

Auctioneers Reveal The Secrets Behind Reserve Prices



The reserve price is something of a holy grail in the auction market. It is something that most auction buyers seek, but are very unlikely to discover – at least before sale day. So in this report we will look at how reserve prices are arrived at and take in some insight from auctioneers as to how they determine them.

What exactly is a reserve price?

In auction parlance a reserve price is the minimum price at which the seller has authorised the auctioneer to sell a property for.

Auction reserve prices are kept strictly confidential between seller and auctioneer and not revealed to buyers. Of course, it may become apparent what the reserve price is or was during or after the sale – although that is of little use when planning a purchase.

Reserve prices and the connection to guides

While reserve prices are not disclosed to sellers before the sale it is possible to get a handle on what they may be by looking at the guide price quoted in the auction catalogue. The guide price is not the reserve price, nor necessarily the selling price (although it may sometimes turn out to be). It may be a single figure or a range, eg. £225,000-£250,000.

Surveyors' organisation RICS recommends that 'the guide

price is an indication of the range within which or, in the case of single figure guide prices, within 10% of which, the minimum sale price will fall.'

So how are reserve prices arrived at?

It is logical to expect that reserve prices originate by looking at recent comparable sales prices and trying to establish a market value. Of course, one snag is that some properties are listed at auction because it is difficult to ascertain their market value. For example they may be unique with few comparables or may need rectification or improvement work.

The state of the respective commercial or residential property market at the time of sale is also relevant. Auctioneers are likely to look at what supply and demand is like, and whether prices are rising, falling or static. They will also likely look at factors including yields, the likely cost of any work, and perhaps the development cost when arriving at a value.

This is unlikely to be the whole story however: Pretty much every auctioneer will tell you that fortune favours the brave when selling at auction. Low guide prices (and hence reserve prices) promote competitive bidding and may help to achieve a higher selling price than when higher guides are used. But this will very much depend on the circumstances of the seller. For example, how much they want or need to sell and whether they

are willing to go to market with a reserve that is considerably lower than market value in order to not only achieve a sale but potentially one at a better price too.

Thoughts from the auctioneers

Next let us take in some thinking from auctioneers as to how they arrive at guide prices for their sales.

Phillip Arnold, Managing Partner and Auctioneer at Phillip Arnold Auctions outlines the process: "The reserve price is the minimum level that a property can be sold at. It needs to be competitive as that is the nature of auction. Therefore the reserve needs to be at least 20% below what is considered open market value.

"A good auctioneer will research the market properly and consider comparable evidence in reaching an opinion of what the open market figure would likely be and then deduct 20% to set the reserve.

"This isn't a precise formula as other factors need to be considered such as the vendor's situation and reason for sale, whether the contract has any additional costs to pay etc. This may mean that the auctioneer will suggest a reserve 25% to 30% below open market value to accommodate these instances.

"However, the most important factor if selling at auction is to set the reserve at a level that the property is almost guaranteed to

sell at. That being the case, it will be sold and should attract enough interest to sell towards the open market value.”

Ian Kitson, Director of Property Auctions & Valuations at Cheffins points out that setting a reserve price is very much a matter of finding the right balance: “When it comes to agreeing a reserve price for a property, this is a balancing act between estimating the market value of the property and also taking into account the sellers’ expectations.

“Whether this is for a house, a piece of land or a commercial building, we look at recent comparable sales results and put these into the mix along with the current state of the market and this generally gives us a good idea of the property’s worth.

“But to overwrite that, sometimes we have sellers who need to make sure of a sale and in this sort of scenario we would put a lower reserve (and indeed guide price) against the property in order to boost the chances of success on the auction day. There is also the opposite end of the spectrum here, where a seller might have too high an expectation and want a high reserve, but this would necessitate a high guide price which is likely to deter buyers.

“At the end of the day, this is a balance between our recommendations of market value and the sellers’ aspirations and individual situations.” ●

Mark Hempshell
