



On the Courthouse Steps A Risky, But Potentially Profitable Way to Purchase an REO

By
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Qualified homebuyers have the upper hand in today's real estate market, as the oversupply of housing inventory, historically low interest rates and depressed property values have characterized the market as a 'buyer's market.' The distressed environment has buyers seeking out discounts; many look at foreclosures as a viable option. Foreclosures may be purchased directly from the bank through a real estate agent – these real-estate-owned (REO) sales afford the buyer many of the safeguards as a non-bank-owned sale does, such as contract contingencies as well as ample time for inspections, appraisal and other buyer diligence. Alternatively, some foreclosures may be purchased at a public auction. As this article will divulge, property auctions are challenging arenas with unique risks and rewards when compared to traditional transactions.

Foreclosure auctions are held in cities across the nation, in public areas which usually are literally on the courthouse steps. The timeline for a foreclosure loan is lengthy and multi-faceted. Foreclosure is the legal process by which an owner's rights to a property are terminated because of a loan default. After foreclosure, the lender sells the property to recoup money owed on the defaulted loan. In California,

non-judicial foreclosure is the most widely used proceeding, which does not require the participation of the court system. This foreclosure is a three step process. First, a borrower defaults on a home loan - generally by not making payments. A Notice of Default is then recorded and the borrower has generally 90 days to remedy the default by paying the deficient amount plus any applicable fees and interest. Second, if the default is not cured in this period, a Notice of Trustee Sale is recorded, indicating that the lender or trustee will publicly auction the property in a specified number of days. At auction, if the property does not receive bidding at a price acceptable to the lender they take possession and sell it as a REO property in the open market.

Notices of Trustee Sales are public record. A buyer can research the public records at the local County Recorders Office to find out if a particular property has a recorded notice of default and when the first potential date of sale would be. Buyers can also subscribe to a number of online websites that will provide a list of the properties that are going to be auctioned on a given day and what the starting bid is. Often, the actual starting bid is much lower than what is published, which is typically the outstanding balance on the loan plus costs associated with the sale. Although

the list of properties to be auctioned is readily available through multiple channels, the list varies considerably from what is actually auctioned that day. The list, which may contain hundreds of properties, is greatly narrowed on the auction day as properties are pulled for a variety of reasons. Foreclosure sales may be postponed up to three times by the borrower, lender or investor in addition to a host of other reasons such as the borrower filing for bankruptcy, progress in a short sale transaction, or because the owner has brought the loan current.

The actual auction is a surprisingly informal process when you take into consideration millions of dollars worth of inventory will be sold in just a few hours. The process literally takes place on the courthouse steps with all the distractions of a typical courthouse. Buyers participating at the auction are dressed in all different ways so you can never be sure who your competition will be. When you arrive at the auction you will need to introduce yourself to the auctioneer, check in with a photo I.D. and show the auctioneer that you have the ability to close a deal with proof of funds or there is a good chance you will be overlooked.

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Participants in the auction are from varying backgrounds. The largest group is people who represent sophisticated investment groups. The bidder is part of a team which includes ground scouts, who investigate properties on the day they are being auctioned to check on their condition, occupancy status and external factors which may affect value. Also part of the team are analysts, who check title information and determine a price point at which they are willing to acquire a property and make a required profit. The most crucial part of the team is investors who provide capital to the team in return for the chance to make a positive return on their money. These investment groups typically rehabilitate distressed properties and flip them as quickly as possible.

There also may be non-professionals at the auction. These buyers may be looking for a discounted home for their own occupancy, or may be attempting to compete with investment teams by flipping an auction property themselves. Generally, both of these scenarios are hard to successfully do and many individuals prefer the option to buy REO properties on the open market with the help of a licensed agent. It is difficult to compete with the sophistication of structured investment groups, but occasionally an individual buyer can place a winning bid on a property. This will be either because of a difference in the perceived risk (such as a difference in information between the individual and the investor group, like a foundation issue or title issue one of the parties is not aware of), or because of a difference in required/preferred returns. If an investment group holds a highly preferred margin, they may not bid as high as an individual who will be satisfied with a smaller profit. This same situation may happen to a person wanting a home to live in themselves. Although the possibility is there, it is not easy for an individual to do proper diligence, value properties appropriately and spend considerable time at the auction location without the support of qualified professionals.

If you are interested in purchasing a foreclosed property at the auction, you need adequate available funds. You will

need to bring certified checks or money orders made out to yourself. If your offer is accepted then you will sign over the checks to the auctioneer. It's a good idea to bring several checks in various increments ranging from \$1,000 to \$50,000. If there is an overpayment you will receive the balance back within a few weeks. **Remember that all purchases are final, but that does not mean you do not owe any more money, as I will now describe.**

Efficiencies make auctions attractive, but they also cut out many of the consumer protections that the traditional real estate process provides, like title insurance and the ability to easily finance. Another challenge with purchasing a foreclosed property at auction is most often there is no inspection period unless the property was previously listed for sale and the buyer had the opportunity to conduct an evaluation. A buyer may get an excellent deal on an auctioned property only to pull up the carpet after the purchase to find a cracked slab. Termites, water damage, dry rot, plumbing, electrical and roofing problems and other deferred maintenance issues may plague a foreclosure. It is also common for the property to be either occupied by tenants or the former owner. Often, a negotiation process involving cash-for-keys will be used to bring the property vacant, as it is preferred to a formal eviction which typically takes

longer and can be more costly than the cash-for-keys route.

One of the biggest risks associated with auction homes is the issue of the property's title. It is not uncommon to find out a property title is encumbered with items such as property tax liens, IRS liens, mechanics liens, HOA liens and a backlog of special assessment debt. If you have a particular house in mind it would be wise to spend the time and money for research into liens that will affect title. There are some online websites that provide this service. You could try to research the title yourself, contact a title company or contact your real estate broker for assistance as they normally have a working relationship with a title company.

Purchasing a foreclosed property at auction is risky and every precaution should be taken to minimize the wide variety of risks, but it can also get you a great property for an extraordinary discounted price, given that circumstances are in your favor. The risks and rewards in participating in foreclosure auctions are clear, and there are people whose risk preferences are such that they may find it worthwhile. ☺

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