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AUCTIONS AND §1031 EXCHANGES

Using the auction process can maximize the value in your next §1031 exchange.

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Investors today can find themselves daunted by the prospect of selling their highly appreciated real estate given the complex issues which must be addressed to ensure that the investor receives maximum value on the sale of his or her property. These issues include how and where to market the property, how to evaluate and qualify the offers received and the offerors that made them and how to determine the true fair market value of their property given its highest and best use. Ideally, if an investor could convey information about the property to all potential buyers, the marketplace would itself determine its highest and best use and, consequentially, its fair market value. Therefore, since disseminating this information to all potential buyers is so essential to a successful marketing and sales program, sophisticated investors are increasingly electing to sell their property via auction. Note that while auctions were traditionally utilized to sell bankrupt or non-performing assets, this is no longer the case. Highly appreciated, performing properties are now commonly sold via auction as well.

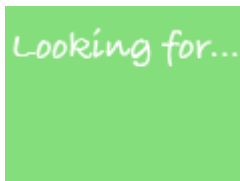
Proceeding with an auction as the selected disposition strategy provides numerous advantages with which conventional methods of sale simply cannot compete. The real estate auction is an accelerated and structured sale whereby the seller alone sets the terms of sale, including those of the actual purchase and sale agreement. A properly conceived marketing program should be comprehensive, the goal of which is to reach all potential buyers in the marketplace for the subject property. The seller's property is sold and subsequently closed upon as-is and on a non-contingent basis on dates that are designated by the seller. Furthermore, inherent in the auction process is a deadline, which creates the sense of urgency that forces buyers to act immediately. Finally, in many cases, a property sold at auction will attract more potential buyers than one sold conventionally simply because many buyers have the perception that they may be able to obtain a better deal when purchasing through an auction.

Another major advantage that the auction provides is the minimization of carry costs associated with prolonged conventional marketing programs. Moreover, not only will the competitive bidding process, sustained by an atmosphere of excitement and urgency, yield the highest price for the seller, it may also in fact cause the property to trade for a premium. In effect, the auction process establishes value without ever setting a ceiling on price. Consider a conventional program where it is unlikely that property will trade for more than the asking price, which is generally the starting point. In an auction, however, 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.

Finally, and perhaps most importantly, for an investor wishing to exploit these advantages as well as those of a §1031 tax-deferred exchange, is the fact that, in an auction, the timeline for due diligence, inspection, sale and closing are determined almost unilaterally by the seller. While timing is always important, in order to execute a §1031 exchange, it is imperative. The auction affords a seller



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with the ability to sell property as-is and on the timeline that is consistent with the seller's trading objectives.

Consequentially, investors ask on an increasing basis whether they may perform a §1031 exchange when utilizing the auction process to sell property. The answer is that both forward and reverse §1031 exchanges may be performed where property is sold via auction provided that the exchange is properly structured in advance of the auction. If, in fact, an investor is in the process of performing a reverse exchange and has completed the acquisition of the replacement property, but not yet sold the relinquished property, using an auction to sell the relinquished property may enable the investor to timely complete his/her exchange within the 180 calendar day safe harbor period where, otherwise, the exchange might fail.

As with all §1031 delayed exchanges, where the relinquished property is sold before the replacement property is purchased, the investor must satisfy all of the requirements under §1031 to perform an exchange. He or she must still satisfy the requirement that the property has been "held for investment or for use in a trade or business." In addition, exchange documents must be prepared and executed prior to the sale of the property reflecting that an exchange is to be performed. Finally, the contract of sale must permit its assignment to the qualified intermediary prior to closing or the sale of the property and then subsequently must be assigned. A qualified intermediary should be engaged to provide guidance as to the above issues and to make sure that the exchange documents are properly drafted. The qualified intermediary should be apprised in advance of the particular requirements of the auctioneer conducting the auction and the terms of the contract of sale to be used by the auctioneer. Careful advance planning and consultations with a qualified intermediary and one's legal and tax advisors is critical to the success of the exchange.

Once the exchange is structured, the auction may proceed in the same manner as it would if an exchange was not being performed. In fact, there is no need for bidders to be made aware of the fact that the seller may be performing a §1031 exchange during the bidding process.

In summary, the auction process provides investors with a way to ensure that maximum value is obtained through the structured process detailed above while simultaneously accommodating the requirements of a §1031 exchange. Thus, by realizing the highest possible sales price, on ownership's terms, while minimizing carrying costs and deferring taxes, investors can truly maximize value by implementing an auction in conjunction with a §1031 exchange.

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