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The 3 stages of foreclosures

Many real estate investors dream of swooping in to get a great deal. It's possible, but it helps to know the landscape.

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NEW YORK (Money Magazine) -- Regardless of the state of the housing market, Americans will always cling to the foreclosure dream - to buy that dream home for pennies on the dollar.

Some want to flip them right away; some want to play landlord. In both cases, bargains are out there, but it's not easy.

If you decide to look for a foreclosed property, there are several points in the foreclosure process, and after, during which you can make your move.

Stage 1: Default

Your first opportunity comes in the "pre-foreclosure" stage, when owners have already defaulted on their mortgage payments but actual foreclosure hasn't happened yet. To find out about houses in default, visit the local courthouse where defaults are registered. You can then make offers directly to the defaulting homeowner.

However, few pre-foreclosure bargains exist among the most desirable homes. Many of those will sell for near their appraised values.

Properties that sell at a 20 percent to 40 percent discount usually need repair or are in unstable communities.

At this stage you have about 90 days to act after the default notice is posted and another 21 to 25 days after auction sale date is published.

Stage two: Auction

If a property doesn't sell in pre-foreclosure, and the home owner actually defaults on his mortgage, the home goes to public auction. During this stage you can find the best bargains, but it is fraught with difficulties.

Here's some of what you're up against:

- Many auctions are canceled at the last moment as the property has been sold or payments reworked.
- Court-appointed trustees only accept cash or cashiers' checks.
- There's little time to arrange inspections, so bidders may have no clear idea of what they're buying.
- Properties are sold "as is," without warranties. Sellers needn't disclose problems. Buyers may find themselves with unexpected -- and expensive -- repairs.

Not all auctions are created equal. If the loan was guaranteed by the U.S. Department of Housing and Urban Development (HUD), then the department takes ownership of the home and either sells it through a real estate agent or auctions it on the Internet.

These properties are not the bargains some potential investors think they are. For one thing, there's a lot of competition.

As for auctions of homes owned by banks or other private lenders, investors should not show up without preparation. All investors should know the state's laws and the particulars of the property they wish to bid on.

They should also be ready to put down a cash deposit of 10 to 20 percent of the sale price on the spot should they win the bidding. The balance will most likely be due in less than 30 days - in many cases in as little as 24 hours.

Financing is not the only obstacle for buyers at a foreclosure auction. The homes may still be occupied by the delinquent owners, and it is up to the high bidder to deal with the messy question of eviction. In some states, the former owners have up to a year after the sale to buy back their home for the amount they owe plus foreclosure costs.

Also, don't expect a clean title search or title insurance to accompany an auctioned property. It is not uncommon for a winning bidder to be unpleasantly surprised by an unpaid \$6,000 bill from a roofer or a claim by a third cousin who has an interest in the property.

And while some auctions take place in a house's front yard, allowing you to actually look the place over, just as many are sold online or "on the steps," meaning at the county courthouse. Good luck locating someone with a key to let you in for an inspection beforehand.

Simply put, these auctions are too risky for most buyers. A property could have multiple loans, liens, back taxes, be in need of major repairs. Individuals can look at homes at [HUD's Web site](#) and [Homesales.gov](#).

Stage three: REOs

Here's the investor's last chance. If the foreclosure didn't sell at auction, it has nowhere else to go but back to the lender, where it takes on a new name: real estate owned.

Lenders hate REOs. An empty house is a nonperforming asset on their books. The longer a house sits unoccupied, the more its value depreciates. Meanwhile, the lender is spending money for its upkeep -- or not, in which case it faces the possibility of a thorough trashing and an "as is" sale price.

Most large lending institutions won't deal with investors directly, preferring to hand over properties to real estate agents. But smaller banks, eager to save on the commission, may want to talk.

This may be the best chance for "mom and pop" to buy a foreclosure. Experts suggest that when a lender buys a house you want, quickly send an overnight letter to the bank president offering to pay their bid price for the property. The bank may want a quick turnover.

Banks do want to maximize profits, though. So buying from a lender may not result in big savings.

Some of the best foreclosure deals may be had through governmental or quasi-governmental agencies such as Fannie Mae, Freddie Mac, HUD, and the VA. Listings are numerous and available on their Web sites, but the properties they feature are often less upscale. Web auctioneer eBay lists thousands of foreclosed homes, too.

[Foreclosures surged in August](#)

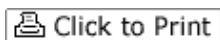
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This is adapted from Joan Caplin's "[Bargains for the Brave](#)" from the May 2004 issue of Money Magazine. ■

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