

# **PURCHASING AND FINANCING FORECLOSED PROPERTIES**

by: Lawrence J. Rose

## **INTRODUCTION**

At the end of the 1980's a real estate market boom ended. Prices fell, particularly among condominiums, and there were a large number of foreclosures. Numerous people lost their homes or investment properties, while others took advantage of the weak market and scooped up properties at what turned out to be bargain prices. Once real estate prices began rising again there were far fewer foreclosures and the bargains became rarer. The current real estate market has spawned new rash of foreclosures. Real estate prices are stable or declining. People who were previously able to refinance their way out of trouble are no longer be able to do so. As more foreclosure auctions take place more people will consider bidding for properties at the auctions.

## **MEET JOHN DOE**

This is the story of John Doe who one day decided that the way to get a real estate bargain would be to bid for property at a foreclosure auction. John scanned the newspaper notices until he found some promising auctions. He drove to the properties and looked them over. Of course he could not get inside because each property was occupied. He particularly liked the looks of the one at 21 Elm Street. From what he could see it looked like it had four bedrooms and most likely 2.5 baths. He checked out some other properties that were for sale in the same town and came to the conclusion that this one would sell for about \$360,000.00. John decided that he would bid up to \$280,000.00. Before going to the auction John went to see a mortgage loan originator who pre-qualified him for a loan of up to \$290,000.00.

On the appointed day he went to the auction with his \$5,000.00 bank check in hand. He qualified as a bidder by showing his bank check and giving his name and address to the auctioneer. The auctioneer started the auction by asking if anyone had any questions. John wasn't sure what kind of questions he could ask so he didn't ask any. Then the bidding began. John joined in and started to bid. Several people were bidding and suddenly someone else bid \$280,000.00, John's planned highest number. Now John had to make a quick decision. Go higher or quit. He only had a few seconds. Quickly he raised his hand and bid \$285,000.00. But the bidding kept going and John kept bidding. When it was over John was the high bidder at \$300,000.00. John was elated.

Although he had bid more than he had planned he still had the property for \$60,000.00 less than what he thought it was worth.

What John didn't know was that his troubles were just beginning!

## **BANK OWNED PROPERTIES VERSUS BUYING AT AUCTIONS**

Most mortgage lenders will obtain an appraisal before foreclosing. Often the appraiser cannot get access to the inside of the property. Consequently the appraisal can be inaccurate. Before the auction the lender will decide how much it wants to bid. Unless the appraisal is less than the amount owed, it will usually bid the amount owed to it on the mortgage. The lender will not identify the person bidding on its behalf, although he or she is usually easy to spot. Frequently, the lender is the high bidder. Once it acquires the property the lender will usually evict the occupants and then list the property with a real estate broker.

Often these bank owned properties are sold at below market prices. Prospective purchasers can inspect them like any other property and can get mortgage financing without any unusual problems. What buyers should not expect are any special mortgage financing deals from the seller. In fact buyers will sometimes find that the seller refuses to give them a mortgage. That's because some lenders feel that once they have a bad loan on a particular property they don't want to finance that property again.

Finding lender owned properties is not difficult. A real estate broker can help or you may be able to find them on the internet.

For most people who are looking for a bargain in real estate, scouting for lender owned properties is the way to go.

## **BUYING AT AUCTION: WHAT TO EXPECT**

The most important thing to know about foreclosure auctions is that the properties are sold as is without any promises or warranties and subject to whatever liens, real estate taxes, water/sewer fees, and encumbrances may exist. Most often the properties are occupied by the former owners. There is no way to get inside before the auction and no way to know the condition of the interior of the property. Even if the interior is in good shape, the buyer assumes the risk that the former owners will damage the property before the closing takes place. Anyone bidding at an auction should assume that the property will need some repairs and renovations.

Additionally auction buyers pay certain charges that are paid by sellers in standard real estate transactions. In standard real estate transactions the seller pays a transfer tax to the

Commonwealth of Massachusetts. That tax is \$4.56 per thousand dollars (Eg. On a \$300,000.00 purchase the tax is \$1,368.00) In a foreclosure auction sale, the buyer pays the tax. The buyer will also be responsible for paying all water/sewer bills and real estate taxes up to the date of the closing.

The successful bidder will sign an agreement called a memorandum of sale, that has been prepared by the seller. The buyer cannot expect to negotiate any changes in the memorandum of sale. In fact, the memorandum will be available for inspection before the bidding begins. Once the auction is over the successful bidder is legally obligated to sign the memorandum of sale without making any changes.. The memorandum will contain the price, terms and closing date, but will not give the buyer any rights to inspect the property or to get out of the deal if they can't get a mortgage.

Sometimes the property is vacant and bidders can get inside to inspect it. However, that is not usually the case. Because some of the problems of buying at auctions are eliminated when the properties are vacant it is worth paying a little more for those properties.

One other thing to expect is that foreclosure auctions are often postponed. The day before the auction, call the lawyer who represents the lender and make sure it is still scheduled.

## **BUYING AT AUCTION: DO YOUR HOMEWORK FIRST**

Let's get back to John Doe. John thought he was getting a bargain, but he didn't do his homework. He soon learned that there were back real estate taxes owed in the amount of \$3,000.00, an outstanding water/sewer bill in the amount of \$1,900.00, and a \$1,500.00 balance due on a sewer betterment assessment. That extra \$6,400.00 plus the \$1,368.00 transfer tax he would have to pay was starting to make his purchase look less and less like a bargain. Then he received a call from his loan originator explaining that the appraiser could not get into the property, and that without an appraisal he could not get his mortgage. He finally arranged to have the appraiser gain access only by promising the occupants \$1,000.00 in exchange for their cooperation. He made sure to be there for the appraisal so that he could look at the interior himself. His spirits sank when he saw its poor condition and realized that he would have to spend thousands of dollars on renovations and repairs. From there things only got worse. The Mortgage Lender's attorney called him after completing the title examination. There was a prior home equity mortgage on the property. It would cost John \$10,000.00 to pay it off. When the appraisal came back his loan originator informed John that the property appraised for only \$320,000.00, not the \$360,000.00 he had calculated before he started bidding..

You have perused the auction notices in the newspaper, looked over the properties, and identified those that interest you. Now its time to do your homework.

First assignment: Go to Town Hall

You can get a wealth of important information at Town Hall. Check with the tax collector to find out exactly what real estate taxes and other assessments are owed. Find out the assessed value of the property. Then head for the building department and check all of the building records. You will discover when the house was built and what improvements were made. Often you can look at the house plans. If the property is served by a septic system you should look for the septic certification. Go the water department and find out if there are any outstanding water/sewer bills.

Second Assignment: Try to get inside.

This is a tough one. The current occupants really don't want to talk to prospective auction bidders. You can knock on the door, but you should expect a frosty reception, if indeed anyone even answers. But if you can get inside, you can learn about the condition of the property and something about the occupants. Moreover, if you try to get inside and can't, that information itself will tell you something about the people that you will have to deal with if you are the successful bidder.

Third Assignment: Know your value.

Successful bidders are good at determining the true value of properties. Don't just check real estate listings, look at actual sales. Local newspapers and Banker and Tradesman list all sales prices. A friendly real estate broker may help. Listings are helpful in providing detailed descriptions of properties. Educate yourself. Attend some auctions without bidding. Look at some houses that are on the market. Learning how to appraise real estate is a whole course of study in itself. The best auction bidders are experts in real estate valuation.

Fourth Assignment: Check the Title

You can learn how to search titles or hire someone to do it for you, but you must check the title yourself before bidding. The auctioneer makes no guarantees. You need to know if there are any prior liens such as other mortgages, tax liens, attachments, etc.

### **BIDDING AT AUCTION: QUESTIONS TO ASK**

Some auctioneers will take questions and others won't. Those that take questions will answer inquiries about the bidding process and the memorandum of sale. They are reluctant to give out any information about the property because they don't want to be in a position of having promised anything. For that reason they won't tell you anything about how much is owed or the condition of the property.

If you have done your homework then you won't need to ask many questions. If you haven't

then you want to ask if the mortgage being foreclosed is in the first mortgage position and you want to ask if there is a municipal lien certificate that you can review. However, if you have to ask those questions then maybe you shouldn't be bidding in the first place. Moreover, some auctioneers will refuse to answer.

If the property is a single family house, ask if the auctioneer knows whether the people occupying the property are the owners or tenants. The answer will help you later on when you have to contact the people. Also, if they are tenants you need to be concerned about whether the owner might be holding a security deposit or last month's rent, both of which will be your responsibility if you acquire title to the property.

If the property is an occupied two or three family, ask if the auctioneer knows which unit if any is occupied by the owners and whether any of the units are vacant..

## **BUYING AT AUCTION: BEING PREPARED**

Aside from doing your homework you have to know how you are going to pay for the property. Ideally you have the money already available. If you own other property and can obtain enough financing on that property to pay for the new property you are better off. You may also consider lining up short term financing with or without collateral with the idea that you will obtain mortgage financing on the new property after you have taken possession.

If you must get a mortgage on the new property in order to buy it you should be prepared to make a substantial down payment. Check with a loan originator in advance. Find out if they can provide you with any financing based on a drive by appraisal.

Make sure that you are preapproved for a mortgage and that your loan originator can complete the process in the time frame allotted in the memorandum of sale ( not more than 30 days).

Before bidding at an auction you will have to qualify. That means showing the auctioneer that you have with you good funds in the amount stated in the auction notice. The best way to do it is to get a bank check payable to yourself to bring to the auction. If you aren't the high bidder you can redeposit the check in your bank account.

## **FINANCING THE AUCTION PURCHASE**

Obtaining a mortgage on auctioned property is not much different then getting a mortgage on any other property but for two very important differences. First: You have signed a memorandum of sale instead of a purchase and sale agreement. That contract does not contain a mortgage

contingency. If the you can't get financing you will lose your deposit. No ifs ands or buts and no excuses. The contract also sets a closing date that is 30 days after the auction. Most sellers will give you some extra time if you need it but there are no guarantees and the seller has the

right to take your deposit if you are not prepared to close on the designated day.

The Second major difference is that the property is usually occupied by the former owner who is not too happy about their situation. These former owners tend to be uncooperative. Most importantly: **THEY WON'T LET THE APPRAISER INTO THE PROPERTY.** Since the appraiser cannot complete the appraisal without observing the interior of the structure, the appraisal doesn't get done and the mortgage cannot get approved. Sometimes the occupants are tenants. Don't get excited if the occupants are tenants rather than former owners. Tenants are often even more difficult than former owners.

The best way to deal with the situation is to be prepared with a substantial down payment, probably at least 40% of the purchase price. Some lenders may accept a drive by appraisal if the down payment is large enough. If you know that you can obtain financing with only a drive by appraisal then much of your risk is eliminated.

If you don't have a substantial down payment you are taking on added risk. However, if you have done your homework and know that the appraiser will be able to get into the house then your risk is much less. In order to get the occupants to let the appraiser in you may have to make it worth their while. That means offering them money. Even getting the occupants to talk to you is often tricky, but it can usually be accomplished. Most occupants, once they realize they are in a no win situation, will respond to offers of money. For around \$800.00 they may agree to allow the appraiser access. You should pay half up front and the balance during the appraisal. Of course, you will not know what to expect from the occupants until after bidding at the auction. In some cases they are so bitter that they won't listen to reason or accept any reasonable amount of money for their cooperation. When that happens, you are out of luck and will lose your deposit.

## **AFTER THE CLOSING: WHAT TO DO NEXT**

Now that you own the property you will most likely have to evict the occupants. At this point you need to hire an attorney to start the eviction process. Before you bid, consider the costs. You will have to pay attorney fees which will most likely exceed a thousand dollars. But unless you get really lucky, you will also have to pay court costs, constable fees and possibly even moving expenses to get the occupants out. Depending on how vigorously the occupants defend themselves, the process can take from six weeks to six months or more and cost anywhere from \$1,000.00 to \$8,000.00. It can take longer to evict occupants who are former tenants than it takes to evict former owners because Massachusetts affords substantial legal protection to tenants in foreclosed properties.

In order to cut your risk and your losses consider offering the occupants some money if they will move out and not damage the place. How much money is a matter of negotiation, but figure on around \$2000.00 as an average. Naturally you should time the payments to insure compliance, but if you can get the occupants out by paying them you can generally get them out faster and cheaper.

## **CONCLUSION**

Poor John Doe. He ended up paying more for his new home than if he had just bought a house from a real estate broker.

As you can see buying properties at auction is not an amateur pursuit. It requires work, time, knowledge and experience. But if you are willing to learn the process and do your homework, you can be successful.

*Lawrence Rose is a principal attorney at Sweet & Rose, with offices at 14 Page Terrace, Stoughton, Massachusetts. Mr. Rose has been providing services to real estate buyers, sellers and lenders for over 25 years.*