Current Real Estate Market has a Larger Proportion of Distressed Sales

In our current market with its increased number of distressed properties—such as short sale, foreclosure, and REO (real estate owned or lender/bank owned) properties— the value of surrounding properties are impacted and non-distressed properties for sale may find it difficult to get an offer at fair market value (FMV).

A distressed property sale generally includes any property that sells below FMV. Other examples of distressed properties include properties in which sellers are in a position where they must or want to sell a property, generally to get out from under mortgage payments. This could include sales as a result of a divorce, job loss, decreased income, poor health, probate, and a myriad of other types of sales.

Let me explain some of the real estate terms commonly used in our current market in relationship to distressed sales, such as foreclosure, REO, and short sale. Foreclosure is a legal process with set timelines and outcomes and begins when a property owner, usually after a couple of missed payments, receives a notice of default (NOD). Some may call property that has received an NOD a pre-foreclosure, though this is strictly a marketing term. At this point, the property owner has the option to bring his or her account current and avoid foreclosure proceedings. If the property owner is unable to bring his or her account current, the property will be put up for sale at a public auction known as a trustee sale, which is held at the court house in the county where the property is located. Only experienced investors should consider a trustee sale. When purchasing property at a trustee sale, there could be risks such as title problems, IRS liens, people still occupying the property, structural problems, superior loan pay offs, and more. If no one offers the minimum bid—generally because the outstanding balance on a home is too high or an investor, after doing his or her research, realizes the property is not a good investment—the property will end up as an REO.

With REO properties, ownership has reverted back to the lender. An REO is listed by a REALTOR®, who is hired by the lender, to sell the property that has been foreclosed. The lender will remove all liens ***on*** title and clear issues that may slow down the sale of the property. However, there are reported instances where unknown liens have appeared after the close of escrow and the new buyer is held responsible. One recent case in the Inglewood area involved a $35,000 utility district assessment.

Most REO properties are listed fairly close to the price the bank will accept. Lenders have already taken a big loss and offers significantly lower than the listed price on these properties will normally be disregarded. Lenders are usually very motivated to sell these properties though providing a great opportunity for qualified buyers.

Lenders are not in the property management business and do not want to delay recovery of their investment any longer than necessary.

Whereas REO properties are in the possession of the lender as a result of foreclosure or forfeiture, short sale properties are still in the possession of the owner. However, any contract must be approved by the lender. Short sales, in most circumstances, are the first step to avoid foreclosure.

The term short sale refers to a property that is generally in the foreclosure process but is sold prior to auction for an amount less than what is owed to the lender. Not all short sale listings though are properties in foreclosure. If property owners know they will not be able to continue to make their payments at some point in the near future, they can keep their account current while attempting to sell their property and make arrangements with the lender for a short sale prior to the owners missing a payment or entering foreclosure.

Lenders will consider a short sale for various reasons; although, a letter of hardship must be submitted with a multitude of additional paperwork required by the lender. Lenders evaluate all requests on a case-by-case basis and will also consider, among other things, the appraisal amount of the property and market conditions. Lenders may prefer a short sale in lieu of going through the foreclosure process because the cost of foreclosing on a property may be more than the bank's loss by taking a short sale, and even if the property goes to auction, the bank may still be forced to take it back as an REO, which they would then have to maintain, list, and sell.

Short sales can take months, are very complicated, and the outcome is not guaranteed. Also, each lender handles short sales differently. Both sellers and buyers of a short sale need to be patient since lenders—especially if you are dealing with a property with a first and a second mortgage—will require more work than a typical real estate sale. If a short sale is approved, it is important to know that the sale will, in most cases, still show up as a short sale foreclosure on the sellers' credit report.

"A short sale, once sold, will show satisfied after 2 years and the sellers can qualify for an FHA and conventional loan," said Daniel Roberts with Evofi-One. "However, if a foreclosure shows, it generally takes from 4 to 7 years depending on how the lender reports and how they extend the credit report. The best way to handle it is to try mediation. If that does not work, the lender at least can show they tried before they foreclosed."

Andrew Pence with Acceptance Capital said, "For a foreclosure, it is at least 3 years to obtain FHA financing and 4 years to obtain conventional financing. However, if the foreclosure was the result of documented extenuating circumstances that were beyond the control of the borrower and the borrower has re-established good credit since the foreclosure, the lender may grant an exception to the 3-year and 4-year requirement."

Pence further explained that extenuating circumstances include serious illness or death of a wage earner, for example; on the other hand, the inability to sell the house because of a job transfer or relocation to another area is not an extenuating circumstance.

However, before sellers request a short sale from their lender, they should consult with their CPA and attorney because depending on the type of loan and the sellers' financial situation, it may or may not be the best option.

Although, most recognize that distressed properties can be a great value for home buyers, purchasing a distressed property also helps property owners by relieving them of a heavy burden or by providing lenders the ability to recover all or a portion of their investment.

Locally, I know that not all agents with listings in our MLS (Multiple Listing Service) have properly identified their listings that fall into the foreclosure, short sale, or REO categories (under Features/Terms). This makes it difficult to determine the number of distressed properties we have among our residential listings. However, I would estimate that at minimum a quarter of our residential listings are distressed.

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