generous one, for the purchaser to examine the property, line up financing and pursue development plans. Finally, if the purchaser opts to stay under contract, the purchaser's earnest money generally becomes nonrefundable and the parties close shortly thereafter.

In an auction setting, on the other hand, many of the purchaser's due diligence and financing work must take place before the auction occurs, with the total time actually spent under contract being very brief.

The best and possibly only opportunity you'll have for due diligence on the property may be before the auction sale date. The seller, through the auction company, should make available a set of existing legal and business documents about the property, usually after agreeing to confidentiality protections. This is the moment (assuming the buyer has the time and opportunity) to go beyond the data room and do what can be done on-site, because as discussed below, the property may not be easily accessed thereafter.

While inspecting the property, the same conditions that would apply for a purchaser

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inspection period after a purchase and sale agreement (PSA) is executed may be required: e.g., minimum insurance coverages, limitations on intrusive testing, indemnification of the seller for any injuries or losses caused by you or your representatives while on the property, and so on.

The need for pre-auction diligence is even more pronounced because, even if an auction seller wants to be helpful once under contract, it may have limited knowledge about the property. Online auctions are attractive to lenders and commercial mortgage-backed securities loan servicers seeking to dispose of real estate owned, or REO (real estate previously acquired by the lender in a foreclosure or deed in lieu).

Those sellers may have only spotty or fairly recent property records, many of which may be second- or third-hand from prior owners or property management companies. Sellers will almost certainly disclaim any representations as to the accuracy or completeness of such materials.

### **Address the Auction Contract Before the Purchase Contract**

In addition to its separate arrangements with the property's seller, the auction company may want to enter into an agreement with the prospective purchaser about the terms of any auctions to bid. This agreement would require the purchaser to confirm consent to auction rules on numerous points, such as when and how bid deposits are due, agreeing to pay a buyer's premium to the auctioneer at closing (a surcharge on top of your purchase price, often calculated as a percentage of the winning bid), and the process for what happens next if you win.

The buyer will also have to acknowledge that the auctioneer is not acting as an agent in any way. The company may impose some additional hoops to jump through at this stage to ensure a qualified bidder, such as proof of funds and, if the purchaser is an entity, documentation that the entity exists and is in good standing.

The auction agreement or a separate terms and conditions disclosure should clarify whether the auction is a reserve sale or not. Reserve auctions mean that the seller has set a minimum selling price (which may or may not be disclosed, and may have nothing to do with the minimum opening bid amount).

Sellers are free to accept or reject any bid, whether or not it meets the reserve. An absolute auction, by contrast, may set a minimum starting bid, but then the seller agrees to sell to the highest bidder. For big-ticket commercial properties, a reserve auction would be more common.

### **Brace for a Seller-Friendly Purchase and Sale Agreement**

Along with the property due diligence materials, the auction company should furnish the form of purchase and sale agreement that the seller will expect the purchaser to sign if winning the auction. The overall terms may be unexceptional, but the details may minimize or outright eliminate various purchaser rights:

- No "free look" period rights or refundable earnest money. Again, the transaction is set up in the expectation that the buyer knows what he or she is getting into by the time the bid is placed, so there may be no further way out of the deal once under contract. (Exceptions would include the occurrence of a major casualty or condemnation)

affecting the property, or a seller default on its minimal obligations.)

- Limited access to the property. The buyer may simply not have the right to go back onto the property for survey updates, environmental assessments and the like, which can put him or her in a real bind when trying to satisfy lender requirements. A reasonable seller, or even a cooperative on-site property manager who wants to stay on after the sale, may make an exception.
- Minimal seller representations and warranties. There is little deal-related motivation for the seller to provide helpful legal representations and warranties regarding itself or the property, so don't expect much comfort there. Representations may be limited to a few basic statements: e.g., that seller has the authority to enter into the transaction, that the PSA is enforceable against the seller, and that the seller's involvement in the deal will not constitute a breach of any other seller agreement. Various other representations that may be expected or hoped for in a negotiated contract, such as reps regarding the property (no litigation or pending condemnation affecting the property, accuracy of operating statements, absence of notices regarding environmental violations, etc.), may be unavailable. The sale is almost certainly going to be "as-is," "where-is," and as such, the seller will further disclaim any representations other than those being specifically given in the PSA (not much, in other words).

This form PSA may be near-impossible to negotiate or modify, especially with large, heavily bureaucratic sellers. The form should be thoroughly evaluated by legal counsel to determine all of potential risks and obligations before bidding.

### **Have Financing in Order**

Not all lenders are familiar or comfortable with the limitations on property diligence or accelerated closing timetables that come with auction purchases. The large auction companies may have relationships with lenders that specialize in auction acquisition financing and know the drill, but that convenience may come at a less competitive price for the financing itself. Be aware as well that the PSA is unlikely to allow any kind of financing contingency.

### **Be Ready to Move**

It will be in both parties' interests to sign up a PSA as soon as possible after the auction is concluded. Although sales of other asset types may constitute enforceable oral contracts, sales of real property are subject to the legal principle of the statute of frauds and, therefore there is no enforceable contract until it is reduced to writing. (This would suggest that if the purchaser has buyer's remorse, he or she could still back out after the sale, but only before the PSA is executed. In practice, though, the purchaser would probably lose a sizable auction deposit, and the seller could have some equitable grounds to enforce the deal anyway.) Also, at the same time that the parties are coordinating PSA execution, earnest money will need to be paid into escrow.

With no purchaser inspection period and no other contractual motivation to provide much time to close, auction sellers want to proceed to a fast closing. There is usually some time lapse between the end of the auction and the closing date, but it may be a lot less for significant purchases — potentially under a month.

In summary, auctions offer exciting possibilities for the commercial investor, but their peculiarities definitely require plenty of advance thought and preparation.

Happy bidding!

—By Kate Lewis, [Nelson Mullins Riley & Scarborough LLP](#)

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