Buying Foreclosure Homes

5 Steps That Will Guarantee a Quality Investment

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Introduction

The process of buying or selling a home is quite complicated. The housing marketing often takes dramatic turns, and real estate prices can shift without warning, reflecting the proportion of sellers to the number of buyers. There are ways, however, to find inexpensive homes no matter what the current condition of the real estate market is.

If you are a buyer who is interested in purchasing a house, there may be ways to save money on the purchase of a new home. Because of a struggling economy, many current homeowners are struggling to get rid of homes they can no longer afford. Homeowners who are not able to make mortgage payments may be facing foreclosure.

Foreclosure is the process wherein a bank or other lending institution tries to reclaim property when the payments for a loan are not made on time. Consumers who cannot make regular mortgage payments may have to foreclose on their homes. During this process and after the foreclosure process has been completed, the price of a home is often listed far below its actual value.

For this reason, many moneywise consumers search for foreclosure homes to purchase. When you buy a foreclosure home, you can get a lot of great house for an equally great price. However, there are some issues with foreclosure homes that should be considered.

This guide will help you understand the process of finding and purchasing a foreclosure home. You can decide, with the help of this guide, which step in the foreclosure process will present the best housing prices with the least amount of risk. As with any major real estate purchase, it is crucial to proceed with caution. If you take your time and evaluate all the pros and cons of a foreclosure home, you may very well be in a position to make the best investment of your life.

What is key with foreclosures, and this is 25 years of experience speaking, is to have clear expectations of your plan for investing in real estate. I cannot tell you how many times we hear about investors following the advice of these books and tapes investors from yesteryear which don't make sense. This misconception of what banks or private note holders are willing to do to rid themselves of the foreclosed property is why I wrote this book. As an REO Broker for 25 years, managing listings for banks during the good times and bad, we rarely, if ever, see the liquidation fever as described in the seminars new investors attend. The one exception is a bulk sale where you are buying multiple properties, good and bad. However, this book is for the "everyday investor" who is looking for the next home to live in, rental, or a flip.

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Chapter 1

Step 1: Getting Started

Home foreclosures can be found in just about every real estate market in the nation. The sudden loss of a job, a generally struggling economy, and other unforeseen financial circumstances can contribute to issues with making regular mortgage payments. Any of these factors can cause problems for current homeowners and result in home foreclosure.

Many interested buyers do not realize that a foreclosure home can actually represent an incredible opportunity for successful investment. A foreclosed home is a home that has been repossessed by the lender who fronted the money for the initial purchase of a home.

If, for instance, a bank provides a consumer with a $100,000 loan for a home, the bank trusts that that money will be paid back in regular payments by the new homeowner. If that money is not paid back, the bank will issue several statements requesting the balance of the loan. If the buyer still does not make mortgage payments, the bank has a right to reclaim the property that was purchased with the intent to sell the property back.

Foreclosure homes are owned by lending agencies. These agencies want to sell the homes in their possession as quickly as possible in order to make back the money that was spent on the bad loan. When banks have multiple foreclosed properties in their possession, they may actually be losing money. For this reason, consumers can often find great deals on foreclosed homes purchased at auction or from the lending company.

If you are interested in purchasing a foreclosed home to save money, there are a few basic steps you need to understand when getting started.

Choosing the Right Foreclosure Stage

Foreclosure is a process, and that process has many different stages at which a home can be sold and purchased. It is important to understand these different stages and choose the foreclosure stage where you will be comfortable purchasing a house.

The three basic steps of foreclosure include:

- Preforeclosure: This is the period of time in which a homeowner is facing foreclosure but still has the opportunity to sell a property himself or herself. Many homeowners quickly sell their homes during preforeclosure so they can pay off the remaining balance of a loan and prevent a foreclosure from appearing on their credit reports.

- Notice of Trustee Sale: The last step of the foreclosure process is where the home goes up for auction. Also known as "buying on the courthouse steps," the home must be purchased as-is and paid for with cash, and interested buyers can submit bid amounts for purchasing the home.

- Repossessed Properties: When banks have owned foreclosed properties for some time, they often offer heavy discounts to encourage buyers to take the properties off their hands. These properties are also known as REO or Real Estate Owned properties.

There are different pros and cons for the buyers who purchase homes at each of these stages. Some consumers choose to purchase homes directly from homeowners who are facing foreclosure. During this stage, known as preforeclosure, the interested buyer may be able to get enormous discounts and great deals on the value of a property.

Other consumers prefer auction sales and repossessed property sales because they can deal with a lending institution rather than a frustrated, angry, or disgruntled homeowner. In the following chapters, you can learn about the pros and cons of each of these foreclosure stages. It's important to limit your home search to a particular stage of the foreclosure process because the things you will have to do and be aware of are different in each stage.

Use an Agent

Even when purchasing a foreclosed home, it is a good idea to contact a real estate agent to guide you through the hoops and speed bumps common to the foreclosure purchase process. A real estate agent can give you helpful advice about purchasing a foreclosed home, perform inspections, and act as a go-between for you and the lending institution that is selling the property.

Be Aware of Foreclosed Home Liens

Liens are outstanding payments that are placed on a property. A foreclosed home will obviously have a lien to the bank or lending institution that owns the original mortgage on the home. However, many prospective buyers do not realize that there are various other liens that may be lurking within a property. If you do not prepare for these liens, you may purchase a property and walk into a situation where you owe more money than you can afford to pay. Common liens attached to a foreclosed property include:

- Back Property Taxes: If the homeowner didn't pay taxes, you may be responsible for making the tax payments current.

- Repair Payments: Plumbers and electricians who were hired to perform services on a house but never paid may decide to retrieve the unpaid balance from the new homeowner.

- Contractor Payments: If the foreclosed home received any recent updates, remodels, or built additions, the new homeowner may be looking at thousands of dollars in contractor liens.

Have a real estate agent check to determine if any liens are currently assigned to the house that you are considering. If there are liens, you must take this into account when calculating the purchase price of the home.

Know the Laws

Every state has different foreclosure laws of which you must be aware before you make an offer on a foreclosed home. These laws dictate everything from the types of paperwork that must be completed to the inspection procedures that must be performed before a house is sold. A real estate agent will have a thorough understanding of these foreclosure laws, and he or she can guide you through the entire process so you don't miss a crucial step.

Find Financing

It can sometimes be more difficult to find financing for a foreclosure property than a property in good standing with a lending institution. Many banks assume that foreclosed properties will be in poor condition or will have mitigating circumstances that lower the value of the property in question. For this reason, it is crucial to begin seeking financing options, such as an FHA 203k, HomePath, or private money loan, for your property before you place an offer on the home.

Make an Offer

If you are dealing with an individual homeowner who is facing foreclosure, you can make an offer on the home that you hope to purchase. Do not make your offer too high, but do not try to "lowball" homeowners and take advantage of their financial situation. Consumers who offer too low of a price on a preforeclosure home may risk insulting the seller and losing the opportunity to continue negotiating on the property. Paying too much for the property, on the other hand, can eliminate the benefits of purchasing a foreclosed home in the first place.

Chapter 2

Know the House's History

One of the biggest problems that interested homebuyers run into is the "love at first sight" epidemic that occurs with certain houses on the market. Buying a house is, after all, an incredibly emotional process. It can be difficult to avoid becoming emotionally overwhelmed by a house. When you fall in love with a house, a neighborhood, or a collection of features within a home, it can be very difficult to use logic and common sense to talk yourself out of making a poor investment.

Unfortunately, the "love at first sight" epidemic is especially dangerous when dealing with foreclosure homes. A foreclosure home often has a secret life of which an interested buyer is completely unaware. The outside of the house may be completely charming, the inside may look fresh and clean, and the price may be unbeatable, but the secrets of the house may make all these factors obsolete.

Unless you take the time to understand the house's history, you may find yourself walking into a bad investment that will hang over your head for a lifetime. Keep emotion out of the home-buying decision. Evaluating a few basic elements of a foreclosure property's history will help you make an informed decision regarding the worthiness of the investment.

Elements of the home's history you need to consider include:

- Construction Dates and Original Builders
- Materials Used and Historical Building Issues
- Recent Renovations, Maintenance, and Upkeep
- Liens and Loans Associated with the Home
- Seller Attitude and Situation

These five elements can be treated like a checklist. When you enter a home that is in a preforeclosure, auction, or bank-owned state, you should find out information in all of these categories. This information will reveal to you whether a home is a wise investment or a money trap.

Construction Dates and Original Builders

The age of the home is your first indication of whether or not the home is a reasonable investment. Older homes are charming and desirable, but some homes are simply too old to be stable or valuable for an extended period of time. Understand that the older the home you are considering is, the more problems you'll likely encounter as a homeowner.

When you find a foreclosure home that was constructed in a specific year or decade, it's a good idea to check out some other homes that were constructed in the same timeframe in your specific location. Usually, the same contractors or building material providers played a role in the construction of homes built in the same general timeframe. You can ask other homeowners what maintenance problems they have encountered from older homes. This will give you an idea of what to expect from the foreclosure home.

It's also important to evaluate the builders who performed the initial home construction. Depending on the age of your home, these builders may no longer be in business. However, you can evaluate other homes the builders constructed as well as information about the construction company's history to determine whether or not the home was built with high standards.

If you are looking to evaluate a foreclosure home that was built by a contracting company that no longer exists, you may wish to consult:

- Newspapers: Historical news stories may offer information about companies, their building practices, and any construction lawsuits that affected the contractors.

- Historical Company Profiles: You can check your local library for information on companies that operated in your general area.

- Other Contractors: If you can find a contracting business that was operational during the time in which the foreclosure home was built, you may be able to find helpful information about the contractors who built your home.

It may seem like a lot of work, but understanding the history of homes built in the same decade as the home you are considering as well as the history of the contractor who built a foreclosure home will give you enormous indication as to the quality of the home in question.

Materials Used and Historical Building Issues

If you're buying an older home, it's also important to evaluate the materials used to build your home. Is the foreclosure home constructed from wood that needs to be replaced? Were dangerous materials such as asbestos or lead-based paint used in the construction of the foreclosure home you are evaluating? The answers to these questions may reveal a lot of interior and structural work that would need to be performed on a foreclosure home before you are able to live in it. Foreclosure homes that are owned by banks and lending institutions are usually sold "as is," so all the construction costs would be up to you, the buyer.

Recent Renovations, Maintenance, and Upkeep

It's also important to consider the history of the foreclosure house you are considering throughout its lifetime. The construction history of the home is the foundation for your home's future, but the regular renovations, maintenance, and general upkeep will let you know if a particular home is in overall good shape.

You can ask a real estate broker or city planning professional for records of large construction and restoration jobs performed on the house in question. It is equally as important to evaluate the contractors and builders who performed these tasks as it is to evaluate the individuals who worked on initial construction.

If, of course, you discover that there has been no major work performed on the house for quite some time, this may be an indicator that something is due to be replaced. Those costs will fall on your shoulders.

Liens and Loans Associated with the Home

This is a part of the foreclosure buying process that many first-time buyers completely neglect. The liens and loans that are currently associated with the home may become your responsibility if you purchase a foreclosure property.

Consider the situation that the seller is in when you are looking at a foreclosure home. The current homeowner is facing foreclosure because he or she has been unable to pay regular mortgage payments on a home. If the mortgage can't be paid, it is very likely that contractor fees and maintenance charges have also been neglected. If you purchase a foreclosure home that recently experienced a large remodel or addition construction, and the fees for those projects were not paid, the liens and loans may transfer to you when you purchase the house.

Back taxes should also be evaluated during a foreclosure sale. Is the homeowner up to date with paying taxes? If not, you may be responsible for catching the home up with the government.

Seller Attitude and Situation

It may not seem like a part of the home's history, but each house on the market is inseparably linked to the individuals who have occupied the home. This is why it is crucial to evaluate the seller when you are considering a foreclosure home, especially in the preforeclosure state.

A homeowner who is forced to sell his or her home before facing foreclosure may be extremely upset about his or her circumstances. Some sellers spitefully damage a home or steal major appliances when they are facing foreclosure.

If you believe that a foreclosure home seller is experiencing any excess anger or frustration with the situation, you might be able to anticipate this type of destruction, neglect, or theft. This is the number one reason why many foreclosure buyers choose to purchase homes from banks and other lending institutions rather than homeowners.

Chapter 3

Preforeclosure Homes

Buying a home that is in the preforeclosure stage is a great way to get excellent houses at shockingly low prices. Thousands of real estate investors prefer to go this route because they know they will be able to present lower offers to sellers who simply want to get rid of a house and avoid the lengthy and frustrating foreclosure process.

This isn't to say, of course, that you should lowball homeowners who are facing foreclosure or try to "get the house for a steal." In fact, this method can be detrimental to both the seller and the buyer. By cooperating with homeowners who are selling due to foreclosure, you'll be able to make everyone happy while still getting a great deal on a real estate property.

The Best Deals are Preforeclosures

Why do preforeclosures present the best deals to interested homebuyers? The foreclosure process is lengthy and quite involved. There are months of court cases, paperwork filings, and meetings between homeowners and lending institutions before a foreclosure actually takes place. During this time, many homeowners simply try to sell their houses and make enough money to pay off the remaining balance of their mortgage.

Yes, they lose money when they choose this route. For many homeowners, however, the prospect of walking away from a home rather than having a home taken out from under them is preferable. When you buy a home from a seller who wants to walk away from a mortgage quickly, you can offer much less than the bank or lending institution would offer. A bank wants to make a profit on a foreclosed home, while a homeowner usually just wants to break even.

You can even turn a preforeclosure home into a second income stream by allowing the homeowner to stay on the premises while paying a low monthly rent to you, the new homeowner. When you do this, you offer the homeowner the chance to stay in the home that he or she has grown to love. This simple olive branch to a frustrated homeowner can dramatically increase your chances of purchasing a preforeclosure home at a great price. Some states, such as Washington, may have legal guidelines that affect this process, so check local laws and standards in your area before proceeding.

How Do You Find Distressed Homeowners?

The biggest problem with finding homes that are in the preforeclosure stage is that most homeowners don't actually put their homes on the market. They may be searching for opportunities to get out of their current mortgages, but they may feel unable to put the home directly on the market for fear of speeding up the foreclosure process.

So, how do you find homes that are about to be foreclosed homes? There are a few tactics you can use to contact interested homeowners:

- Place an Ad: An advertisement that says something to the effect of "Looking to Buy a Home Now" or "We Buy Homes Immediately" can attract the attention of homeowners facing foreclosure.

- Check the Papers: Sometimes, private companies that monitor housing payments will create a Notice of Default list. This list includes all homeowners who have missed two consecutive mortgage payments. This list does not necessarily mean that a homeowner is facing pending foreclosure, but it can be an early warning to interested investors that the property may soon become an REO.

- Social Networking: You may be able to find information about homeowners facing foreclosure by using social networks. Some homeowners post their mortgage woes online, and you can use this information to contact homeowners who are interested in selling.

- Ask Around: There is a great deal of information that can be found simply by inquiring about preforeclosure homes in your area.

Check the House, Neighborhood, and Mortgage Conditions

Once you find a home that is in the preforeclosure stage, it's important to do a little research before you make contact with the homeowner. Of course, you can't just walk up to a home and ask the owner to browse around inside. You can, however, evaluate the neighborhood in which the home is located. You can also talk discreetly to neighbors who may have seen the inside of a home or know more information about the home in question.

When you've determined that the home is a good property in relatively good condition, you need to discuss the conditions of the mortgage with someone who knows what's going on with the home. You can consult the trustee who is handling the foreclosure case to make sure that the homeowner has not already reconciled with the lending institution.

Make Contact

There are very specific do's and don'ts when it comes to making contact with a homeowner who is facing foreclosure. If you come off too aggressive, the homeowner may be insulted or offended and resist selling you the home. If, however, you seem to be too passive, the homeowner may feel like you do not represent a serious chance to escape the foreclosure process.

Here are some great ways to effectively approach a homeowner who may be interested in selling to avoid foreclosure:

- Send a Letter: A polite letter explaining how you heard about the homeowner's situation is usually the best choice. Although the homeowner may be initially distressed to know that you are aware of his impending foreclosure, he may be willing to consider the letter after some time has passed. While it may sound simple, be sure that your letter is grammatically correct and that all words are spelled correctly. Letters filled with errors make the writer seem like an amateur investor, and homeowners may be deterred by these errors.

- Make a Call: Following up with a phone call will show the homeowner that you are extremely interested in purchasing the property. Be absolutely certain to check the Do Not Call list to ensure that you are not violating privacy rights.
- Set Up a Meeting: A meeting between yourself and the homeowner is very important during the preforeclosure buying phase. You need to get to know the homeowner to evaluate whether or not the home has a second mortgage, is in need of repair, or has liens and loans associated with the property.
- Request a Walk-Through: Some homeowners who are facing foreclosure may want you to purchase the home "as is." This will, of course, affect the offer you are willing to make on a home. Explain to the seller that if you can walk through the home, you may be willing to offer more after considering the condition of the home.

Close the Deal

When you've met several times with the homeowner, examined the property, evaluated the cost of liens and loans associated with the property, considered the cost of renovation and repair, and determined the estimated value of the home, you're ready to make an offer.

Generally speaking, interested buyers do not offer more than eighty percent of the estimated value when purchasing a preforeclosure home. You may, however, be able to offer less than this and still receive the home without offending the current homeowner.

Offering to allow the homeowner to rent from you, offering to split the equity of the home after the sale, or offering to pay for the homeowner's first month of living expenses may create a more favorable impression in the eyes of the homeowner. These actions, however, are not legal in certain situations in Washington state, so check with local laws before proceeding.

Chapter 4

Homes at Auction

Immediately after a home has been foreclosed and the homeowner forced to vacate the premises, a lending institution will typically put a home up for auction. The bank or lending institution prefers to sell a home at auction for a variety of reasons:

- Homes sold at auction often generate higher profits because of bidding competition and the thrill of the auction.
- Homes sold at auction prevent the lending institution from having to own the property and lose profits for an extended period of time. Holdings costs for a bank can be as high as 1% per month.
- Properties sold at auction leave very little time for an interested buyer to make a decision, so many buyers rush the process. This is great for banks and lending institutions that are only concerned with making money back on a defaulted mortgage or loan.

Do Your Research

You don't have to fall prey to any of these tactics, however, if you simply do your research before bidding on a home at an auction. If you are interested in purchasing a foreclosure home at auction, you will need to be exceptionally vigilant.

First, it's important to stay abreast of all the foreclosure homes that will be coming up for auction in your area. Banks are legally required to give 30 days of public notice before an auction will occur. However, if you aren't paying attention, it is easy to miss a property during these 30 days. Many banks and lending institutions hold open houses for homes that will be sold at a Trustee sale. If you don't visit the house during the 30 day public notice timeframe, you will not be able to evaluate the interior of the home.

If you are interested in a property but you do not have time to visit an open house viewing before the Trustee sale, you can use the "inside/outside" rule to determine the quality of the home's interior. Generally, the condition of the home's exterior is a great indication of the condition of the home's interior. Bad landscaping, overgrown lawns, old siding and gutters, or the presence of trash can all indicate a trashy interior in disrepair.

The second thing you must do before heading to an auction is research the property that will be sold. You will be looking for any outstanding liens, loans, or second mortgages that the buyer will be responsible for after purchase. An auctioneer will never specifically list any of these other liens. All that will be said is that the buyer is responsible for associated liens and loans. If there is a second mortgage on the property, and the second bank is not foreclosing, you will be responsible for picking up this mortgage even after you have purchased the home.

Bidding Tips

One of the keys to finding success at a bidding auction is knowing how to bid correctly. An auction is an energetic and fast-paced experience. With a few bidding tips, however, you can act like a professional and get a great price on your investment.

- Act and Dress the Part: You will be bidding against other potential investors. Unless you want to wind up in a bidding war, you need to appear confident, experienced, and wealthy. If other buyers assume that you'll walk away with a property, they will be less likely to bid against you.
- Stand by the Beneficiaries: Something as simple as standing near the bank or lending institution representatives who are attempting to recover assets through the sale of the property can give you an edge. Other bidders may assume that you are affiliated with a large corporation and avoid bidding against you.
- Bid on Early Properties: The best prices almost always go to the buyers who purchase the first few properties on the market. This isn't always in your control, especially if you are present to bid on a specific property. However, if you have several foreclosure homes that you are considering, bidding early may get you the best price. Most bidders want to wait for the first few homes to be sold, so they can evaluate the other bidders present.

Be Prepared to Pay

If you plan on buying a house at auction, you need to be prepared to pay the full bid value in cash immediately after you win the bid. You must have a cashier's check for the minimum bid and provide smaller checks up to the maximum you will bid on the Trustee sale home. After the bidding is complete, buyers have two hours to make up any difference in the bid amount from the checks that were presented.

If you do not have the money readily available, you will not be able to get the home you've bid on. After two hours, the sale will revert to the bank. Banks don't want to deal with bidders who aren't serious about purchasing a home. Their goal is to sell a home quickly at auction.

Chapter 5

Bank-Owned and Repossessed Homes

After foreclosure has occurred, a bank or lending institution tries to sell the property immediately at auction, assuming that the home is not an FED Property, which must be listed with local real estate companies to market the home in question. The rest turn into REO properties. REO is an acronym that stands for "Real Estate Owned." This means that the bank now owns the property.

This, however, isn't a good situation for banks. When they own properties, they are basically paying for real estate that they are not using. Banks want to sell these properties as quickly as they can. Some real estate investors believe that REO properties are the worst types of foreclosed homes to purchase. They often have not been lived in for months, they were passed up by other buyers at an auction, and they may have other liens and loans associated with them that made other buyers pass at auction.

However, REO properties are often priced much lower than their equivalents at auction. When you consider this, an REO property may start to look like a profitable investment opportunity.

There are three basic facts you need to know about REO purchases. Knowing the facts about REO properties, agents, and costs will help prepare you for this type of investment deal.

What You Need to Know About REO Properties

REO properties can be a great investment, but the price often reflects the quality of the investment. A simple walk-through of the REO property may not reveal the extent of the damage in the home. The home may be in complete disrepair, and these properties often require substantial costs after the sale is complete just to make them livable, so make sure you do a comprehensive inspection so you have a full picture of what needs to be repaired on the home and the associated costs.

What You Need to Know About REO Agents

Most REO properties have only one buyer's real estate agent who is handling the listing. A listing agent is hired by the seller to act as a go-between for seller and buyer. Know, however, that the agent is working predominantly for the seller and not for you. In most cases the real estate commission paid to a buyer's agent has already been negotiated between the seller and the listing agent, so it only makes sense have your own representation as it does not cost you anything. The separation between you and the listing agent, or seller can be very effective for negotiations.

It is a grievous error, however, to assume that all REO agents are untrustworthy. The vast majority of agents have a wealth of experience dealing with interested buyers of REO homes. You will have to evaluate the agent in question and make your own decisions.

What You Need to Know About REO Costs and Bids

When you place an offer on an REO property, you typically have to offer extremely close to or exactly the amount that the bank is requesting. Banks don't like to budge on the cost of REO sales because they are already losing money on the sale.

You also need to be aware of the closing costs and title fees associated with REO sales. Banks rarely share in these costs with the buyer, and you will have to pay all the closing costs after the sale is complete.

When you submit an offer to a bank concerning an REO property, don't be afraid to offer exactly what you are willing to pay. If the bank rejects your offer, resubmit an offer after the next price change or at the end of the month on a cash sale. Be persistent and professional in your contact with the bank. This way, the bank knows that you, too, are serious about the price you are willing to pay for a property. If a foreclosed home is bought out from under you, don't worry. There are plenty of other foreclosure properties that you can purchase within your budget.

Conclusion

Buying a foreclosure home is a great investment opportunity. It is also a complicated, exhausting, and confusing procedure. There are three basic phases of foreclosure to choose from, and each phase presents its own unique positive and negative qualities.

Many interested real estate investors choose to purchase homes directly from the seller during the preforeclosure phase. This offers more opportunities for saving money, but it also presents additional challenges and risks. Buying a home at auction is a quick way to acquire a foreclosure home, but many consumers dislike the stress and immediacy of this process. For other consumers, the simplest way to purchase a foreclosure home is to buy REO homes from a bank or other lending institution. Whichever stage you choose to investigate, foreclosure properties offer incredible opportunities for acquiring valuable properties at competitive prices.

By taking your time during a foreclosure home buying process, evaluating the history of the home in question, being methodical about calculating costs of ownership and repair, and learning a little about the foreclosure industry, you will be uniquely situated to make a great investment that will turn into huge profits for you in the near future.