

Are Foreclosure Properties Good Deals?
By Richard Stanley
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Many of us remember the dark days of the early '90s when lenders were major players in the local real estate market. Then, Los Angeles County went through its worst economic downturn since the Great Depression. At the end of the Cold War, the aerospace industry contracted violently. Jobs—and people—left the area en masse. Prices plunged, as sellers, trying to sell short, raced to the bottom.

In such a scenario, market values can drop below the amount owners owe to lenders. This phenomenon is called being “upside down”. Add in loss of income due to unemployment, illness, death or divorce of a partner and relatively high monthly payments and you have the perfect storm of a foreclosure market—and why market values dropped by half from their 1989 highs to their 1995 lows.

Is this effect what is happening now? No. So far, the local economy is strong—and more diverse than in the 1980s. Demand for certain properties continues. Interest rates and inflation remain low. Most owners have a healthy amount of equity in their homes. So why are foreclosure properties, known in the real estate industry as “REOs”—Real Estate Owned—in the news again?

Market contractions are Darwinian. The weakest real estate markets wilt first—and are the last to revive when a market upturn arrives. The second home market in the desert and mountains and areas where owners have inelastic financial resources are usually the most vulnerable. If you look hard, you might be able to find a few REOs in the Los Feliz area.

All that said, are foreclosure properties good deals? The short answer is: no, not in the current market in our neighborhood. The myth of the REO as a good deal derives from the lingering popular perception that REOs are priced under comparable properties.

This perception was, to some extent, true in the early '90s, when incompetent lender “asset managers”, often in distant “cube farm” offices, processed significant numbers of local properties. These asset managers were bureaucrats with little or no stake in the outcome of a sale. In a rapidly declining market, achieving a lender’s top dollar was not as important as liquidating these failed assets as quickly as possible. In hindsight, some buyers got good deals in the rush to dump.

Then as now, however, it’s important to consider a few facts. REOs are often inherently weak properties due to factors such as condition, location, quality or style. When a property is foreclosed, usually there is a “Trustee’s Sale”.

Anyone can bid at such sales, but usually the lender whose note is in default acquires title to the property. Remember, that if you purchase a property at a Trustee's Sale, all sales are "as is" and final. You will not have any contingencies, nor will you get any disclosures or title insurance. Caveat emptor.

Another fact about REOs is that, when a lender sells a property acquired through foreclosure, the lender/seller is not required to provide usual seller disclosures to the buyer. Again, caveat emptor. Also remember that people who lose properties to foreclosure usually do not treat these properties well. If you're lucky, the house may have suffered only deferred maintenance. Sometimes the house has been victim to what lenders term "destruction of collateral". Major fixtures, such as cabinets, windows, systems—even toilets—may be gone.

One frustrating aspect of buying an REO is that normal contract procedures are ignored. If you want to submit an offer on an REO, have your realtor write it (sometimes on the lender's own form) and fax it to the lender (personal offer presentations never occur). You will have to wait sometimes a week or longer for the lender to review your offer. In the meantime, additional offers can arrive, even a dozen or more. In today's market, the bidding can get heady. Offer prices can rise above the lender's asking price. Counter offers are less-frequently seen on REO properties sometimes a week or more, so make your offer one you will have no remorse over if the lender ignores it. If you are the lucky purchaser, you probably won't see anything in writing for a while. This lack of customary procedure can be nerve-racking. When the paperwork arrives, expect to be asked to sign lots of waivers.

One last fact: in the current market, many REOs are horribly over-priced. They can sit unsold for months, due to poor asset management and little or no marketing. So, are REOs good deals? Not usually. Not yet.

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