

A flood of foreclosures, but should you invest?

Experts caution potential buyers to do their homework

By Amy Hoak, Marketwatch



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CHICAGO (MarketWatch) -- The number of homes in or nearing foreclosure is growing, and some investors are taking advantage of the bargains created. But even with a steady stream of distressed properties coming on the market, jumping into foreclosure investing is dangerous, especially if you are not familiar with the process or new to real estate investing. "Some people are using the phrase 'tsunami;' there's going to be a tsunami of foreclosures," said Dave Jenks, co-author of "The Millionaire Real Estate Investor." "For the people who are pros at dealing with foreclosures and have the infrastructure of information and wherewithal ... they will take full advantage of this." Consider these recent statistics: 1.05 percent of mortgages were in the foreclosure process in the third quarter of 2006, according to the Mortgage Bankers Association. The foreclosure rate increased from 0.99 percent in the second quarter; the rate was 0.97 percent in the third quarter of 2005.

And RealtyTrac reported last week that the number of homes entering the foreclosure process increased by 19 percent in January, compared with December's numbers. Compared with January 2006, the number of homes in the process is up 25 percent. In 2006, a total of 1.2 million homes entered the foreclosure process, 42 percent more than 2005.

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While there are opportunities to purchase homes at reduced prices in many markets, they're "cautious opportunities," said John Anderson, owner/broker of Twin Oaks Realty in Crystal, Minn., a suburb of Minneapolis.

Above all, you can't assume that just because a home is heading for foreclosure means that it is automatically a good deal, Anderson said.

Remember, even for pros, foreclosure investing involves some risk, as does any purchase of "real estate as an investment, as opposed to a home (in which to live)," said Rick Sharga, vice president of marketing at RealtyTrac.

Doing the math

The transaction has to make sense financially, figuring in the costs of getting the property back into marketable condition, the value it's going to have at resale and the length of time it's going to take to find a buyer -- if you do, in fact, plan on reselling immediately instead of holding it to rent out or live in. It's also important to know if there are liens on

the property. Adding to the complexity of the investment are the various state and county foreclosure laws and regulations throughout the country.

"This is hard work," said Daryl White, a foreclosure investor in Valencia, Calif. "Forget about 'If I can do it, you can do it'" lines from late-night television infomercials, he added.

White, a subscriber of Foreclosures.com, a foreclosure listing service and educational Web site, uses a spreadsheet to figure the costs associated with investing in a particular property. When his analysis is complete, he can decide what to pay for the property. The goal, he said, is to buy at 30 percent below the after-repaired market value -- half of the discount allows him to cover such expenses as holding costs and repairs while the other half earns him a profit. The formula is taught through Foreclosures.com.

In the "changing market" he's in, near Los Angeles, he has to factor in that houses are taking about three to five months to sell, which adds to his holding costs, he said. But even in a cooling market, a home that is priced right will sell, said Alexis McGee, president of Foreclosures.com. It's important, she said, to pay careful attention to prices of comparable houses that are selling in a particular neighborhood to get an idea of what return an investment can bring.

In fact, many who have had success in real estate investing will also recommend not depending on a strong market for a good return, Jenks said. "Most of the really good investors will tell you never rely on appreciation to make a deal work."

Homeowners in trouble

There are a couple of key reasons for the uptick in foreclosures, said Sharga, whose site also lists homes in the foreclosure process.

For one, a slower housing market has stretched out the time it takes for a home to sell, making it tougher for families who must sell to strike a deal in time to avoid the foreclosure process, he said. Also at play is the rise in interest rates on adjustable-rate mortgages, at times squeezing "people who have overextended themselves in the first place."

Those looking to buy a home in the foreclosure process can do so during a few different stages.

Some investors, including White, prefer purchasing homes prior to the actual foreclosure. Others make the investment later in the process, at a foreclosure auction. If the property is unable to be sold by the bank at a desired price, an investor can deal with the institution in buying what is called a real estate owned property, or REO.

Each point has its own complications, so tread slowly and do your homework first, Anderson said. He recommends beginners start out by sitting down with a real estate

agent who has experience in the arena, someone who has done it before.

Dealing with a preforeclosure, for example, often involves negotiating with a distressed homeowner -- and doesn't always shape up to be a comfortable situation.

"They (homeowners) don't want to be bothered or may not be as reasonable as they are under normal circumstances," Sharga said. On top of that, there are a number of "foreclosure rip-off artists" who have taken advantage of people when they're most vulnerable, he added. White said he's often battling a negative image because people "don't see the white knight part of it," when, in fact, the sale of a preforeclosure home could help homeowners keep negative marks off their credit histories and also get at any remaining equity.

As a Realtor working with investors, Anderson said his first thought is to try and find a way to keep the homeowner in the house. If a sale must take place, he recommends the seller have fair representation before proceeding -- to ensure they get a fair deal.