

Feasibility of Using Auctions to Sell City-owned Real Estate Assets

EXECUTIVE SUMMARY

At the 2014 June 26 Land and Asset Strategy Committee meeting, the Office of Land Servicing & Housing (OLSH) was asked to examine the benefits, risks and costs associated with using auctions to sell City real estate assets.

Currently, OLSH sells City real estate assets using a submission process where interested parties submit a Purchaser Application Form, containing the proposed purchase price, and a brief description of the proposed development (the Application) by email, or by pre-arranged hand delivery, by a specific time and date.

Three options were investigated: maintaining the current process, use of live on-site auctions or use of online auctions.

ADMINISTRATION RECOMMENDATION(S)

That the Land and Asset Strategy Committee recommend that Council:

1. Receive this report for information
2. Request that the Recommendations, Report and Attachments remain confidential under Sections 23(1)(b), 24(1)(a), 24(1)(g) and 25(1)(b) of the *Freedom of Information and Protection of Privacy Act* until the report is published in the Council agenda.

RECOMMENDATION OF THE LAND AND ASSET STRATEGY COMMITTEE, DATED 2015 MARCH 19:

That Council receive report LAS2015-10 for information.

PREVIOUS COUNCIL DIRECTION / POLICY

None

BACKGROUND

OLSH uses a process in which real estate is sold via a submission process (see Attachment 1). OLSH publicly promotes properties by contacting real estate industry members via emails (Industry Mailout), posting listings on The City of Calgary real estate website (Calgary.ca/realestate), holding open houses and on-site information sessions, and targeting prospective purchasers based on their industry and expressed interest in different types of real estate. Prospective purchasers each submit an Application by a specific time and date. OLSH then analyses the Applications to determine which offers the best return for citizens (price is considered along with economic, social and environmental returns).

INVESTIGATION: ALTERNATIVES AND ANALYSIS

OPTION 1 – LIVE ON-SITE AUCTION

An auction (see Attachment 1) would take place within four to six weeks after the listing goes public. Between the dates of the listing and the auction, the property would be advertised (on The City's real estate website and prospective buyers would be contacted using OLSH's database and Industry Mailout) and the property would be shown to prospective bidders by open house. During this time, bidders would be qualified, which could include the following:

Approval(s): Stevens, Brad concurs with this report. Author: Karla Spilsted
City Clerk's (C. Smillie)

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identity check, collection of a qualifying deposit (amount to be determined) and verification that the bidder has an appropriate line of credit or has preapproved financing to purchase the property (finance clauses are typically not part of auction sales agreements). An auction would be held at the property and conducted by OLSH personnel. If the bidding reaches or exceeds the reserve price, the highest bid would be accepted and the bidder would enter into the standardized Agreement of Purchase and Sale APS. In addition, the “winning bidder” would have to provide a deposit in the amount of 10 per cent of the winning bid, minus the qualifying deposit, at the auction. The qualifying deposits would be returned to all unsuccessful bidders.

Benefits

Bidders would be vetted to ensure they have adequate funds or preapproved financing to purchase the property. Time to close a sale would decrease as the only consideration is price. The use of a standardized APS would eliminate negotiation time. Transparency would increase as competing bids are public. The use of an auction could incent more end-users to bid as there would be a cost saving because there may not be broker or agent fees.

Challenges

The most significant risk posed by the use of auctions would be the loss of the ability for The City to achieve municipal objectives through the sales of City-owned real estate assets. Currently, Applications with highest price can be rejected if another Application creates social, environmental and economic benefits for citizens.

The use of a standardized APS means that terms and conditions would be non-negotiable. As there is no ability to negotiate with potential purchasers, The City would be unable to ensure that redevelopment is underpinned by appropriate community engagement and would be unable to support projects that lead to innovative land development.

For any sale of real estate by public auction, The City will have to comply with the requirements of the *Fair Trading Act* (Alberta), *Real Estate Act* (Alberta) and the *Public Auctions Regulation* (Alberta). OLSH staff will need to qualify and be licensed as auctioneers and will need to set up and maintain the appropriate trust accounts and records. Additional up front due diligence work will be required to create the marketing materials to ensure that all statements accurately and correctly disclose all relevant information relating to the quality, condition or sufficiency of the property for any use or purpose.

The ability for live auctions to maximize price is unproven in the Calgary real estate market. In May 2014, two luxury properties went to auction. One of the luxury homes failed to sell at auction and was listed on MLS (as of August 28, 2014) for \$1 million below the original list price. The other luxury property, a 45-acre ranch, was reportedly sold at auction on May 9, 2014 for \$3.75 million. It had already been on the market for 106 days at \$4.5 million.

Live auctions are not common practice in Calgary, and in the North American context are used most often to sell “distressed properties” and agricultural holdings (i.e. farm dispersals). Marketing real property by way of auction may not be hitting the appropriate market for the sale of City real estate holdings as prospective purchasers may not be looking for auctions of real

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estate. Industry Mailouts may not be passed to prospective purchasers if there are no broker or agent commissions payable.

Past experience with City of Calgary tax sales demonstrates that auctions have not been successful because the reserve price is higher than auction attendees are prepared to pay despite the fact that the reserve was included on promotional materials for the event. Public perception is that there is a deal to be had when properties go to auction.

The use of an auction may result in lower bids if the bidder is required to pay a fee of six per cent of the selling price to the auctioneer within 48 hours of the closing of auction. In OLSH's submission process, consistent with conventional real estate practice, the vendor pays the broker or agent commissions or finder fees.

Finally, attendance at on-site auctions is affected by weather. Research confirms positive correlations between bid levels and the number of bidders for upmarket homes in Australia.

Option 2 – Online auction

In addition to the steps outlined in Option 1; in an online auction, potential buyers would register, qualify as bidders, and submit bids directly through a website (see Attachment 1).

Benefits

In addition to the benefits listed in Option 1, an additional benefit of online auctions is that attendance is not impacted by weather. Also, online auctions are useful for bidders who are unable to attend a live auction. Finally, online auctions (such as liveauction.com) provide the flexibility to mask or reveal bids.

Challenges

In addition to the risks listed in Option 1, adding the capacity for The City to conduct online auctions via Calgary.ca or a standalone website would require considerable time and funds to create an e-commerce site that is secure and reliable. The site would need to be hacker proof to ensure that the highly sensitive information needed to qualify bidders' identities and financial information would be protected.

While sites such as Kijiji and eBay offer opportunities to reach broad audiences, they also pose risks in terms of copy cat or fake ads. In 2014, there were several cases of scams in which listings were misrepresented to lure prospects on Kijiji.

In the context of Canada and the United States, the ability of online auctions to maximize price is unproven.

Ritchie Brothers Auctioneers (Ritchie Brothers), the world's largest industrial auctioneer, was contacted as they are a full service auction company with offices located within the province of Alberta. Their head office is located in Vancouver, British Columbia with auction sites worldwide. As a full service auction provider they are able to provide on-site, online and off-site auction services and a combination thereof, including all administration for qualifying buyers, taking deposits and verifying identities. While the majority of Ritchie Brothers auctions of real

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estate are primarily focussed on agricultural/rural sector they do indicate they have had limited experience in the sale of urban properties within in the Edmonton area.

Fees for Ritchie Brothers action services are a set 10% commission on the value of the property being sold plus a marketing budget. The representative we spoke with tells us the marketing budget is typically a minimum of \$10,000 per property and upward, depending on the objectives. This could be negotiable and a business decision could be made by Ritchie Brothers that for higher value properties the marketing budget could be included in the commission. However, the representative was not prepared to disclose a value for which the marketing budget may be included.

Ritchie Brothers only sells unreserved, meaning they do not allow sellers to place minimum bid prices, reserves or rights of first refusal on properties. All properties are sold to the highest bidder no matter the price. Sellers are not permitted to participate in the auction, so prices are only driven by the potential purchasers. In addition to the fees to the seller, Ritchie Brothers also charges a 2.5% buyers fee up to a maximum of \$950.

Once the auction has completed and the property is sold, Ritchie Brothers takes the deposits from the buyer (require 25% of the sale value, minimum of 10 % may be considered with documentation demonstrating their financial ability to close on the sale) along with the sale documentation and forwards directly to the sellers lawyer for production of the APS and closing arrangements. They do not create trust accounts and do not hold deposits, so this may pose some challenges for The City as our Law Department is not able to create a trust account in compliance with Law Society rules and cannot accept/hold deposits. A solution would be need to be developed to address this.

Ritchie Brothers indicates they would be able to manage the inclusion of specific terms and conditions The City may require as part of the sale of City owned land, such as, building commitments, options to repurchase, architectural design review, etc. However, the more complex the transaction the more lead time they will require to prepare and ensure the information is clearly communicated out to potential purchasers so they understand the obligations attached with the sale. As part of the upfront research and preparation for the auction OLSH would be expected to complete necessary due diligence to confirm the state of the property (i.e. environmental assessments, geo technical reports, building assessments, addition/removal of any encumbrances, etc.) to address or remove concerns that could affect value of the property. Properties are sold "as is" so if items generally perceived as risk that may require the potential purchasers to take on additional responsibility or liability then they may negatively affect the final purchase price. As a result OLSH will be undertaking work and incurring costs generally left to a potential purchaser to undertake through their due diligence after negotiations have completed through the current submission process.

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The potential for setting up and operating on-site or online auctions through The City of Calgary presents many challenges. However, the opportunity to work with a full service auction provider opens up the potential. If The City were to proceed with using an auction to sell property the following should be taken into account prior to proceeding.

- Commission for auction 10% (Average commercial real estate commission is 2 – 3%)
- Marketing budget of \$10,000 or more per property (over and above our own marketing)
- Sale would be unreserved
- Council Authority authorizing auction, and sale required outside of Real Property Bylaw
- Additional upfront costs for due diligence may be required (resources, time and dollars)
- Potential purchasers qualified for financial ability to close only, no qualifications for experience or ability to deliver on conditions of sale
- Purchasers fee of 2.5% to a maximum of \$950

The representative with Ritchie Brothers recommended auctions be used for properties that have not sold through conventional means and a date certain sale is required.

Option 3 – Current Submission Process

OLSH's current submission process creates auction like conditions in which applicants submit an Application before the submission period closes. For example, in the case of the disposition of Fire Hall #3 (1030 9 Ave SE), over 22 Applications were received and four applicants submitted higher purchase prices as the deadline approached. OLSH's submission process closely resembles the process that currently takes place within the real estate industry.

However, The City is unique in that the sale of City owned land often needs to achieve other corporate objectives and is not solely based on the highest price offered. The current process of publicly marketing allows for OLSH to review each Application for the overall benefits it will bring to citizens in ensuring it provides the most benefit to the City while taking into account not only the financial impact but also other triple bottom line (Social, Economic and Environmental) objectives as well as specific corporate objectives that may be required i.e. timing of future development.

OLSH is in the process of undertaking further analysis and review of the sales process to identify potential opportunities within the existing process to obtain efficiencies. In addition, the review is expected to identify tactics to be utilized in achieving various objectives that will be set out in a guideline for members of Real Estate Sale & Marketing to reference. OLSH will be providing status updates to Council through LASC as work progresses in the coming year.

Stakeholder Engagement, Research and Communication

A number of organizations use auctions to sell real property. The City of Calgary currently conducts tax sales via auction as required pursuant to the *Municipal Government Act* (Alberta). Properties going up for auction typically tend to be in poor condition (homes) or unusual properties (parking stalls or odd shaped lots) where taxes are in arrears and the property owner is unable to bring their property taxes up to date. Past experience shows that tax sale auctions have failed to generate regular sales as the reserve price is higher than auction attendees are

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prepared to pay, despite the fact that the reserve price was included on promotional materials for the event. In addition, some successful bidders have failed to complete the purchase once they understood the auction process and what they are buying.

The Province of Alberta's Department of Energy uses a public offering process for mineral rights leases which is similar to OLSH's current sales process. Each year, the Department of Energy holds an average of 24 sales (Public Offerings) of petroleum and natural gas rights. The Crown always retains title to its minerals and sells petroleum and natural gas rights by way of lease or license. Companies or individuals submit bids and a petroleum & natural gas agreement is issued to the highest bidder for each parcel. The process takes 20 to 22 weeks in total.

McKenzie's Associated Auctioneers is currently taking bids (as of November 14, 2014) on a home in Leamington, Ontario. Bidders register online and provide information that allows the auctioneers to verify their identities and financial qualifications. A \$10,000 deposit is required to bid (certified cheque payable to the auctioneer). If the deposit has not been received before registering, the bidder cannot bid until the deposit has been received. The successful bidder is required to pay an additional \$50,000 by certified funds within 48 hours of the closing of the auction. The property is sold as is, where is, with all faults. McKenzie's website includes a disclaimer saying that they have made every attempt to show the condition of the property and they strongly encourage bidders to view the property in person. McKenzie does not charge a fee to conduct the online auction. Instead the successful purchaser pays six per cent of the selling price to the auctioneer within 48 hours of the closing of auction.

The website liveauctiongroup.com conducts online auctions of real estate predominately for banks and municipalities in the United States. The onus is on the property owner to check identities, financial qualifications and collect deposits (typically 20 per cent of anticipated sale price). Live Auction Group would build a City of Calgary branded micro site for a fee of \$2,500.00 and would charge \$175 per asset. Calgary.ca would have links to the third party website used. Further investigation would be required to determine if the Live Auction Group website complies with the Alberta legislation and could be used.

Websites such as eBay and Kijiji provide venues to post ads at no cost or at low cost. A search of current listings on eBay yielded zero listings in Calgary and a search of Kijiji showed that most ads were used to gain exposure for the listing realtor; and as the start to a traditional face-to-face sales approach.

Strategic Alignment

OLSH uses a submission process to obtain market value in alignment with its current business process.

Social, Environmental, Economic (External)

General

Although all sales techniques achieve the same goal, the transfer of net proceeds to the Real Estate Retained Earnings reserve or the Revolving Fund, the biggest risk posed by the use of auctions would be the inability for OLSH to negotiate APS that achieve municipal goals and objectives.

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Social

Currently, OLSH can negotiate with purchasers on projects that will preserve historical buildings, adding to the mix of non-market housing units, revitalize communities or create economic development.

Environmental

Negotiated APS's include terms and conditions which can enforce environmental building practices or innovative building technology. Terms and Conditions set out the responsibility and liability for purchasers as it relates to the environmental condition of properties at the time of sale and protect The City. The current process employed by OLSH in the sale of property allows for the disclosure of known environmental information and also allows for potential purchasers to complete the necessary due diligence prior to waiving conditions for sale. Through an auction, there is a greater onus on The City not to mislead any bidder as to the environmental status of the property and may result in more time, resources and costs incurred by The City to thoroughly investigate the environmental status of the property. An auction would not allow sufficient time for bidders to complete environmental due diligence on their own and they would be unlikely to undertake the cost prior to knowing they would be the successful bidder. The result being that properties being sold "as is" through an auction with no ability for bidders to undertake additional due diligence may be reflected in lower prices being offered.

Economic

In the current process, the highest price can be rejected if another Application achieves City economic goals and objectives such as job creation, economic diversification or support an emerging industry.

Financial Capacity

Current and Future Operating Budget:

Option 1: Live Auctions

Staff resources would be needed to verify identities, qualify bidders, manage the collection and return of qualifying deposits and conduct on-site auctions. This time is not included in current staffing allocations for OLSH.

Staff would need to qualify and be licensed as auctioneers. A trust account will need to be set up, operated and maintained in strict compliance with the *Public Auctions Regulation* (Alberta). All auction records will need to be maintained and held in accordance with the *Public Auctions Regulation* (Alberta). The staff resources required for this is not included in current staffing allocations for OLSH, nor is there a budget for the additional costs for staff to qualify, pay licensing fees and maintain status as auctioneers.

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Options 2: Online Auctions

Considerable staff time and costs would be required to build an online system capable of verifying identities, qualifying bidders and accepting bids. As online auction sites are attractive targets for hackers, the system would need to be monitored on a 24 hour basis to ensure highly confidential information on bidders is protected.

A full service auction provider removes the requirement for OLSH to internally resource and ensure staff are appropriately qualified and licensed as auctioneers. However, the upfront preparation of properties for sale, and marketing budget for auction are not currently included in operating budgets and adjustments may be required to accommodate increased costs associated with these activities should full service auction providers be used.

Use of an auctioneer's websites (such as McKenzie's Associated Auctioneers) or third party auction websites (such as liveauctiongroup.com) to conduct online auctions would shift the website costs away from The City but not all the time and effort required to qualify bidders. Use of an auctioneer's site would require a link on Calgary.ca. Typically auctioneers do not charge a fee to conduct an online auction but instead charge the purchaser six per cent of the selling price.

Use of a third party entity (such as liveactiongroup.com) would cost \$175 per asset and would require City staff time to qualify bidders. In addition, OLSH staff would need to qualify and be licensed as auctioneers, a trust account must be set up and auction records maintained in accordance with the *Public Auctions Regulation* (Alberta).

Option 3: Current Submission Process

The submission process used by OLSH is currently reflected in 2015 – 2018 Action Plan and covered by the current and future operating budget.

Risk Assessment

Risks for Option 1 and Option 2 are outlined in the challenges section on page 2 and 3.

Should the property not sell through any of the three options as a result of offers not being received or bids not meeting reserve price it is possible a "stigma" may be attached to the property. Option 3, Current Submission Process, provides OLSH the flexibility required to adjust the list price of the property with minimal cost and time incurred. The existing marketing materials can be updated electronically and re-released to our website and sent through the industry mailout. However, given the level of upfront cost to prepare for options 1 and 2 with specific marketing materials geared toward an auction, administrative costs of qualifying bidders and preparing and running the auction The City would have sunk costs as new marketing materials would be required to market the property through our current process or we could reuse the same marketing materials to run another auction and additional costs for preparations and administration of the auction would be incurred.

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REASON(S) FOR RECOMMENDATION(S):

The current submission process benefits citizens by:

- using a proven method that reaches the appropriate market and creates auction like conditions that yields fair market prices for real estate assets;
- the ability of auctions to extract higher price is unproven in academic research on the topic;
- provides the opportunity for Council to achieve the economic, social and environmental goals outlined in the Municipal Development Plan;
- provides citizens of Calgary an equal opportunity to participate in all sales transactions with The City;

Attachments

1. Process Overview