

# RealityCheck

## Your Guide to Purchasing Bank-Owned Properties *What to know and what to watch out for*

With the number of foreclosures skyrocketing in California in recent years, there is a lot of interest from would-be buyers in purchasing bank-owned properties which are also known as real estate owned or REOs.



On the face of it, short sales, foreclosures, and REOs may look like the same thing, but they are different. As pointed out in the *Realty Times*' August 15, 2007 article entitled, *Foreclosure Basics: Foreclosures, Short Sales and REOs*, if you enter the "market wanting to 'do foreclosures,' without understanding the entire process, you could wind up in trouble."

This handout has been designed to explain some of the terminology of these types of sales and to answer some of the critical questions that someone who is considering purchasing a bank-owned property should know.

### **What are the differences between short sales, foreclosures, and REOs?**

**What is a short sale?** Short sales occur when the value of the property is less than the encumbrances. As the *Realty Times* article points out, short sales are attractive "because lenders often agree to take less than what is owed on the property. The idea here is that you are saving the lender time and money" by avoiding the foreclosure process. Some lenders may agree to a short sale after a default has been filed.

**What is a foreclosure?** As the *Realty Times* article points out, "When a property is in foreclosure, the owner has stopped making payments and the lender has given the borrower a written Notice of Default that the payments must be brought up to date or the property will be sold off. The notice is a public document (which is why so many websites offer foreclosure lists). It normally takes about two missed payments for a lender to issue a Notice of Default, but not always." The property is then sold through a public auction process.

**What is an REO?** As the *Realty Times* article points out "If no-one bids high enough to meet the lender's price at auction, the foreclosure completes and title transfers to the lender. Real Estate Owned means the property is owned by the lender."

The article went on to point out that "Some investors see REO homes as the best way to buy property because there are no emotions involved: it's strictly business between the investor, their agent, the lender, and its agent. And because most lenders aren't landlords (nor do they want to be), investors can often get a very reduced price."

### **How common are these types of sales in today's market?**

While it depends on the market, short sales, foreclosures, and REOs are becoming commonplace in many markets throughout Northern California. Let's take a look at the facts according to a *DataQuick News*' July 22, 2008 article entitled *Another Increase in California Foreclosure Activity*.

- "Last quarter's number of defaults was the highest in DataQuick's statistics, which go back to 1992."
- "On primary mortgages, California homeowners were a median five months behind on their payments when the lender filed the notice of default. The borrowers owed a median \$11,583 on a median \$346,400 mortgage."
- "On home equity loans and lines of credit, homeowners were a median eight months behind on their payments. Borrowers owed a median \$3,492 on a median \$60,000 credit line. However the amount of the credit line that was actually in use cannot be determined from public records."
- "On a loan-by-loan basis, mortgages were least likely to go into default in San Francisco, Marin, and San Mateo counties - an historical norm. The likelihood was highest in Merced, San Joaquin and Stanislaus counties."

According to a *DataQuick News*' August 19, 2008 article entitled *Bay Area home sales climb above last year; median price falls hard*:

- "Bay Area home sales eked out their first year-over-year gain since early 2005 last month as buyers responded to price cuts and snapped up more inland foreclosures. The median sales price dove to a 53-

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month low, a real estate information service reported.”

- “Foreclosure resales – homes sold in July that had been foreclosed on in the prior 12 months – made up 33 percent of all resales. That was up from 29.9 percent in June and 4.2 percent in July 2007. Foreclosure resales ranged from 4.6 percent of the resale market in San Francisco to 65.9 percent in Solano County.
- “In Solano and Contra Costa counties, where deeply discounted foreclosures are most common, 11 zip codes posted sales of existing houses that were at least twice as high as in July 2007.”

According to the *Sacramento Bee's* August 19, 2008 article entitled *Sacramento-area home sales rise for fourth straight month:*

- “Sacramento-area home sales surged past last year's levels for a fourth straight month in July as 4,126 buyers embraced falling prices and deals on foreclosed homes.”
- “Banks in July continued their reign as the capital region's top sellers. Their foreclosed properties accounted for 70 percent of closings in Sacramento County alone, according to the Sacramento Association of Realtors.”

**So if you are interested in buying a bank-owned property, here's what you should consider:**

## Get Pre-Approved and Be Ready to Act

In the REO market, competition can be fierce. It's not uncommon for there to be multiple offers on bank-owned properties. Just as you are looking for a bargain, so are many other buyers. You should be financially prepared to make a down payment and you should have a pre-approval letter from a lender in place before making an offer.

## Know Where and How to Look

REOs are usually listed on the Multiple Listing Service and can be found on the majority of websites that feature properties for sale. There are also several websites that specialize in foreclosed properties. You can see which properties are in the process of foreclosure on RealtyTrac.com or find homes that have already been foreclosed upon by checking sites like CaliforniaMoves.com, Trulia.com and Zillow.com. Many lenders also have their foreclosed properties listed directly on their websites.

## Hope for the Best, Prepare for the Worst

In all likelihood, you will not be “wowed” when walking through the door of an REO. Most are sold “as is.” In the months leading up to foreclosure, the homeowner may have disregarded maintenance and let the condition of the home deteriorate. Do not be surprised if you see homes stripped of appliances, light fixtures and any other items that can be sold. In the worst case scenarios, homes fall victim to vandals and transients who take advantage of a vacant property. It's not always a pretty sight, but for buyers who are looking for a challenge, or who can afford the time and effort involved in buying an REO, these types of properties may be right for you.



## It May Take Longer Than You Expect

Each bank/lender works a little differently, but they all have similar goals. They want to get the best price possible; they have no interest in “dumping” the real estate they own cheaply. Generally, banks have an entire department set up to manage their REO inventory, and in this current market, with the increased number of bank-owned properties those departments are often back-logged for days, if not weeks and thus cannot always respond quickly to offers or other inquiries.

Once an offer to purchase is made, banks generally present a “counter-offer.” It may be at a higher price than you expect because the bank has to be able to demonstrate to its investors, shareholders and auditors that they attempted to get the highest price possible. You are then free to accept, reject or counter the bank's counter-offer.

Your offer or counter-offer will probably have to be reviewed and approved by several individuals and/or other companies. As such, this process may take several days to complete.

It is important when purchasing a bank-owned property that you understand that the timing is often much longer and drawn-out than a typical resale. Simply put, you should be prepared to wait.

## Understanding the Property Condition

Banks typically sell a property in “as is” condition. Some banks will agree to provide a Section 1 Pest Certification, but not unless that requirement is included in the final contract. Banks will usually allow you to get all the inspections you want (at your expense), but they probably will not agree to do any or all repairs.

Offers to buy REO property may include an inspection contingency period that allows you to terminate the sale if the inspections reveal defects that the bank will not correct and that you might not want to accept. Be aware that some banks require use of their own contract forms which do not include the same types of provisions as standard Realtor forms. In those situations you should review the bank's purchase contract documents with your own real estate attorney.

Even if you have agreed to buy the property “as is,” you may request that the bank make repairs or give you a credit after you have completed the inspections. Some banks will re-negotiate to save the transaction instead of putting the property back on the market, but that possibility should not be taken for granted. Most banks will not provide financing on their REOs but it doesn't hurt to ask.

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## Making the Offer

Before making an offer, have your Agent contact the Listing Agent and ask the following questions:

- Are there any inspection or repair reports?
- What work has the bank performed and/or what work will the bank agree to perform?
- How long do you anticipate that it will take the bank to accept an offer?

Offers are usually faxed to the bank. The Listing Agent needs your originals. There is generally no formal presentation. Keep in mind: nothing happens on evenings and weekends as banks are closed.

The keys to remember are: You should have sufficient money available to put down a reasonable deposit; you need to be pre-approved by a reputable lender; your offer should contain reasonable, straight forward contingencies and the offer should specify a closing date that is within a reasonable amount of time. The combination of these factors can position you as a stronger buyer in the eyes of the bank.

## What are Some of the Pitfalls to Watch Out For with REOs?

- **Determine all fees associated with purchasing the property.** There may be hidden fees like liens, unpaid taxes, penalties, etc. to contend with.
- **How low will they go?** Lenders may not be willing to negotiate the price down from market or close to market. This is especially true in areas where home values have fallen further than lenders want to acknowledge.
- **Be prepared for a counter.** Because the sale of bank-owned properties are becoming increasingly popular and therefore, competitive, we are seeing cases in which banks are countering at an amount that is above the original list price. These actions can discourage some buyers.

## There Are No Guarantees in Buying REOs

On the surface, it might sound like a bank-owned property is a steal but if the bank wants to sell its inventory on the open market for the amount of money that was once owed to the bank, it may not be as good of a deal as one might think. Couple that with the fact that bank-owned properties are not always left in the best condition; a great deal of work and money may be needed after escrow closes to improve the property.

When considering the purchase of an REO, you need to look closely at comparable sales in the neighborhood and be sure to take into account the time and cost of any repairs or remodeling that may be needed. In most cases, banks do not want to indefinitely hold on to their inventory as it isn't in the bank's best interest to let the property sit. Therefore, some banks have incentives to price a home for less than market value just to get rid of it. However, while it is true that banks are typically anxious to sell bank-owned property quickly, they are also strongly motivated to get as much as they can for it.

The bottom line is that although bargains with bank-owned properties exist, it is important to understand the pitfalls that may also exist in buying REO property. That is why it is imperative that when you do decide to explore the purchase of a bank-owned property that you do so with the aid of a professional, experienced Realtor, like myself, who will guide you through the intricacies of this type of transaction.

If you are ready to explore the opportunities available in today's real estate market, please contact me today:

## Linda Pinkul

Coldwell Banker Office

720.479.5445 (Direct)

303.674.4479 (Fax)

[LindaPinkul@wispertel.net](mailto:LindaPinkul@wispertel.net)

[www.LindaPinkul.com](http://www.LindaPinkul.com)

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