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REAL ESTATE

Opportunities in the Housing Slowdown

by Pat Mertz Esswein

Investing in a foreclosure can be rewarding, but success is hardly a sure thing.

If you flip channels late at night, you probably see the infomercials that portray investing in foreclosed houses as a sure thing. But talk to people doing it, and they'll tell you that buying a foreclosed home to flip or rent out isn't an easy, quick, cheap or surefire route to wealth. The pitch for foreclosures seems timely, with all the talk about homeowners overburdened with rising ARM payments and little or no equity who will throw their keys back at the bank. But the typical deal comes with more problems than the average do-it-yourselfer can handle.

Investing in a foreclosure can be rewarding if you're willing to do your homework. Compared with a year ago, foreclosures are up more than 60% nationally, according to RealtyTrac, an online marketplace for foreclosed properties. And the chance of obtaining a bargain is likely to rise as the slowing housing market forces foreclosing lenders to offer bigger discounts to lure a smaller pool of buyers.

Investors Andy Heller and Scott Frank say they're "licking their chops" in anticipation of diminished competition for foreclosures as fair-weather investors flee the market and would-be owner-occupants look for easier pickings. "This is the time when you should be diving in," says Heller, who co-wrote, with Frank, *Buy Even Lower: The Regular People's Guide to Real Estate Riches* (Kaplan, \$19).

Range of discounts

At the market's peak, in the first half of 2005, the nationwide median discount off market value for foreclosures was 14.6%, according to First American Real Estate Solutions, in Santa Ana, Cal. As the market slows further, the discount is bound to increase, although opportunities will vary from area to area.

How much of a bargain you need to make a deal work depends on your post-purchase plans. The shorter the time you intend to hold a property, Heller and Frank say, the greater the "minimum investor discount" you require. They recommend trying to buy homes for 20% to 30% off market value if you plan to flip the property; 10% to 20% off if you'll rent it out with the option to buy; and 5% to 10% if you intend to rent it out indefinitely. Keep in mind that the days when you could flip for a quick profit are over -- at least for now.

Savings per square foot

Bruce Reeks has been adding to his retirement savings by buying foreclosures. Reeks, who owns 15 such properties, identifies a bank-owned foreclosure on a multiple listing service, then compares its price per square foot with those of homes recently sold in the same subdivision. The difference signals opportunity, he says.

Last year, Reeks purchased a five-bedroom, two-bath home in Austell, Ga., northwest of Atlanta, for \$102,900. After he spent \$7,800 on repairs, the property appraised at \$142,000. If Reeks had flipped the house, he would have made about \$24,000 after commissions and other costs. Instead, he collects rent of \$1,190 and pays \$850 per month toward the mortgage, reaping a gross profit of \$340 a month. Meanwhile, Reeks builds equity as he pays the mortgage with the renter's money, he enjoys tax write-offs, and he expects to benefit from price appreciation. He anticipates cashing out his portfolio in the next five years and retiring to Asheville, N.C.

Foreclosure laws vary by state (for an overview, go to www.realtytrac.com, then verify the information with your county's clerk of court). You can buy foreclosures three ways: negotiate with a homeowner before the bank forecloses, bid at a county foreclosure auction, or, as Reeks does, buy a real estate owned property, or REO (see below).

Plenty of pitfalls. At a foreclosure auction, you'll buy a home "as is," and you might not be able to do more than peek through the windows beforehand. Cleveland agent Mike Phillips says you could be bidding on a home that has been vandalized -- sometimes by a distraught owner who has stripped it of everything valuable. Long-vacant homes may have water or mold damage. And the property may have legal warts: liens, difficult-to-evict tenants or, in some states, a mandatory "redemption period" that gives the former owner time to try to get the home back.

REOs, properties that lenders have bought back at auction, generally offer the easiest route for novices. With an REO, you won't become entangled with a harried homeowner facing foreclosure. You'll probably find nicer properties than the dregs left on the courthouse steps by lenders. And although an REO is likely to be sold "as is," you will have the right to an inspection, a title search and contingencies. Another advantage: You can finance the purchase with a conventional loan. However, the buyer of an REO is generally not likely to get as deep a discount as an investor in other kinds of foreclosures.

In Stone Mountain, Ga., Kelly Wiley shopped REOs but took a slightly different tack on buying-and-holding. Wiley, a real estate agent with Metro Brokers/GMAC, decided to look for a foreclosure large enough for herself and her sons, Javon, 13, and Juwan, 11, and to rent out her former home. To start, she focused on a few desirable neighborhoods, setting strict standards for price and condition. Over two and a half years, other buyers outbid her on several homes, mainly because she took anticipated repairs into account when calculating her offers.

Last summer, Wiley finally found her dream home: a four-bedroom, two-and-a-half bath house in Stone Mountain. It was in move-in condition and listed for \$214,000. Wiley bought the property for \$199,900 with a no-money-down, fixed-rate mortgage, for which the rental income on her former home helped her qualify. Her new home appraised for \$221,900. "I had instant equity," she says.

Buying it back from the lender

For novice foreclosure investors, the best bet is often a real estate owned home, or REO, a property that a lender bought back at auction to resell for close to market value. You can find REOs on local multiple listing services, which may be available online. Other sources include the Web sites of federal agencies and government-chartered corporations or their affiliates, such as HUD.gov, Ocwen.com (for VA-owned homes), FannieMae.com and FreddieMac.com; national online listing services, such as Realtytrac.com and Foreclosure.com, available by subscription; or property wholesalers, such as Homevestors.com (the "We buy ugly houses" people).

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