Bank-Owned Real Estate May Be Plentiful, But Learn the Ropes Before You Invest

Last month, RealtyTrac, a leading online market for foreclosure properties, reported that over 3.16 million foreclosure filings were made in 2008, up 81 percent from 2007 and up 225 percent from 2006. There was one more stunning fact – that *one in 54* U.S. housing units received at least one of the following -- a default notice, auction sale notice and/or full-scale bank repossession – during the last year.

For those with money to invest in real estate, this is an exciting but extremely risky time. 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.

You'll hear many advertisements telling you how easy it is to invest in foreclosures and make a fast profit. But those who deal regularly in foreclosures know that making a profit can be tough, and that's true even for individuals with lots of cash, close ties to lenders and public officials and plenty 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 not 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 intermediaries 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 a local government building 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. That's where the risk comes in – it's not uncommon for owners losing their property to neglect it or damage it on purpose on the way out. Repairs can be costly.

Cash or loan? Borrow to buy a foreclosure property? With today's credit environment, don't count on any lender to stake you no matter how attractive your credit rating is. This is risky stuff. There's also a second reason. While the typical purchase of a home or business property 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, a lender marketing foreclosed property likes 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.

Where to learn more? Start with some solid advice about your personal finances and your tax situation. A financial planning 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.

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