

Buying Foreclosed, Short-Sale and Bank-Owned (REO) Properties

Excerpt from: South of 49 by Philip McKernan, Dan Sampson, and Mike Cunning

Step 1: Notice of Default (NOD)

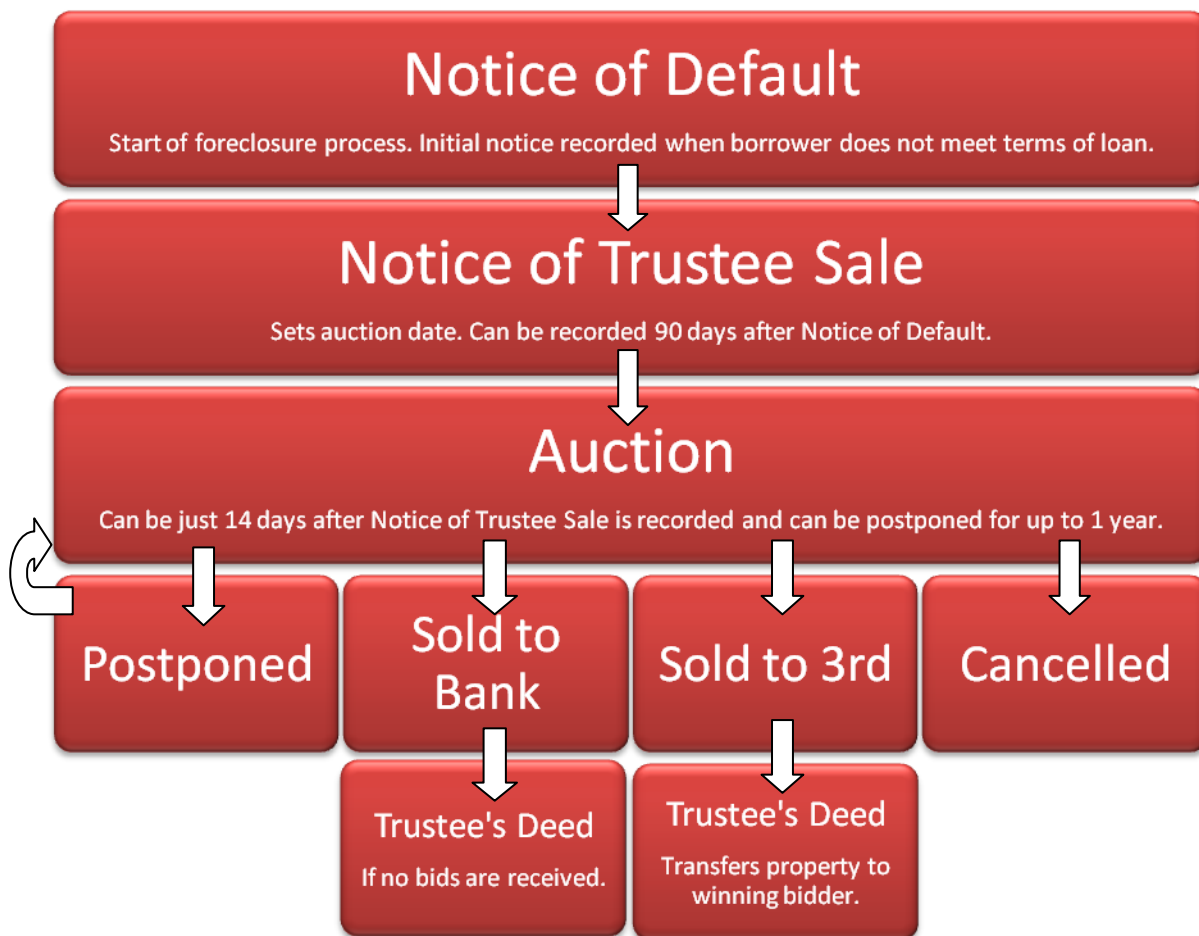
Properties are considered to be in pre-foreclosure from the filing of the initial Notice of Default until the property is sold at an auction. During this period, the owner/borrower can cure the default by refinancing or working out a payment plan with the lender; a buyer can purchase the home directly from the owner; real estate agents can list the home and sell it for more than the amount due, or ask the lender to accept a short sale.

Step 2: Auction

After 90 days, there is generally a Notice of Trustee Sale filed, setting the auction date 3 weeks in the future. The notice must be advertised for 3 consecutive weeks. If the default is not cured by the sale date, the property goes to auction. Anyone can bid at the auction. However, the first bid amount will be equal to the outstanding loan balances plus fees and must be paid IN FULL by cashier's cheque at the actual auction.

Step 3: Unsold Property Reverts to Bank

If there are no bidders, the property reverts to the bank. Bank-owned properties are commonly referred to as REOs (Real Estate Owned). Buyers can try to purchase these properties directly from the bank, but, in general, the bank will list the property for sale with a real estate agent after evicting tenants and clearing liens. They will usually not do more than cursory repairs prior to putting the property on the market.



Foreclosed Properties

When a property owner is no longer able to make his mortgage payments and defaults on the loan, the property goes through a process known as foreclosure. When this occurs, the lender initiates the sale of the property by auction through a third party, called a trustee. The trustee is required to advertise a notice of default of the property in the newspaper for 3 continuous weeks. Take a look in the classified section of your local newspaper and you'll see a list of foreclosed properties for your area. The owner of the property has until 5 days before the scheduled date of the auction to pay all monies owed; if the owner cannot come up with the money within the allotted time period, the trustee conducts an auction for the property on the steps of a courthouse located in the county where the property is located. As previously stated, when buying a property during a foreclosure sale, you must pay at least the loan balance plus any interest and other fees accumulated during the foreclosure process. You must also be prepared to pay with cash in hand. And on top of all that, you'll receive the property 100% "as is". That could include existing liens and even current occupants who need to be evicted. Foreclosure auctions are particularly attractive to all-cash buyers and investors who are familiar with the process and are looking to get the most value for their investment dollar. However, many properties currently going through this process have little or no equity and will not sell for less than the current market value. Considering the property would come to the auction winner complete with tenants and senior liens, many properties revert to the bank and become REOs (see below).

Short Sale Property

A short sale property is a property being sold by an owner that is heading to foreclosure. The owner realizes that he can no longer afford the monthly payment and tries to sell the house before the lender completes the foreclosure process on the property. The term "short" means that the owner has listed the house for an amount which is less than the amount owed on the loan, the listing price being a reflection of current comparable properties in the area. As an example, let's say someone purchased a home 2 years ago with 100% financing for \$680,000 in the middle of the hot real estate market. The home was purchased with an ARM (adjustable rate mortgage); then ARM matures after 2 years and the owner's mortgage payment jumps by \$1,500 a month. In the meantime, the real estate market cools down, driving down prices of homes in the area. The owner is no longer able to make the house payment and decides to put the home up for sale. An appraisal on the home puts the value at \$599,000. The owner is now upside down, owing more on the home than it's worth. He can't sell it for more than the current value of \$599,000 so he's hoping the lender will cooperate with him and accept less than the full amount owed. In the short sale process, the lender has the authority to approve, deny or counter the submitted offer.

REO Properties

REO stands for "Real Estate Owned." These are properties that have gone through foreclosure and are now owned by the bank or mortgage company. This is not the same as a property up for foreclosure auction. When buying a property during a foreclosure sale, you must pay at least the loan balance plus any interest and other fees accumulated during the foreclosure process. You must also be prepared to pay with cash in hand. And, on top of that, you'll receive the property 100% "as is." That could include existing liens and even current occupants that need to be evicted. An REO, by contrast, is a much "cleaner" and attractive transaction.

An REO property did not find a buyer during foreclosure auction. The bank now owns it. The bank will normally see to the removal of tax liens and mechanics' liens, evict occupants, if needed, and generally prepare for the issuance of a title insurance policy to the buyer at closing. Be aware that REOs are exempt from normal disclosure requirements like the Transfer Disclosure Statement - the document that requires sellers to tell you about any defects they are aware of.

Most buyers assume that any REO must be a bargain and an opportunity for easy money. This simply isn't true. You have to be very careful about buying an REO if your intent is to make money on it. While it's true that the bank is typically anxious to sell quickly, the bank is also strongly motivated to get as much as it can for the property. When considering the value of an REO, you need to look closely at comparable sales in the neighbourhood and be sure to take into account the time and cost of any repairs or remodelling needed. The bargains with money-making potential exist, and many people do very well buying foreclosures. But there are also many REOs that are not good buys. This is where you have to do your homework to make sure the property you are interested in fits your needs.