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Foreclosures at Rock-Bottom Prices

Opportunity knocks for buyers who aren't put off by legal squabbling and potential delays.

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When we wrote about Kerry Deland in the January issue, she was stuck in limbo by "foreclosure-gate" (see When Home Prices Will Head Up). Last August, Deland, of St. Cloud, Fla., finally nabbed her dream home -- a bank-owned foreclosure with three bedrooms, two baths and five acres of land for her horse -- for an easy-to-take $111,900. But her closing was delayed in October after the seller, Fannie Mae, temporarily put all of its foreclosure properties on hold.

Deland patiently waited out the scare. By late November, as all 50 state attorneys general continued their investigation of so-called robo-signers and the process used to repossess many homes, Fannie Mae -- as well as Freddie Mac, Ally Financial, Bank of America and JPMorgan Chase -- lifted the freeze. Deland's contract was extended to December 30, and she lined up an appraisal, a home inspection and homeowners insurance. Now she is back on track to close on her new home. "To me, it's been worth it," she says. "This is what I've been wanting for over a year."

Before the robo-signers and the missing documentation of foreclosure-gate came to light last fall, bank-owned properties sold for an average discount of nearly 41% off the price of "normal" homes for sale. The discount could get even more attractive if spooked buyers stay out of the market. That spells opportunity for buyers prepared to do their homework and abide by the sellers' rules -- yet act quickly when they spot a good deal.

Bona fide bargains

How do you avoid getting caught in the red tape of a foreclosure dispute? Lenders imposed the foreclosure freeze for two reasons: to determine whether completed foreclosures were handled properly -- and, if not, to fix them -- and to correct the process for future foreclosures. So the more recently a foreclosed home was listed for sale or relisted following a review, the more confident you can be that the bank or institutional seller holds "good title" to the property and has the right to sell it.

Another clue: A title insurer will commit to providing you with an owner's policy. That means the odds of a challenge to your ownership are slim enough that the title insurer is willing to agree to defend you. And all the legal squabbling won't change the fact that the vast majority of homeowners in foreclosure belong there.

You can bid on a foreclosure at auction. But for most home buyers, real-estate-owned properties, or REOs, are a far less risky route to a bargain. If bidders at foreclosure auctions fail to meet the bank's minimum (usually the balance of the mortgage), the bank will buy back the home and sell it as an REO. With an REO you don't have to deal with a harried homeowner, a difficult-to-evict tenant or, in some states, a mandatory redemption period during which the previous owner can try to get the home back.

For banks and other institutional sellers, REOs are financial baggage. They aim to sell them quickly and efficiently and to recoup as much of their money as they can. They typically respond to purchase offers within days and will close as quickly as possible.

Contrast that with short sales, in which distressed homeowners hope to sell for less money than they owe on their mortgage, subject to their lender's approval. In Las Vegas, almost half of the available listings are short sales, but exclusive buyer's agent Adele Hrovat says that it can take six months or longer for a bank just to say it will consider the offer. It can take a year or more to actually decide (and the answer is usually no).

To avoid the angst, Ralph Spence III, 25, shopped for an REO foreclosure instead of a short sale in Las Vegas last summer. Spence thought that prices had fallen low enough to make buying worthwhile and set a limit of $200,000. His first bid lost out to an all-cash offer. He bid on a second home -- with five bedrooms and two and one-half baths -- after seeing only photographs of the place. The lender repossessed it at auction for $155,000 and listed it for $180,000. The lender countered Spence's full-price offer with a request for his "highest and best" offer -- so Spence offered $196,000 with contingencies for a home inspection and financing. After the bank accepted his offer, Spence was relieved to discover that it looked as good in person as it did in the listing photos, and the inspection turned up only minor problems.

While Las Vegas has a plethora of REOs on the market, in other areas the pickings aren't as easy as you might think. In the third quarter of 2010 (the most recent data available), more than two million homes in the U.S. were somewhere in the foreclosure process, according to RealtyTrac, which tracks properties in foreclosure. The greatest numbers were concentrated in California, Nevada, Arizona and Florida. Of the total, lenders held 952,489 REOs, but RealtyTrac estimates that just 30% are listed for sale. Lenders will continue to dribble them onto the market to avoid creating a glut that depresses home prices even further.

Tips for buyers

The more unencumbered you are as an REO buyer, the more likely you'll succeed. Lower offers from cash buyers generally win out over higher offers from buyers who need a contingency for financing. Most institutional sellers won't accept a contingency for the sale of your home or other property.

It's also smart to hire a buyer's agent who has had recent experience with REOs, especially in your target neighborhoods. You want someone who knows what's selling there and what constitutes a really good deal. You can go to www.realtor.com or www.crs.com and search for agents who specialize in buyer agency and in foreclosures or REOs. Or you can hire an exclusive buyer's agent (www.naeba.org).

Patience and keeping your cool are imperative, say agents, because you may have to put in many offers before you get a house. Exclusive buyer's agent Dawn Rae, in St. Petersburg, Fla., says real estate agencies that specialize in bank-owned properties often have working relationships with groups of investors that will snap up properties before anyone else can.

Be prepared to accompany your offer with a minimum $1,000 earnest-money (escrow) deposit. If you need financing, you must include a prequalification letter from a recognized lender. If the seller receives multiple offers, "its procedure is discretionary," says Orlando broker Dorothy Buse, who lists REOs for institutional clients. You won't know how it picks one offer over another.

The seller will generally take at least five working days to accept or reject your offer. If the seller accepts, it will send a signed contract within about two weeks. If you can't meet the agreed-upon closing date, the seller may provide an extension -- or not. But if it does, it will typically impose a penalty of $50 to $100 for every day past the original date.

Triple protection

Although sellers hold the upper hand, you're not without influence:

Have the home inspected. REOs are sold "as is," and you've probably heard the horror stories about missing appliances and cabinetry, stripped wiring, and cement-filled toilets. Although agents say that banks now make more of an effort to make properties appealing, Minneapolis real estate lawyer Steven Nash says that sometimes paint and carpet just cover up problems. The longer a home has been in foreclosure or sits vacant, the more likely it is to have issues. Nash suggests that you talk with the local police and fire departments as well as neighbors to learn whether the home was damaged or vandalized.

The home inspector should look under, inside and behind everything possible, and use a moisture meter or infrared thermography to check for dampness. If you're thinking of renovating a home, you may also want to hire a structural engineer for a review. If the results of the inspections are unacceptable, you can bail out and get your earnest money back.

Get title insurance. One of the advertised benefits of buying an REO is that the seller assures you of clear title -- the seller has eliminated any claims against or defects in the title that could impede your ability to resell the property later or force you to defend yourself against those claims. But title searches aren't perfect, and foreclosure-gate has cast doubt on the validity of the title to some foreclosed properties (especially in states where foreclosure decisions are reviewed by a judge). Your best defense is an owner's title-insurance policy. With it, the title insurer will either "perfect the title" or pay any valid claims. Without one, you must bear your own legal costs to defend against a claim.

Ideally, you should obtain an *enhanced* owner's policy, which the American Land Title Association says covers a broader range of risks existing before and after the settlement date than a standard owner's policy does. Be sure to review the policy's Schedule B, which lists exceptions to coverage. Don't accept a policy that excludes challenges to your ownership deriving from the foreclosure process.

Get a lawyer. Hire your own real estate lawyer to scrutinize the seller's contract as well as your title-insurance policy. Nash charges $200 to review closing documents and review or negotiate a title commitment.

Nash and real estate agents recount instances in which a seller, having failed to do something specified in the purchase agreement, has come to the closing and said, "Take it or leave it." At that point, the buyer has little choice but to cave or walk away. Before closing, don't invest more money than you're willing to lose.
