

The Massachusetts Homeownership Collaborative

HOMEBUYER COUNSELING CORE CURRICULUM

SECTION XII: HOW TO PURCHASE A FORECLOSED PROPERTY

Section Objectives:

- **To inform participants about the process in purchasing a foreclosed property**
- **To assist participants in shopping for a foreclosed property**
- **To inform participants about the legal and financing issues in purchasing a foreclosed property**

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A. INTRODUCTION

The purpose of this chapter is to help property buyers prepare for purchasing foreclosed property. This chapter is designed to give a homebuyer information about many of the complexities involved in purchasing foreclosed property and suggest a model to prepare for buying. It is recommended that buyers seek professional assistance when purchasing foreclosed property. Buyers should consider enrolling in a homebuyer education course to increase their understanding of homeownership issues.

B. B. TYPES OF FORECLOSURE SALES

The term foreclosure sale encompasses sales in process when the owner is in default with their mortgage payments, when the lender is forcing the sale at an auction, and after the bank has taken possession of the property. While the details of the sales process for each type will be discussed later in the chapter, here are brief definitions of each type.

- **Short Sale.** In a short sale, the homeowner is attempting to sell the property for less than he owes the lender for the mortgage. The homeowner's mortgage lender and others who have debts secured by the property (liens) must approve of the sale price before the homeowner and the buyer can go forward with the sale.
- **Foreclosure Auction.** A property may be sold at auction when the homeowner is not able to pay what they owe in unpaid mortgage payments, late fees, and lender attorney fees. The lender, through their agent or attorney, is selling the property at auction to the highest prepared bidder. If no one makes a bid high enough to satisfy the lender, the lender will take possession of the property.
- **REO (Real Estate Owned).** A property has the REO (real estate owned) or bank-owned status when the lender has taken possession of the property and, in many circumstances, has placed the property for sale with a real estate broker. As part of the process the lender's attorney works to clear liens on the property so that it can be sold.

C. C. BENEFITS AND CHALLENGES OF BUYING FORECLOSED PROPERTY

There are benefits and challenges to purchasing foreclosed property. Some of the benefits of purchasing foreclosed property are:

- There is the potential to purchase property below market value. Some properties are purchased below the appraised value and that can be a good deal for the buyer.
- Fixing up and occupying vacant or potentially vacant property helps to preserve neighborhoods. Vacant property attracts criminal activity that threatens safety and devalues property.
- Tenants will be able to remain in place preventing homelessness.

Purchasing foreclosed property can also present challenges to the buyer. Some of the challenges are:

- The property may be in poor conditions due to lack of maintenance, vandalism, or abandonment. Although the property may be bargain-priced, a lot of money and resources will be necessary to make the property livable.
- The seller may have multiple liens to settle before the sale can be completed. The sales price will have to be sufficient to release liens on the property so that the buyer can close.
- Completing the sale can take longer than a conventional sale because of the number of parties involved. If the buyer is planning to use a purchase rehab loan, the added time to arrange the construction process takes time. The buyer must be prepared to wait.

D.

E. D. WHO IS INVOLVED IN A FORECLOSURE SALE?

In addition to the buyer and seller the following parties may be involved in a foreclosure sale. These parties may have recorded liens and other recorded documents that can be researched at the county's Registry of Deed. Most counties in Massachusetts can be accessed through the website www.masslandrecords.com.

The lack of a recorded lien does not mean that the obligation does not exist. There may be a time lapse between when the obligation is made and the lien is recorded. Other parties who may have an interest in the property include:

- Lenders and mortgagors that have balances due on the property. The owner may have first and second mortgages as well as equity loans.
- Condominium associations that may have placed liens on the property because of unpaid condominium association dues, fees, or special assessments for work performed on behalf of the condominium association.
- Government agencies that provide financing to affordable housing developments. These agencies have a vested interest in insuring that the property remains affordable to protect public investment.
- Agencies who provide down payment assistance and agencies that subsidize repairs. These organizations may have placed liens on property to insure repayment of the assistance upon sale of the property.
- Unpaid government entities (real estate and personal taxes). If the current owner owes real estate or personal taxes the property will not be clear for transfer.
- Affordable property developers who monitor affordable housing covenants. The covenant will be a recorded attachment to the deed that will specify the conditions of

ownership to that property. The covenant will specify the parties that are involved in contributing to the development of the property.

- Unpaid contractors who may have made repairs on the property.
- Unpaid utilities (water, gas, electric). Utilities may have obtained a judgment in court against the owner and may have placed a lien on the property
- Other parties that may have attached the property for money owed. If the property owner owed alimony or child support or was party to a lawsuit, there may be liens attached to the property.

These parties are waiting for the property to be sold so that they can recapture their investment in the property, fees for service, or the money that they are legally owed.

F. E. THE BUYER'S TEAM

Putting together a professional real estate team familiar with foreclosed property sales will contribute to the buyer's success in purchasing the property. The buyer should consider pulling together a team of real estate professionals experienced in foreclosure property sales before looking for the property. That way, the professionals will be in place when the buyer finds a property.

- A lender that has purchase rehabilitation loan products can help the buyer purchase and repair the property. Most foreclosed properties have damage that needs to be repaired or replaced. The buyer may need a substantial sum in case the house is not habitable. With a purchase rehab loan the buyer will be able to borrow funds to purchase and fix up the home. It is important that the lender understand that the buyer is considering a foreclosed property purchase. The lender may not have products to assist you if the home needs a lot of work. If the home is not habitable, the buyer may be declined for conventional mortgage products or the seller may be required to make repairs before the closing.
- A real estate broker or agent can provide the buyer with property listings for short sales and bank owned (REO) property. Not all agents participate in short sales and REO property sales so the buyer should ask. There is additional work on the broker's part in some sales so experience in working with these types of sales is a plus. He/she will know that the process will require timely responses among the buyer, seller, and their lenders. The broker should have experience in negotiating, especially in the case of a short sale where the buyer's offer must satisfy the lender and other lien holders. The broker will also have additional information on the neighborhood such as recent sales, transportation, and schools.
- A real estate attorney familiar with working with foreclosed property can advise you on price negotiations. He/she will review legal documents and make recommendations that will protect the buyer's interest during the sales process.

Foreclosures have more complexities than standard real estate purchases. The buyer will need legal guidance on how to proceed in the event that there are complications with the seller, owner, property, or lender during the transaction.

- A home inspector will provide the buyer with valuable information regarding the condition of the property. Consider hiring a home inspector who has technology to review the systems and structure in the house the buyer is planning to purchase. This includes thermal imaging, moisture meters, and tools that can reliably check the status of the plumbing, electric, HVAC, roof, foundation, and other important systems in the property.
- A rehabilitation specialist (rehab specialist) may also be required by the lender if the property needs substantial repairs. He/she will provide the buyer with detailed work write-ups that will allow a contractor to give accurate estimates for the work to be completed. The rehab specialist will follow the project until it is completed.
- A contractor who can provide estimates for home repair costs. It is important to have an estimate of repair costs from a contractor that the buyer has chosen to work with instead of a referral from someone who will have an interest in the sale of the property.

The **most important member** of the buyer's team is **the buyer**. This is his/her project. The buyer must keep the other team members informed of progress, delays, and project requirements. Team members will only act on tasks according to the buyer's direction. The buyer should keep project information organized as it will be key to helping the purchase process go well.

The buyer will want to interview each team member prior to selecting him or her for a foreclosure purchase. Some questions the buyer may want to ask:

- Have you worked with foreclosure purchases before? How many?
- What is your service fee?
- What services are included in your fee?
- What additional charges will be added if my situation is more complex or difficult?
- What documentation do you provide as part of your service?
- What guaranties or warranties do you provide?
- Have you ever performed a substantial rehab/home inspection on an abandoned property?

The buyer should ask for and check at least three references as part of the team evaluation process.

G.

H. F. PURCHASING A PROPERTY SHORT SALE

Purchasing a property using a short sale may appear very similar to the regular purchase process because the property owner still owns the property and may be using a real estate agent or trying to sell it himself. A short sale is also known as a pre-foreclosure sale because the property owner is still involved in the sale process and is in jeopardy of foreclosure. The buyer will be

able to walk through the property and see what he is proposing to buy. The owner is anxious to sell to stop the foreclosure.

Short sales offer a few additional steps to the standard purchase process. The lender may have begun the foreclosure process with the current owner and the owner has made the decision to sell the house. Some short sales have one lender involved, which makes the process easier but many have two lenders because of equity loans and equity lines of credit.

The most important factor of a short sale is that the mortgage lender and its representatives as well as other lien holders must agree to what they will receive from the proceeds of the sale. The purchase price must cover that total amount. If this is determined in writing in advance of an offer, the sale will proceed faster.

Even though the owner, lender, and lien holders may have prearranged a short sale, the lender and their attorney continue with the foreclosure process in the event that a buyer cannot be found. The real estate broker should be aware of the status of the foreclosure process and know the date when no further negotiations will be accepted.

When the buyer makes an offer that is less than what the owner owes on all liens and the owner wants to accept that offer, further negotiation will be required with all lien holders to allow the sale to proceed. The buyer must be cautious of investing any finances in the property other than earnest with the Offer to Purchase until he is certain that the deal will go through and that all liens will be released upon purchase. Any monies that the buyer commits as a deposit should be held in an escrow account.

Many properties sold through a short sale are sold "as is" meaning no repairs will be made before the property is sold. Even if the property is sold "as is" the law does require that the seller disclose known defects. If basic health and safety repairs are not included in the sale price, the buyer will have to make those repairs before moving into the property.

Although there is the temptation for the buyer to make many concessions to purchase the property, it is important to keep the attorney informed during the negotiation process. The buyer should not sign anything without reviewing the documents with an attorney. Short sales take longer to process than a traditional home purchase. The lender should be informed so that the buyer does not lose the mortgage commitment during the negotiation process.

Finally, the buyer should not invest any of his funds to pay off lien holders or make repairs on the property. The property belongs to the current owner until after the closing and there may be a very good chance that the buyer could lose the money.

G. PURCHASING AT AUCTION

The sale by auction process is now used for all types of home sales. The property may or may not be in foreclosure. It may be sold at a function hall, at the property, or on-line. The auction may be initiated by the homeowner or by the foreclosing party. In any case, the sale may be a

bargain or a disaster. It is important that the buyer do his homework before bidding on a property. The process of the auction sale is:

- The property, time, date, location, and terms of the auction are publicly announced. The property description will include the property location, description of the house and land. Terms will include the mandatory deposit, how the deposit is to be made (usually cash, certified check, or bank check), when the check is payable, and the deadline for when the buyer must complete the sale. Additional terms and conditions may be disclosed at the auction.
- Some properties may have a preview period. The preview will be an opportunity to walk around the property or a walk through the property. A walk through is generally not conducted in a foreclosure if the property is occupied.
- The auctioneer and bidders meet at the auction site. Bidders register by giving their name, address, and, presenting proof of the deposit.
- The auctioneer discloses the terms of the auction and starts the bidding. He may either give an opening bid or ask for an opening bid.
- The bidding continues until a bid on the property is accepted.
- The successful bidder pays the deposit and receives the information on completing the purchase process.

In a foreclosure auction, all lien holders may be represented at the auction and are usually prepared to bid to recapture their interest in the property. In many sales, the lender will bid an amount equal to their interest in the mortgage. This can be more than what the other bidders are willing to bid for the property. If the mortgage and liens are less than the value of the property, it is possible to purchase the property at a low price.

The person with the winning bid will be required to give his deposit to the auctioneer and sign a document that is the equivalent of a Purchase and Sale Agreement. In most situations, the successful bidder will be given 30 days to close the deal. Some auction sales require that the bidder finalize the sale in as few as 21 days. This will mean that the buyer's lender will have to schedule an appraisal to determine if the property is worth what the buyer is offering to pay and their attorney will perform a title search and request a tax lien certificate to determine if the property is free of liens.

In an auction, the successful bidder's deposit is at risk. If the deal does not go through, she will lose the money that was paid to secure the deal. If the property is in poor condition, the buyer must be prepared to repair it or resell it. If the previous owners and/or tenants have not moved, the buyer will be responsible for negotiating with them whether they should stay in their unit or move once the sale goes through. It is important that buyers research the property before participating in an auction.

I. H. PURCHASING REO PROPERTIES

REO or Real Estate Owned properties are properties that have been foreclosed and the lender took ownership of the property at the auction. Some of the tasks that the lender may have performed in taking possession of the property are:

- Removing all tenants from the building, including the previous owner;
- Clearing the title of outstanding liens;
- Turning off utilities;
- Winterizing the property to prevent damage by freezing temperatures;
- Securing the property by padlocking, boarding, and fencing;
- Clearing property of debris.

The lender places the property for sale with a local real estate firm. The buyer will be able to walk through the property, have the right of inspection before signing a purchase and sale, and negotiate the price. The lender may ask the buyer to prequalify for a mortgage with their company prior to entering any agreement with the buyer. This process serves as a guarantee to the lender that the buyer will be able to purchase the property. The buyer should be mindful of the terms of this mortgage. He will want to be able to pay the mortgage and make the repairs necessary to make the building habitable.

Even if the buyer decides to use the lender that owns the property for the mortgage, the buyer will use the standard purchase process including negotiating the Purchase and Sale process and commissioning a home inspection, appraisal and title search. The home inspection should wait until the utilities are on so that leaks and other problems can be detected. As with all properties, the buyer will not be able to close until the title is cleared.

J.

K. I. FINANCING FORECLOSED PROPERTY

Financing foreclosed property is different than financing a regular property sale. The factors that affect the financing are

- Completing the sale or closing on the foreclosed property may take months due to potential title problems.
- The condition of the property may require substantial repairs that will affect mortgage financing. A traditional mortgage will require that the buyer move into the property after the closing.
- In a market of declining values, the property may not appraise for the value that the buyer is offering to pay.

As part of the preapproval process, the buyer will be preapproved for a maximum purchase price. The buyer will have to purchase and rehab the property for an amount that does not exceed the preapproval. Lenders who are selling REO properties may require that the buyer be preapproved

through the lenders' bank or mortgage company because the lender wants to make certain that the buyer can obtain a mortgage.

There are special mortgages for buyers who want to purchase and make repairs to a property called Purchase Rehabilitation (Purchase Rehab) Mortgages. Two government-supported Purchase Rehab mortgages are MassHousing Purchase Rehab (www.masshousing.com) and HUD 203K (www.hud.gov). These mortgages can be found at a variety of lenders. Check the websites for lenders who are currently participating in these special mortgage programs.

L. J. HOW TO FIND FORECLOSED PROPERTY

While there are many websites promising to connect buyers with foreclosed properties for a fee, it is not necessary to pay. Free information about foreclosed properties can be found from the following sources:

1. Foreclosures are posted in the classified/legal notice section of the major newspapers every day. The two categories of published foreclosures are notice of foreclosures and notice of foreclosure auctions. The first category will require a short sale purchase if you purchase prior to auction; the second category will require that the buyer attend an auction.
2. Some lenders list REO property on their websites or on the websites of companies that they have contracted to sell the property. Lenders who have REO properties linked to their sites are Bank of America, Countrywide, and Wells Fargo. The websites have the capacity for the buyer to register with the site so that he/she can be notified if a property meets his/her criteria. HUD and other government agency foreclosure sales are listed on Homesales.gov.
3. Real estate agents have foreclosed property as part of their inventory of property for sale. When working with a real estate agent, the buyer can ask to see those properties.
4. At the Mass Land Records website (www.masslandrecords.com), a buyer can research properties that have foreclosure as a document type. There is a high volume of records so it is recommended that the buyer search a narrow range of dates.
5. Lenders and real estate agents sometime hold Foreclosure Home Tours where prospective buyers tour foreclosed properties in a defined area.

M. K. RESEARCHING FORECLOSED PROPERTY

Researching foreclosed property before bidding at an auction or making an offer is key to making an informed purchase. It will not guarantee that there are no problems but at least the glaring issues will be discovered before the buyer becomes deeply involved in the purchase. The Internet is a great resource in the research process because many public records may be reviewed online. Information that the buyer should review:

- How long has the property been in foreclosure? This will let the buyer know whether the he is negotiating with the owner, the lender, or the lender's attorney.
- What was the last sale price?
- What does the owner currently owe?
- Are there liens on the property in addition to the mortgage?
- What is the tax-assessed value?
- Is the building currently occupied? If not, how long has it been vacant?
- Are other homes in the neighborhood in trouble?
- If the building has more than one unit, is it a 2-4 family property or has it been split into condominiums?
- If the buyer is dealing with a condominium, what is the status of the condominium association?
- Are there any special assessments due to the condominium association?

Answers to many of these questions can be found at the Registry of Deeds websites for the county in which the property is located Most counties in Massachusetts can be accessed at the www.masslandrecords.com website.

Most cities now have tax assessments posted online. Property tax information includes the assessed value of the property, the history of the tax-assessed values, the current value, and the tax history. There is also a map of the property line with the building sited on the land. Even if the city or town does not publish the information online, it is public information and the buyer can ask for it at the city or town hall

The buyer should go to the property and see as much of the property as he possibly can. It is useful for the buyer to bring someone along who can offer a professional opinion on the condition of the property. The buyer should determine/notice:

- whether there other abandoned buildings in the neighborhood;
- whether the property is abandoned or has tenants;
- the condition of the building/property from the outside (walk around it);.

The buyer should also try to schedule a walk-through with the owner or real estate broker. By addressing these concerns before signing agreements, the buyer can evaluate how much time, effort, and finances he/she will need to invest in a property.

N. L. PREPARATION STEPS TO PURCHASE FORECLOSED PROPERTY

1. Take a Homebuying Class to learn the purchase process. It is especially critical to learn how to work with lenders, real estate professionals, and attorneys. Many cities and towns have down-payment assistance and other special programs to help buyers interested in foreclosed property.
2. Get pre-approved so that the buyer will know how much you can afford to borrow. Ask the lender if purchase rehab loans are available and get an idea of the process of using that type of financing. Pre-approval will be necessary as a bargaining tool for short sales and REO.
3. Research programs in cities and towns as well as state programs that will assist the buyer in repairing foreclosed properties.
4. When looking at property, ask the real estate agent or seller if the property is in foreclosure. If a short sale is planned, ask if the lender and other lien holders have agreed on a sales price.
5. Before making any offer, research the property at the Registry of Deeds and city or town Tax Assessing Department.
6. Have liquid cash to get a cashier's check if you plan to participate in an auction. The standard amount is \$10,000.
7. Put together a team of real estate professionals experienced in working with foreclosed properties. The buyer will need a real estate attorney familiar with the short sale and foreclosure process. The home inspector should be experienced in inspecting abandoned properties. The lender should be able to provide purchase and rehab financing. The buyer's construction team should be able to provide estimates of time and resources.
8. Research construction teams to get the property habitable. The buyer will be able to receive repair estimates quickly so that he/she can plan how long it will take for him/her to occupy the property.
9. Only perform the home inspection once all utilities are working. Damage to electrical, plumbing, and heating systems can not be determined if electricity, water, and gas are not connected.
10. The buyer should be realistic on his/her capacity to finance and manage a construction process. He/she must watch the budget and the progress of the construction at all times.

11. Foreclosed properties are often delivered vacant. If the buyer is purchasing a property with rental units, the buyer should make a plan on how he/she will find tenants. If the property is not vacant, the buyer should decide before purchasing how he/she plans to work with the occupants of the property.

O. M. CONCLUSION

Purchasing foreclosed property can be very beneficial for the buyer, seller, lender and the community if it is handled with great care. There are resources and experienced professionals available to assist you.