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REAL ESTATE

Risky business: buying foreclosures Being quick and liquid helps, but booby traps are legion

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SAN FRANCISCO (CBS.MW) -- In the complicated yet potentially bargain-laden market in foreclosed homes, one person's tragedy can spawn another's opportunity.

When San Bernardino, Calif., resident Jeff Powell saw blazing wildfires devour property after property last October, he realized how the altered landscape of supply and demand would add tinder to one of the hottest pockets of the nation's housing market.

Powell immediately sought education and instruction in buying distressed properties -- a three-day workshop through [Foreclosures.com](#). He's since been racing across the area, identifying and snatching up undervalued properties -- and having fun to boot.

But buying foreclosures at a true discount isn't always easy or even fun, and it's not for the faint of heart. Like many real estate investments, locating a great deal requires a commitment to performing copious amounts of research, plus a working knowledge of your state's title and lien laws.

Further complicating matters, there are three main stages of foreclosure investing -- preforeclosure, foreclosure auctions and real estate owned (REO) properties -- each with its own set of tactics and strategies.

Additionally, the burgeoning number of online foreclosure-education and listing sites can present an onslaught of misinformation or saturated leads. Ultimately, it's up to the house hunter to separate the wheat from the chaff.

"Buying foreclosures is tough for your average buyer unless you're savvy, quick, liquid and can close inside of 10 days with substantial down payment and, very often, no chance to inspect," says Don Kramer, a Denver, Colorado-based real estate agent.

Powell identified his first property online on [Foreclosures.com](#), based in Fair Oaks, Calif., one of the few online sites that lists "preforeclosures" -- properties whose owners have notices of default, or lis pendens, but have time before they lose their home, equity and credit in a foreclosure auction.

The ideal preforeclosure owner is a "motivated seller" with substantial remaining home equity (the difference between existing loans and appraised home value). In Powell's case, his sincere approach to helping one owner out of a challenging situation helped avert foreclosure; he paid the owner cash for the remaining equity and took over their first mortgage.

After spending \$20,000 more on fix-up costs, he quickly netted over \$50,000 in profits. It hasn't hurt Powell that San Bernardino is currently the No. 1 housing market in the U.S., where home prices have appreciated 28.9 percent over the past year.

No easy road

Preforeclosure investors often get torched, however, with trip-ups such as buying without title insurance at a trustee auction, or not being able to perform a thorough property inspection to estimate repair costs.

"In no other type of distressed property investment is specialized knowledge so highly rewarded and ignorance so harshly punished," says Thomas Lucier, chief executive officer of Tampa-based Home Equities Corp. and author

of the book "How to Make Money Buying Pre-Foreclosure Properties before They Hit the County Courthouse Steps." The subheading of his book: "How to avoid getting ripped off when buying a pre-foreclosure property."

For the owner, undergoing the process of foreclosure is always a painful last resort. The most common reasons for foreclosure are divorce, loss of employment, drug-related problems or death in the family.

The foreclosure market can be a bull or a bear, depending in part on the number of homeowners facing financial trouble. But predicting whether the future rate of foreclosures will rise or remain steady is a tough game; it depends on a number of factors also linked to interest rates, mortgage debts and consumer debt.

A recent revised survey by the Mortgage Bankers Association shows that the seasonally adjusted delinquency rate -- a precursor for foreclosures -- for mortgage loans on one-to-four unit residential properties fell to 4.49 percent in the fourth quarter of 2003, its lowest level since the second quarter of 2000, when the rate was 5.51 percent.

"As the economic recovery continues, delinquency rates are declining from their post-recession peaks," said Doug Duncan, Mortgage Banker's Association's chief economist.

Walter Moloney, spokesperson for the National Association of Realtors, agrees that we may have seen a peak in foreclosures. "You usually see foreclosures lagging in a recovery," he says. "The rate of home price increase is going to slow this year, but we're still in a seller's market."

Low interest rates and the refinancing boom have allowed many homeowners to increase their overall net worth faster than their rising levels of debt. Still, the foreclosure inventory percentage at the end of the fourth quarter was 1.29 percent, near a record.

Where to start

So where does a liquid investor find these foreclosure listings? Traditionally, newspapers run notices of local foreclosure auctions; local state and county offices usually provide information as well. Research firms like Foreclosures.com collect preforeclosure data from various local county recorder offices for their active members.

Despite a wealth of online resources – www.bargain.com, www.foreclosurelistings.com, www.webreo.com, www.firstgov.gov -- investors might find it difficult to find undervalued houses on the Web, mostly because these listings are REO properties: homes that went to sale at foreclosure auction, but nobody wanted.

That means the lender retains ownership of the defaulted property, now a nonperforming asset; they usually then fix it up and sell. These are the same lists as those houses you'll find from sources like [Fannie Mae](#), [Freddie Mac](#), [HUD](#), the Veterans Administration and banks like [Citigroup](#).

"When it gets to the REO stage, everybody's selling from the same list," says Alexis McGee, president of Foreclosures.com.

"REOs are always going to ask for retail because they have no incentive to discount," says Lucier. "Your best opportunity is to deal directly with the owner before the loan is foreclosed."

Another site that offers pre-foreclosure training is www.preforeclosures.com.

The difficulty in finding bargains at the REO stage is related to general strength in the housing market. According to McGee, REO bargains are found when realty agents can't keep up with the number of incoming properties and are content to sell "as is," or when they have a number of bad loans. These conditions usually exist in a declining market. Hint: not now, in most places.

Powell has largely avoided REO properties, but he's been eyeing select properties as they head to the county courthouse for auction. In foreclosure auctions, the opening bid is set by the lender and is based on the full amount owed on the loan. Powell performed hours of due diligence, underwent a complete title search and had his cash ready on one particular home. "I should be able to profit \$75,000 to \$80,000 if I'm able to get it at the sale," he said before the auction.

As it turned out, Powell did not get the property. He reports that it sold "for above what I thought was the market value -- I had it valued at \$230,000 after repair and it sold for \$243,000 as is."

"Oh well, that's one difficulty in a sellers' market," he wrote in an e-mail.

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