CHAPTER 22

The REO Revolution in Real Estate:

The Rules Have Changed

By Jonathan Modene

What's REO real estate? It's "real estate owned" by the bank, which typically means foreclosed or soon-to-be foreclosed (in the case of short sales) real estate. Banks don't like owning these assets. In fact, banks *hate* owning, caring, managing, repairing and paying the taxes and utilities on these assets. They're a bad part of the lending, banking and loan servicing business that banks make their money on.

Today, there are no better buys than purchasing REO properties, whether it's for your first home, an investor looking to add real estate to an investment portfolio, a buyer getting their next home, or even a hedge fund looking to make money. But the rules for playing this market have changed since the '90s real estate boom. Here are the rules for the new REO market:

RULE #1: THE OLD MARKET IS GONE, GONE, GONE

Most people don't like change, but change comes—and in business, it comes fast. In the American residential real estate market, change has come—and come fast. And it's not going back to the way it used to be. Why?

- *The old banks are gone.* In my city, 20 years ago, a great savings and loan operated. They did things one way: their way. They operated however they wanted to, and then—poof—gone. A whole new panoply of lenders, loan originators, mortgage brokers, and new banks moved in… and they did things how they wanted to. Now, most are gone. The regulatory rules and legal overhead is crushing for a smaller mortgage broker or small local bank. The banks that left, the savings and loans that closed—they're not coming back.

- *The old loan programs are gone*. Love them or hate them, but they're gone, gone, gone. I'm talking, of course, about the "liar loans" of the '90s and '00s. Remember? You "stated" your income on a piece of paper, and no one checked or verified what the borrower wrote down, so they became known as "Stated Income Loans." They're gone—crashed with the stock market and the real estate market, and the other fast and wild ways of 10-plus years ago. Gone too are the other exotic and esoteric loan programs for people who didn't have money to buy houses they couldn't afford at prices that didn't really make sense, and they're not coming back.

- *The old mortgage brokers are gone.* Vanished, vanquished. The great mortgage brokerages have largely vanished in the Midwest. In their day they were glorious to behold—titanic machines spitting out loans and loan packets, bundling the completed packages of loans to German investors and Japanese insurance companies. But then the market turned. The tranches of pooled "Grade A" risk were exposed in the harsh light of day for what they really were—pools of putrid risk; pigs with bows and ribbons festooned about them, but they were still stinking pigs. The mortgage brokers who did this? Gone, and they're not coming back.

- *The old appraisal rules are gone.* In the "old days," five or so years ago, if a house wouldn't appraise, you would—and I'm serious here—just get another appraisal. See how simple that problem solved itself? The loan officer would simply call "his favorite" appraiser to make sure it was "properly appraised." Imagine that! (Common sense would tell you if a house doesn't appraise for what you're paying for it, you shouldn't buy it at that price!) But I digress. The appraisal rules of today are rigid. They're rigorous, and they have teeth behind them. Appraisers are reviewed, graded, and subject to state and federal regulation. The old appraisal rules are gone, and they're not coming back.

- *The old buyer/seller tricks are gone.* It happened. The buyer got his downstroke from the seller (wink/wink). The seller got a special secret mortgage back from the buyer. The buyer got new furniture. The seller paid for this. Back and forth the money flew—all under the radar. Off the books. Under the table. At its simplest, it was just the seller paying the closing costs for cash-poor buyers, with a "carpeting allowance" or a "redecorating allowance" covering the action up. At its worse, it was sophisticated legal/criminal acts designed to defraud the lender. It's gone, and it's not coming back.

- *The old values are gone.* They are. If they aren't in your market or your country yet, they'll be gone soon. The bubble has/is/will be popping. Sorry, but the game is over. The string has run out. The fat lady has sung. The gig is up. And a seller who's certain that waiting for prices to come back is a matter of time is right, but your kids or grandchildren will be the ones who see it come to pass. The old peak real estate values are gone, gone, gone, and they're not coming back.

RULE #2: THE NEW MARKET IS ABOUT INFORMATION

In real estate, before you look, negotiate, close, and move in, you must have information. Information make makes everything work better. No money? You can still buy if you have the best information. Special needs? You can get a great house, if you have the right information.

- *The internet has changed everything about real estate, and the party with the most information usually wins.* In real estate today, the best source of readily accessed real estate is found online. So you *must* learn about your local market or the market you're buying in, and you can only do it right with online data sources. Find the county auditor. Learn to look and navigate that site well. Learn how to download and access the comparable pricing data that's available. See about accessing other data sources for sold information on the market times, price reductions, and environmental, zoning and governmental issues that affect real property where you're buying. Why?

- *The right information gets better terms, better deals, better prices, and helps you make a better decision.* In every case, in my experience, in this new market, the buyer with better information gets a better price. A better house. A better deal. Information crushes every other mitigating factor. Under all is the land. But overall is intelligence. Actionable intelligence. So above all, get the best intelligence on the real property you want to purchase. Get help. Pay for it. Borrow it. Beg for it. But get it.

RULE #3: THE BEST BUYS AND THE BEST DEALS TAKE PREPARATION AND WORK

Things that are worth having are usually worth working at. REO real estate deals are definitely worth working at!

- *Tactic #1: Find the bank-owned bargain.* This is simple: The best bank-owned bargain is the house you can actually buy today. Many foreclosures are in "unable to market status." They're foreclosed but not for sale. Or they're in a terrible state of limbo—zombie-like houses that are haunted with sellers or tenants who can't move on, and buyers who can't move and get clear title. Each state has a different foreclosure-time horizon, so here's a simple rule: Worry about, care about, and learn about and work for the property that you can actually buy—that the bank is marketing for sale.

- *Tactic #2: Find the seller in trouble with means to get out.* Hard to do but a great thing to pull off when you can. How? A seller who's mobile, gainfully employed, and who doesn't want to go through the trauma of having a foreclosure or short sale on their credit history. Someone who's upside down and owes more than their house is worth, and knows it. They need to have moved out of denial to acceptance. And they have to be able to write a check or satisfy the bank for the pain they're experiencing. If you find this seller, get a great deal and a potentially safe house.

- *Tactic #3: Find the seller who's in trouble but whose one best buy is working with their bank.* This is a "short sale." The seller will be "short" when the house is sold and not able to pay the mortgage. But if the bank accepts *all* the money and if the seller agrees to either walk away with nothing and/or sometimes pay more later, then you, the buyer, get the best deal of all: a below-market-priced home without the damage or unknown issues that a cold/empty/vacant/distressed bank-owned home can bring. Find a great short sale bargain, and you're most likely getting the absolute best REO buy in your market.

RULE #4: THE SMART BUYER SHOULDN'T BE AFRAID TO NEGOTIATE

This is where money in real estate is made. Only here—on the front end. When you buy. When you negotiate.

- *The bank wants to sell—and their only way out is to sell.* Understand this. They're not going to keep this house. Be patient. Be informed with great information (see above). But don't be hasty. They have to sell this house. You can buy any house. And if you pay too much? That money is gone forever. So understand their motivation and position and be patient.

- *The bank needs to sell because only bad things happen to empty houses.* Lenders and REO management companies have figured this out. The value will go down, not up. The mold will increase in mass and coverage area, not dry up and blow away. The vandals won't gently shut the door on their way out with the copper, the HVAC system, and the siding. Nothing good happens to empty houses. That's what's in your favor.

- *The bank must sell, but only if you're "their" kind of buyer, so make it very, very easy for the asset manager to work with you.* The bank makes the rules. Obey them. Cheerfully. Even if they're foolish. They want blue ink? Give them blue ink. They want you to be "pre-approved for a loan" by their own mortgage division? Sure! Great! They want their addendums filled out? Yes! Happy to! They want earnest money in Indian Rupees? Yes! Happy to go to the airport and exchange my dollars for rupees! The goal is to get the right house at the best price. And the path to this is to the follow the rules, play by their rules, and show them that you're a serious and easy-to-work-with buyer. It's that simple.

RULE #5: THE BUYER MUST BEWARE

So you find the house. You get the information. You negotiate the deal. The contract is signed. Now it's time to verify.

- *No one can tell you what's wrong.* If they say they do, they're guessing. They didn't live there. So if you *must* have all the facts known, then you shouldn't buy a bank-owned house, because no one in the transaction knows.

- *Your new, putative neighbors may have issues/motives you don't know.* They may not want you to buy it, so they'll "talk the dog" on the house. They may want you to buy it but not tell you what they think they heard the foreclosed owner tell them about the leaky basement because it's not any of their business. You just don't know! So you can't—at least at this point—trust the neighbors.

- *Your home inspection is simply a safety check, not a guarantee.* You can only trust the inspection for what it's worth. It's not a guarantee; it's a snap shot—a best guess by a hopefully trained and credentialed inspector. But they miss things. Things are patched and hidden. Houses are often sophisticated systems that evade easy answers. Water moves sideways! Walls are covered, hiding cracks. You just don't know.

- *Many flaws and details can remain hidden—that's why you pay what you're paying.* In the final analysis, you have to get an "REO discount" to overcome the risk of buying distressed, undisclosed, vacant and risky property. And that REO discount has to be greater than the risk you take. Pull it off and you'll get a great house at a great price. It will be cheaper than renting. It will be cash flow. It will be flippable.

It's the new REO Real Estate Revolution!

About Jon

Jon Modene has been setting the standard for real estate sales and marketing excellence in Toledo, Ohio, for many years. He earned his MBA from the Fuqua School of Business at Duke University and then worked in sales and marketing for IBM. Transitioning to real estate, he's the CEO and broker for RE/MAX Masters in Toledo. Last year he sold more than 300 houses in a market where the average agent sells just three. Jon specializes in real estate marketing and sales.

If you're reading this, you probably understand the value of real estate, and you most likely own a house. And, of course, you know that it's not too hard to sell a house if you price it low enough. But dumping a house like that dumps your family's equity—and that's not fun. Any agent or owner can do that. What's more difficult is delivering the right buyers to a property. Quickly. Easily. Especially buyers who are interested in your house and can also close the deal.

If you're a seller, here's what it's all about: properly pricing, staging, negotiating, and marketing your house.

Jon works with private homeowners, banks, asset managers, hedge funds, "for sale by owners," local governments, nonprofits, and people who owe more to the bank than their house is worth. He then finds the right person at the right time in the right way to purchase their real estate. Jon creates the result: a closed deal.

In the end, it all comes down to earning that slogan that Jon has been using for 20 years: "A Tradition of Trust in Northwest Ohio Real Estate"… One sale at a time.

To learn more about Jon and his team of experts, visit www.Modene.com, his award-winning blog, www.PerrysburgBlog.com, or call (419) 466-7653.