

Q&A: Foreclosure Investing May be On the Upswing, But it isn't for the Squeamish

In May, RealtyTrac, a leading online market for foreclosure properties, reported that foreclosure rates were up 4 percent in April from March levels, but up a whopping 65 percent from April 2007.

There's that old saying that one person's misfortune is another person's happiness. But in these troubled times for the mortgage industry, those who consider investing in foreclosure properties should not only understand foreclosure and the importance of cash in the process, but the emotional element unique to this kind of investment. After all, each foreclosure represents someone who has lost a home.

With the rise in foreclosures, you'll definitely hear more about how "easy" it is to invest and make a killing. But in reality, those who deal regularly in foreclosures know that making a profit can be tough, and that's true even for individuals with close ties to lenders and public officials and lots of experience. Here's a look at the foreclosure process and how it works.

What is foreclosure? A foreclosure happens when a buyer defaults on their payments and the lender takes formal legal action to seize the property. Foreclosures have accelerated not only due to a downturn in the economy that's affected home sales, but because many homeowners were tripped up by adjustable-rate mortgages that moved to higher payment levels that they could afford. State rules govern this process, but generally, when a lender decides to foreclose on a property it files a notice of default or a *lis pendens* (Latin for "lawsuit pending"). This document is a public record, and for buyers – including other lenders -- it's the first step in locating a property in foreclosure. A buyer looking for foreclosures can look online for lists of properties in default, but it's particularly important to double-check these listings.

Do all troubled properties have to be in foreclosure to be sold? Actually, no. You will hear about "pre-foreclosure" or "short sale" properties put up for sale by lenders who have entered into agreements with troubled homeowners who elect to give up the property to avoid a foreclosure on their credit report. You will also hear about such sales being done by intermediary companies who claim to deal in these transactions. Some are legitimate, some are not. Check them out.

How do people invest in foreclosure properties? There are three primary ways this happens. First, you will see buyers coming in at the "pre-foreclosure" stage. Second, you will see buyers going after "REO" (real estate owned) properties – literally foreclosed real estate still on the books of a lender. Third, you'll see foreclosures auctioned off at the public courthouse or in private auctions, depending on how the lender wants to market such properties to get them off their hands. Each process has its own conventions for inspecting the properties – sometimes prospective buyers get time to inspect what they might buy, other times little or none.

Can I borrow to buy foreclosures? If you have to borrow money to buy foreclosed or other troubled properties, you might not want to get involved at all. While the typical purchase of a home involves mortgage financing that takes weeks to secure due to credit checks and other factors, the sale of foreclosure properties is typically a fast-moving process that requires no-strings financing. Bottom line, lenders like cash. There's another good reason to enter this process with cash instead of debt. Even sophisticated foreclosure investors often discover ugly surprises when buying – property with greater damage than they anticipated, for example – and they may not have the flexibility to borrow to fix those unexpected problems after they borrowed to buy in the first place.

So, how do I educate myself? Start with some solid advice about your personal finances and your tax situation. A CERTIFIED FINANCIAL PLANNER™ professional can help review your circumstances and how prepared you might be for this risky form of investment. Beyond that, it's a process of learning how various lenders in your community deal with pre-foreclosure and foreclosure property and how public officials and private auction houses in your area handle the auction process for such property. Generally, this is knowledge that will take time to obtain since all the parties involved in this process are busy and besieged by many like you who want to learn. Be patient, take the proper time to study the process and don't spend a dime until you do.

-30-

This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Angel McCall, CFP, a local member of FPA. You will find additional informative articles at www.AngelMcCallCFP.com.