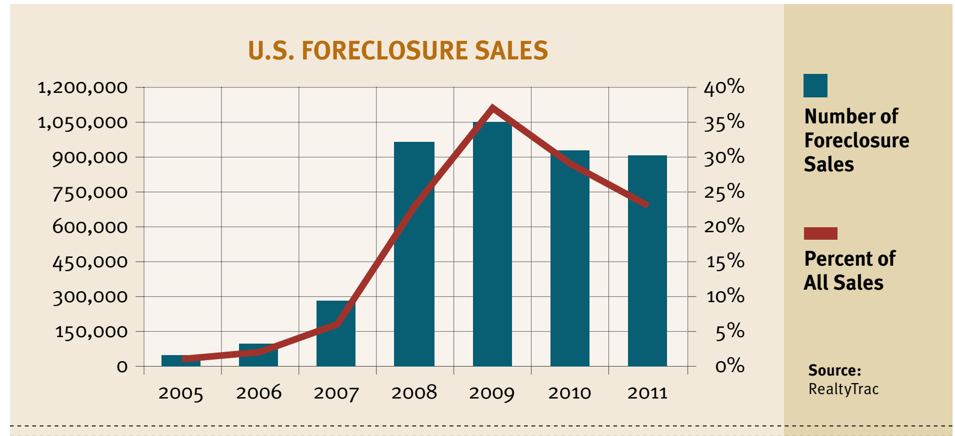
BackSpace

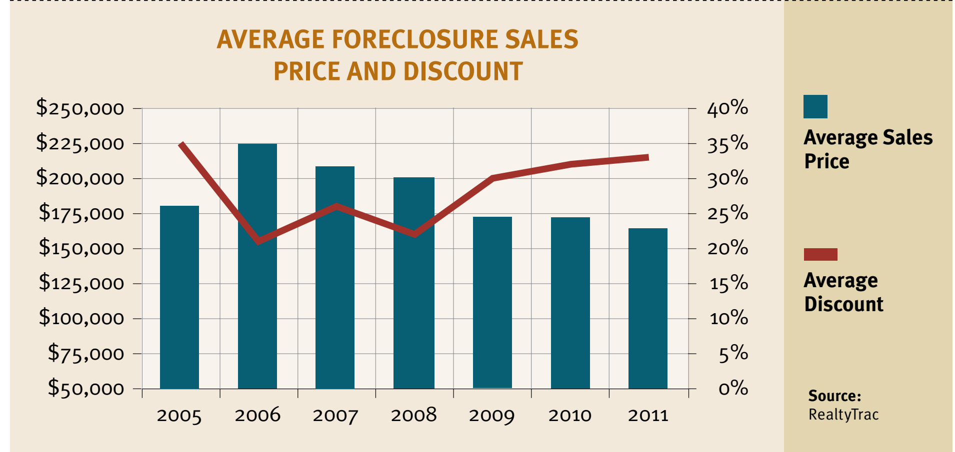
BY JENNIFER E. GARRETT, EDITOR

Deciphering the distress signals

A If you just look at the numbers surrounding distressed properties since 2007, it can be, well, distressing. Since the housing crisis, more than 4 million homeowners have lost their homes to foreclosure, according to RealtyTrac. Foreclosure sales have gone from a mere 1 percent of overall sales in 2005 to nearly 25 percent this past year. And by many accounts, these properties will be a problem for the real estate industry for some time to come.

Here's a look at several of the factors influencing the distressed-properties market, where the market stands today and where it is going.





The state of distress

As of this past February, one in every 637 housing units in the U.S. had a foreclosure filing, according to RealtyTrac. The February numbers represent an 8 percent year-over-year decrease, but at the same time, 21 states had an annual increase in foreclosure activity — the most since November 2010.

"There's quite a bit of distressed property out there," says Benton Neese, president of REOMAC, a national nonprofit trade association for the mortgage-default industry. "Estimates range anywhere from 2 million to 4 million properties [that are] in some form of serious delinquency. And that doesn't take into consideration the fact that there also are about 11 million properties that have negative-equity positions." It is likely that between 20 percent and 25 percent of those 11 million properties will default if no modification or other mitigation is done, Neese adds.

Further complicating the issue is the fact that, although this is a nationwide problem, the state of distressed properties varies widely from market to market. According to Geoffrey Jacobs, a principal at Arizona-based The Empire Group of Companies, influential factors include: whether the state is judicial or nonjudicial in terms of foreclosure actions, how sharply home prices declined and the individual market's overall economy.

For example, Phoenix — a city hit hard by the housing crisis — appears to be headed toward recovery, despite the fact that Arizona had the third-highest number of foreclosures in 2011, according to CoreLogic. "In the last six months or so, we've really seen an uptick in pricing," Jacobs says. "The battle's not over yet, but definitely the worst is over in our market, and I think to some degree in other parts of the West."

Although the country as a whole hasn't hit bottom in terms of housing prices, it may be getting close. "Prices are still going down," says Bob Dorsey, vice president of data and analytics at FNC Inc., a mortgage technology company that authors the FNC Residential

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Price Index. “There are certain areas that are doing well, but the aggregate measures are still going down — but not as fast as they used to be.”

The settlement

Uncertainty has surrounded the distressed-properties market since the robosigning scandal, as many lenders waited to see what would happen before moving forward with foreclosure actions. This past February, federal agencies and 49 states reached a settlement agreement with the country’s five largest mortgage servicers. The $25 billion settlement includes monies for loan writedowns, refinances and other borrower assistance, as well as penalties for the banks. Although it aims to bring some relief to distressed homeowners, one consequence of the agreement may be an increase in foreclosures this year.

Because banks slowed or even halted their foreclosure activity while the lawsuits were pending, RealtyTrac anticipates a jump in foreclosures this year. The company estimates as many as 1 million foreclosures will be completed in 2012 — a 25 percent increase over 2011.

The settlement also may lead to an increase in pre-foreclosure activity. “It’s put such a tight scrutiny on foreclosure actions that you’ll see more lenders doing deeds in lieu of foreclosure, trying to see if there’s any way that they can do another modification, short sales — things like that to avoid foreclosure scrutiny,” Neese says.

Invest in distress

If the settlement adds to the distressed market, it just may be investors who bring inventory back down. According to the National Association of Realtors (NAR), investment-home sales increased a staggering 64.5 percent this past year, with 1.23 million homes sold to investors. Distressed-property transactions made up half of all investment sales, NAR reports.

“There’s so much money circling this space,” Jacobs says. And he should know: The Empire Group is a real estate investment and development company that has purchased nearly 1,000 distressed residential properties and manages them as rentals. Like The Empire Group, many investors are looking to purchase homes at a discount and turn them into rentals. Even some of the hardest-hit areas may represent a good investment.

Locations like Detroit can generate high rental yields now but likely little appreciation in the long run, Jacobs says. Although a property in Phoenix may not generate as much rental yield now, it likely will have greater home-price appreciation in 10 years. “It really just depends on what you’re looking for as an investor as to what market is compelling,” Jacobs adds.

Working in this market

Whether it’s an investor purchase or an owner-occupied sale, there are deals to be made in the distressed arena. And the one thing everyone working in distressed properties needs to have is patience, Neese says. Because there are a multitude of variables that come along with short sales, real estate owned (REO) properties and foreclosures, these deals can take time.

Mortgage brokers and originators must do their homework when attempting to finance these properties. To determine what they’re dealing with, Neese says, brokers should know:

- **Does the borrower still own the property? Or is it in foreclosure?**
- **Is there a second mortgage?**
- **Are there investors involved?**
- **Is there a mortgage insurance company involved?**
- **Does the property have a servicer?**

In addition, brokers and originators should know the different products available. Because many of these properties have suffered in the foreclosure process, they often need work done. In addition to the Federal Housing Administration’s 203(k) loan, some lenders also offer construction-to- permanent loans that allow borrowers to finance the purchase and rehabilitation of a property in one mortgage.

“It’s critical for originators to look at those kinds of options,” Neese says. “If they can go to a borrower who is looking at this house and say, ‘We can take care of this for you, and here’s how we can do it,’ it’ll make it a smoother process.”

The future of distress

With all that’s going on in the distressed-properties market, what can mortgage brokers and originators expect for the rest of this year and into next?

Unfortunately, it seems like more of the same. Jacobs anticipates a slight upward trend in pricing for many markets, with investors helping to keep the increase in foreclosures in check. But most agree that more distressed properties are on the way. “There’s such a big backlog that we’re going to be dealing with foreclosures for another couple of years,” Dorsey says.

Neese agrees. “For the rest of this year and most, if not all, of 2013, the distressed market will continue to be a substantial share of the overall housing market,” he says. “There’s still a lot of inventory out there.” ●

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