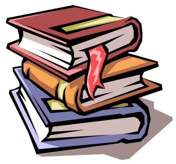
Success in a Distressed Real Estate Market 3-hour CE

TALK THE TALK



Cost-push Inflation: This occurs when the prices for the key inputs of goods and services rise (supply side), such as raw materials and labor.
Changing the Discount Rate: The Discount Rate is the interest rate that the Federal Reserve System charges its member banks. Helps control inflation.
Demand-pull inflation: When there is too much money and demand chasing too few goods.
Distressed Real Estate: Properties that are sold at a discount due to adverse conditions.
Foreclosure: The judicial process whereby the lender sues in court requesting a summary judgment to have the property sold by the courts to pay an outstanding debt.
Inflation: Inflation is a measure of the gradual, broad increase in prices throughout the economy. Typically, 2%.
Recession: Temporary economic decline during which the economy contracts, typically by a fall in Gross Domestic Product (GDP) in two consecutive quarters.
REO: Real Estate Owned by the bank.
Short Sale: Selling a property when more is owed than it is worth and with permission from the lender.

AREAS OF CRITICAL CONCERN

- Define hyper-inflation
- Define a recession
- List five types of distressed properties
- Understand the foreclosure process
- Know what an REO is
- Understand the process of the short sale
- Know what a Lis Pendens is and how to locate them
- Understand the difference between short-term and long-term distressed proper
- Know what the best target inflation rate is for the U.S. economy

I. Introduction

Real estate represents approximately 75% of the wealth in the United States of America. It is the only tangible asset that can not be reproduced. In other words, they are simply not making any more real estate. I is up to us to use and manage this precious asset for it's highest and best use.

On occasion, however, outside forces (typically man-made) intervein and disrupts the use and rights that we in the United States have with owning real estate. Distressed real estate is one of the major disruptions.

II. Distressed Real Estate Defined

Distressed real estate, often referred to as "opportunistic" **real** estate, is property that is sold at a discount due to one of five specific conditions: overpricing, deferred maintenance, mismanagement, a short-term environmental problem, excessive debt causing the property to become vulnerable to foreclosure, or unusual economic conditions such as a recession, hyper-inflation, or both.

1. Over pricing properties has a series of negative effects. The end result is they become stigmatized and creates a downward spiral in their values unnecessarily; Here is how it works:

   a. Overpriced = few or no showings

   b. Overpriced = NO offers! Many questions arise about this including property conditions.

   c. Price reduction = what is wrong? how low will they go? Stigmatized.

2. Deferred maintenance created a visual problem as well as a structural problem. Prices will be negotiated down to compensate remodeling.

3. Mismanagement in rental properties creates deferred maintenance which attracts less qualified tenants which creates a reduced net income which creates a lower value.

4. Short-term environmental problems such as a toxic spill certainly causes value problems. Demand for such properties has diminished considerably. Who wants to purchase in these areas? And how long will it take to recover or in the case of contaminated soil, to perk through.

5, Excessive debt is not uncommon. In the United States, buyers will inevitably finance the maximum amount a lender will qualify them for. If there is the slightest movement down in income or decline in prices, the homeowner is now in trouble.

6, Recession and inflationary periods are a major reason for distressed Properties. Loss of jobs will be part of the fallout. In addition, climbing interests will make it difficult for middle class America to purchase or even maintain affordable housing.

III. Recessions and Hyper-Inflation Periods

A. Introduction: Most real estate professionals have worked their way through a recession but have not experienced the devastation of a hyper-inflated real estate market. Recessions are typically short-lived. But recessions driven by hyper-inflation can drag on for some time. Perhaps years rather than months. It must be remembered that markets, especially real estate markets, are created by humans. And in many cases, they are government humans residing in our nation's capital. Good management, good economy. Bad management, bad economy.

B. Causes and Effects of a Recession: As of 2021, the United States is in a mild Recession. This is defined as a period of temporary economic decline during which trade and industrial activity are reduced, generally identified by a fall in Gross Domestic Product (GDP) in two consecutive quarters.

A recession is caused by a chain of events in the economy, such as disruptions to the supply chain, a financial crisis, or a world event. A recession can also be triggered after a high-inflationary period. When inflation increases, central banks raise interest rates to slow the economy with the goal of bringing down inflation. With higher interest rates, the probability of a recession increases, leading to layoffs, fewer jobs, and decreased consumer and corporate spending, among other effects found in a slowing economy.

As companies and consumers become anxious about the economy, they hold on to their money and cut spending. Businesses are forced to reallocate resources, scale back production, limit losses, and lay off employees as the economic downturn intensifies. Trends during a recession include an increase in unemployment. Currently, the U.S. Government unemployment numbers are fairly good because a large part of the work force has dropped out and are not seeking employment, for whatever reason. It is not uncommon to hear in many parts of the business world "we can't find anyone to work." This is mainly in the service industry.

C. Cause and Effect of Hyper-Inflation: Inflation is a measure of the gradual, broad increase in prices throughout the economy. It is usually expressed as a percentage, which represents the rate at which the costs of goods and services have increased over the last year. A good inflation rate is 2%. This is what the U.S. was experiencing from 2012 to 2020. A minimal level of inflation is expected and even encouraged. But it becomes a problem if the inflation rate gets too high. In the U.S., a common measure of inflation is the Consumer Price Index, a basket of items consumers often purchase. This includes food, housing, clothing, transportation, and health care.

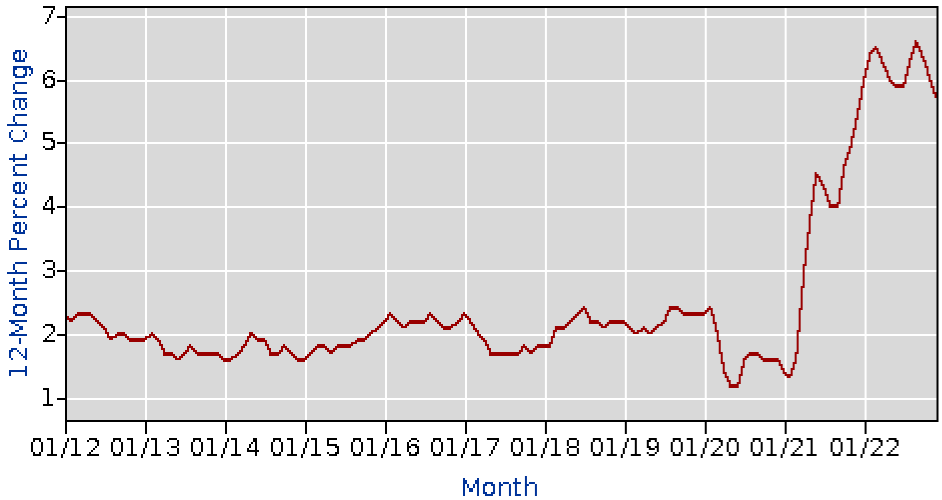
Excessive inflation (hyper-inflation) can severely impact the economy in a number of ways. Grocery story prices have skyrocketed as has most other consumer essentials. From clothes, to cars, to fuel, and the list goes on. As prices continuously go up, consumers have less money to spend on goods and services. People have to adjust their financial habits, which will slow down growth throughout the economy. Business will see lower demand and higher costs which will lead to higher unemployment.

There are two factors that can cause inflation.

1. Cost-push Inflation: This occurs when the prices for the key inputs of goods and services rise (supply side), such as raw materials and labor. When companies must pay much more for inputs, they pass on the costs to consumers in the form of higher prices. When cities, states, and countries are locked down, high unemployment is inevitable. This created a supply chain shortage, thus an extreme increase in prices. Until COVID, nothing has had such a devastating impact on the economy in this regard.

2. Demand-pull inflation: When there is too much money and demand chasing too few goods, it can push prices up and up to the ridiculous. COVID sent millions of workers home, some never to return to the same job. In order to make up for this devastating economic loss of family income, the Federal Government printed and spent trillions of dollars to compensate this massive income loss. The U.S. economy has more money in its monetary system than ever before. It is estimated the 40% of all money in the U.S. economy was injected into the system from 2020 to 2023.

The Federal Reserve uses monetary policy to achieve its target rate of 2% inflation. This is mainly the change in the Fed Rate (interest rate Fed Charges). Inflation should, **if managed properly**, return to 2% in 2024.



D. Monetary Policy: The Federal Reserve Bank is the "Central Bank of America" because of its design and legislated functions. It was created in 1913 by a few of the country's (and world's) richest men. Among them were John Rockefeller, J.P. Morgan, but more importantly, the Rothchild family that owned and still owns the Bank of England. It is quasi-government in that it is owned by private stockholders but heavily regulated because of its exclusive position. The Federal Reserve Bank (FRB) has the responsibility of implementing **monetary policies** which affect the way America uses its money supply.

The Federal Reserve System (the "Fed") can influence the cost of borrowing money in the banking system and control the amount of money in circulation with several economic tools.

1. Discount Rate: It primarily affects short-term interest rates like credit cards and automobile loans. It does not have an immediate or direct effect on long-term mortgage interest rates, but it does curtail the amount of money in circulation which **helps control inflation**. When the Fed raises the Discount Rate, short term interest rates also go up. The FED rate should be close to the inflation rate to have any effect of cooling the runaway economic conditions.

2. Changing the Reserve Requirement: The Reserve Requirement indicates the percentage of deposits that a bank must keep on hand and in the vault at all times. In 1863 the National Banking Act imposed a 25% reserve on all banks as a cushion in the event of note defaults. If the Fed raises the reserve requirement, banks have less money available for loans which causes interest rates to rise. When the requirement decrease, there is more money to lend and interest rates move down. Supply vs. Demand. That percentage has varied

through history but has steadily decreased. In March of 2020 the **cush** for defaults was reduced to 0%. The good news is that banks can lend out every nickel that is deposited. The bad news is there is no longer a cush!

3. Open-Market Operations: The most effective method of influencing long-term mortgage interest rates (increase or decrease) is through open-market operations. The Federal Reserve Bank (FRS) is the central bank of the United States. The U.S. Government is the biggest borrower of money from the Federal Reserve Bank. The loan is secured by a bond (note). When the government borrows money from the FRS, it reduces the amount of money remaining in the system for everyone else to borrow. This causes interest rates to increase (supply and demand). When the government repays the loan (buy back the note), it injects money back into the central banking system, causing interest rates to decrease.

Currently the FED's are trying to slow inflation by raising the discount rate in increments. This is a long-term process, regardless of what is being reported. The following is a chart of the Inflationary periods and how the FEB's responded with the rise of the discount rate:

YEAR	**INFLATION RATE YOY**[4]	**FED FUNDS RATE***[5]	**BUSINESS CYCLE (GDP GROWTH)**[67]	**EVENTS AFFECTING INFLATION**[8]
1929	0.6%	NA	August peak	Market crash/Depression
1930	-6.4%	NA	Contraction (-8.5%)	Smoot-Hawley
1931	-9.3%	NA	Contraction (-6.4%)	Dust Bowl
1932	-10.3%	NA	Contraction (-12.9%)	Hoover tax hikes
1933	0.8%	NA	Contraction ended in March (-1.2%)	FDR's New Deal
1934	1.5%	NA	Expansion (10.8%)	U.S. debt rose
1935	3.0%	NA	Expansion (8.9%)	Social Security
1936	1.4%	NA	Expansion (12.9%)	FDR tax hikes
1937	2.9%	NA	Expansion peaked in May (5.1%)	Depression resumes
1938	-2.8%	NA	Contraction ended in June (-3.3%)	Depression ended
1939	0.0%	NA	Expansion (8.0%	Dust Bowl ended
1940	0.7%	NA	Expansion (8.8%)	Defense increased
1941	9.9%	NA	Expansion (17.7%)	Pearl Harbor
1942	9.0%	NA	Expansion (18.9%)	Defense spending
1943	3.0%	NA	Expansion (17.0%)	Defense spending
1944	2.3%	NA	Expansion (8.0%)	Bretton Woods
1945	2.2%	NA	Feb. peak, Oct. trough (-1.0%)	Truman ended WWII
1946	18.1%	NA	Expansion (-11.6%)	Budget cuts
1947	8.8%	NA	Expansion (-1.1%)	Cold War spending

YEAR	INFLATION RATE YOY[4]	FED FUNDS RATE*[5]	BUSINESS CYCLE (GDP GROWTH)[67]	EVENTS AFFECTING INFLATION[8]
1948	3.0%	NA	Nov. peak (4.1%)	
1949	-2.1%	NA	Oct trough (-0.6%)	Fair Deal, NATO
1950	5.9%	NA	Expansion (8.7%)	Korean War
1951	6.0%	NA	Expansion (8.0%)	
1952	0.8%	NA	Expansion (4.1%)	
1953	0.7%	NA	July peak (4.7%)	Eisenhower ended Korean War
1954	-0.7%	1.25%	May trough (-0.6%)	Dow returned to 1929 high
1955	0.4%	2.50%	Expansion (7.1%)	
1956	3.0%	3.00%	Expansion (2.1%)	
1957	2.9%	3.00%	Aug. peak (2.1%)	**Recession**
1958	1.8%	2.50%	April trough (-0.7%)	Recession ended
1959	1.7%	4.00%	Expansion (6.9%)	Fed raised rates
1960	1.4%	2.00%	April peak (2.6%)	**Recession**
1961	0.7%	2.25%	Feb. trough (2.6%)	**JFK's deficit spending ended recession**
1962	1.3%	3.00%	Expansion (6.1%)	
1963	1.6%	3.5%	Expansion (4.4%)	
1964	1.0%	3.75%	Expansion (5.8%)	LBJ Medicare, Medicaid
1965	1.9%	4.25%	Expansion (6.5%)	
1966	3.5%	5.50%	Expansion (6.6%)	Vietnam War
1967	3.0%	4.50%	Expansion (2.7%)	
1968	4.7%	6.00%	Expansion (4.9%)	Moon landing
1969	6.2%	9.00%	Dec. peak (3.1%)	Nixon took office
1970	5.6%	5.00%	Nov. trough (0.2%)	**Recession**
1971	3.3%	5.00%	Expansion (3.3%)	Wage-price controls
1972	3.4%	5.75%	Expansion (5.3%)	Stagflation
1973	8.7%	9.00%	Nov. peak (5.6%)	End of gold standard
1974	12.3%	8.00%	Contraction (-0.5%)	Watergate **Inflation**
1975	6.9%	4.75%	March trough (-0.2%)	Stop-gap monetary policy confused businesses and kept prices high
1976	4.9%	4.75%	Expansion (5.4%)	
1977	6.7%	6.50%	Expansion (4.6%)	**Inflation**
1978	9.0%	10.00%	Expansion (5.5%)	
1979	13.3%	12.00%	Expansion (3.2%)	**Recession**
1980	12.5%	18.00%	Jan. peak (-0.3%)	
1981	8.9%	12.00%	July trough (2.5%)	**Reagan tax cut**
1982	3.8%	8.50%	November (-1.8%)	**Recession ended**
1983	3.8%	9.25%	Expansion (4.6%)	Military spending
1984	3.9%	8.25%	Expansion (7.2%)	
1985	3.8%	7.75%	Expansion (4.2%)	
1986	1.1%	6.00%	Expansion (3.5%)	Investment Tax Increase

YEAR	INFLATION RATE YOY[4]	FED FUNDS RATE*[5]	BUSINESS CYCLE (GDP GROWTH)[67]	EVENTS AFFECTING INFLATION[8]
1987	4.4%	6.75%	Expansion (3.5%)	Black Monday crash
1988	4.4%	9.75%	Expansion (4.2%)	Fed raised rates
1989	4.6%	8.25%	Expansion (3.7%)	S&L Crisis
1990	6.1%	7.00%	July peak (1.9%)	**Recession**
1991	3.1%	4.00%	Mar trough (-0.1%)	Fed lowered rates
1992	2.9%	3.00%	Expansion (3.5%)	NAFTA drafted
1993	2.7%	3.00%	Expansion (2.8%)	Balanced Budget Act
1994	2.7%	5.50%	Expansion (4.0%)	
1995	2.5%	5.50%	Expansion (2.7%)	
1996	3.3%	5.25%	Expansion (3.8%)	Welfare reform
1997	1.7%	5.50%	Expansion (4.4%)	Fed raised rates
1998	1.6%	4.75%	Expansion (4.5%)	LTCM crisis
1999	2.7%	5.50%	Expansion (4.8%)	Glass-Steagall repealed
2000	3.4%	6.50%	Expansion (4.1%)	Tech bubble burst
2001	1.6%	1.75%	March peak, Nov. trough (1.0%)	Bush tax cut, 9/11 attacks
2002	2.4%	1.25%	Expansion (1.7%)	War on Terror
2003	1.9%	1.00%	Expansion (2.9%)	JGTRRA
2004	3.3%	2.25%	Expansion (3.8%)	
2005	3.4%	4.25%	Expansion (3.5%)	Katrina, Bankruptcy Act
2006	2.5%	5.25%	Expansion (2.9%)	
2007	4.1%	4.25%	Dec peak (1.9%)	Bank crisis
2008	0.1%	0.25%	Contraction (-0.1%)	Financial crisis
2009	2.7%	0.25%	June trough (-2.5%)	ARRA
2010	1.5%	0.25%	Expansion (2.6%)	ACA, Dodd-Frank Act
2011	3.0%	0.25%	Expansion (1.6%)	Debt ceiling crisis
2012	1.7%	0.25%	Expansion (2.2%)	
2013	1.5%	0.25%	Expansion (1.8%)	Government shutdown. Sequestration
2014	0.8%	0.25%	Expansion (2.5%)	QE ends
2015	0.7%	0.50%	Expansion (3.1%)	Deflation in oil and gas prices
2016	2.1%	0.75%	Expansion (1.7%)	
2017	2.1%	1.50%	Expansion (2.3%)	
2018	1.9%	2.50%	Expansion (3.0%)	
2019	2.3%	1.75%	Expansion (2.2%)	
2020	1.4%	0.25%	Contraction (-3.4%)	COVID/domestic spending
2021	7.0%	0.25%	Expansion (5.9%)	**Inflation**
2022	8.5%	4.25%	Contraction (-1.6%)	**Recession**

Hyper-Inflation should, **if managed properly**, return to 2% in late 2024 or early 2025 . The real estate professional has not seen a recession caused by high inflation since the 1970’s.

E. Inflation vs. Recession: Inflation and recessions are very different economic phenomena, but they are intrinsically linked. High inflation can indicate an impending recession, as businesses react to higher costs by reducing production and increasing prices.

High inflation rates can indicate an impending recession, as businesses react to higher costs by reducing production and increasing prices. And if the Federal Reserve takes action in the form of more rate hikes to curb rising inflation, there's a risk that the move could help trigger a recession.

According to the Economic Policy Institute, economists' opinions vary on which is worse for the economy, a recession or rising inflation. One common argument is that inflation is worse than a recession because it impacts everyone. By contrast, a recession, and the associated job losses that come with it, may impact a smaller number of people.

However, opponents of that school say recessions reduce the income of everyone throughout the economy. With unemployment during a recession, there is also a loss of productive resources, particularly labor, causing the economy to produce less. Neither are good and the U.S. is, as of 2022, experiencing both.

II. Defining Distressed Real Estate

A. Types of Distressed Real Estate: Distressed real estate, often referred to as "opportunistic" real estate, is property that is sold at a discount due to one of five specific conditions: deteriorating physical condition, incorrect pricing, mismanagement, a short-term environmental problem or excessive debt causing the property to become vulnerable to foreclosure. It is important to note that distressed situations can arise because of property-specific issues, OR owner-specific issues, as described below.

1. Deteriorating physical condition**:** When most people think of distressed real estate, they think of a building in deteriorating physical condition. These distressing situations are often caused by a lack of routine maintenance or deferred capital improvements. For example, an owner may have allowed a small roof repair to linger and, over time, that roof deteriorates to the point of collapsing, creating a much more expensive problem that needs to be fixed that the owner cannot afford. In the meantime, tenants have to move out of the building, which disrupts the cash flow. As a result, the owner cannot afford the mortgage *or* the necessary improvements, and therefore, sells it as a distressed asset.

2. High Expectations of Value: High expectation of value refers to a situation in which the owner has overvalued their property, and as a result, the property fails to attract attention from investors. This often happens when a long-time owner tries to sell the property on his or her own, without the support of a broker who would otherwise help price the property appropriately. In situations like these, the owner may begin to defer property improvements until sale—but absent a sale, the property begins to deteriorate (see above). This presents an opportunity for a buyer to present a creative solution to the seller. For example, instead of paying the owner's asking price (which is valued too high), a developer may suggest they engage in a joint venture in which the owner contributes the land and the redevelops the site for a higher and better use, thereby providing the owner with a higher-value exit strategy or increased cash

3. Mismanagement: Mismanagement can take many forms. Most people tend to think of mismanagement as a failure to maintain the property, but it can also be mismanagement of operations. For example, an absentee landlord might fail to stay abreast of local market conditions and as a result, does not increase rents appropriately over time. This makes the property seem of lower value, at least on paper. Or maybe the owner struggles to fill vacancies, which would be easy to fill with modest property improvements. This creates a tremendous opportunity for value-add investors looking to turn a distressed property into a cash flowing asset.

4. Environmental Issues: Some distressing situations come as a result of a short-term environmental problem, such as the COVID-19 crisis. Many hotel and retail investors find themselves in this situation right now. For example, a hotel investor may need a liquidity injection and as such, may sell an asset at a reduced price to a group with reliable capital in order to produce the quick exit he needs to stabilize the rest of his portfolio. It may be that the property otherwise would perform well, but in the current environment (e.g., a lack of travel as a result of COVID) a property is struggling in the short-term and the owner cannot afford to weather the storm.

5. Unable to make debt payments: This is the major problem in most distressed real estate situations. Here are the two distinct categories and circumstances that create the problem:

   a. Non-residential: an apartment or any other commercial investment property is no longer generating the rents necessary therefore creating a negative cashflow.

   b. Residential: The owner can no longer afford their mortgage payment because of a loss of job, illness, insurance premiums skyrocketing, and several other reasons.

Regardless, this will force banks to execute their rights in collection by foreclosing. The moment the bank files a suit to foreclose on public record, the property becomes distressed.

B. <u>Temporary vs. Permanently Distressed Properties:</u> There is an important distinction to be made as it pertains to distressed real estate. Property can either be temporarily distressed *or* permanently distressed—and it is critically important for investors to understand the difference.

A situation of temporary distress is one that can be resolved whether through building improvements, a change in market conditions, better management, or some other solution. For example, a property that is only 70% occupied could be sold as a distressed asset, only for a new owner to come in and make upgrades to the remaining units in order to lease up and stabilize the asset.

A permanently distressed situation is one in which no matter what the owner does, there are conditions that he will be unable to change. This is known as external obsolescence. Something outside the boundaries of a property has happened to cause the subject property to lose value. It is important for investors to know the difference between temporary vs. permanently distressed real estate prior to investing. Be sure to know what is and what isn't in your control.

There is a case to be made for investing in distressed real estate instead of core properties, such as stabilized Class A assets in major metropolitan areas. There's not as much room for upside when you buy a core asset at a 5-8% cap rate. Distressed properties have significant room for upward growth. If an investor overpays for a core property, they are high risk in the event of a downturn or other disruption in cash flow. Buying distressed real estate puts the owner in a greater position of strength. If they buy real estate for a lower cost, they can weather downturns, a loss of tenants, or other cash flow issues more efficiently.

A distressed property is typically a property that is either in foreclosure, or the lender is trying to sell it. This is known as REO (Real Estate Owner). It will cost less than other similar-sized homes in the area. But there is a reason.

V. Locating Distressed Properties

A. <u>Pre-foreclosure</u>: If a mortgagor defaults on the terms of the promissory note, the mortgagee has the right according to the terms of the mortgage to have the property pledged as security sold for the remaining debt owed. The process to accomplish this task is known as foreclosure. Pre-foreclosure properties a found by searching public records for Lis Pendens. This will be a great opportunity to contact the property owner prior to the foreclosure process going too far.

One major cause of foreclosure during a recession is loss of jobs. As the economy contracts, businesses will be forced to cut back those in the workforce that is needed the least. Another would be the spike in the cost of living vs. family incomes inability to keep up with rising inflation.

B. Judicial and Non-Judicial Foreclosure: Foreclosure is a judicial process whereby the lender sues in court requesting a summary judgment to have the property sold by the courts to pay an outstanding debt. The first step in any lawsuit is the filing of a **LIS PENDENS** which is public notice of the suit commencing.

From commencement of the lawsuit through foreclosure sale, the mortgagor has the right to redeem the property by paying the debt in full prior to the foreclosure sale. This is known as **EQUITY OF REDEMPTION**. At the public auction, however, the mortgagor's rights in the property will be extinguished and a new owner will take title.

The mortgagee (lender) can only sue for money that is owed on the mortgage. If there is any money left over after the sale of the property, that money is given to the mortgagor. If, however, the public auction does not generate enough money to pay the amount owed, the lender has the right to obtain a deficiency judgment for that amount.

In a foreclosure, the lienholder foreclosing is paid, and any lien of lesser priority is eliminated if there are no remaining monies for disbursement. Any lien in a superior position will not be eliminated; rather, the new owner will take title subject to the superior lien still attached to the property.

Once the property is sent to a public auction, there will be a bidding process that takes place. It will be sold to the highest bidder. The bank's representative will be at the auction to protect the banks asset and will bid along with others to insure a fair price or allow the bank to buy the property and attempt to resell it at a later date. If the bank is the successful bidder, this is known as REO or Real Estate Owned by the bank.

The bidding process is as follows: Auctions are held on foreclosure properties offered for sale to the highest bidder. The Clerk's Office conducts the sale via public auction on the Internet in accordance with Chapter 45, Florida Statutes. The property or interest being auctioned may be worth less than the assessed value.

Anyone may bid on the properties. All bidders must register with the Clerk on this web site prior to the sale. The site provides information for each sale item, including the name of the owner, and legal description.

At the date and time specified for the sale, each item is auctioned in order of file number and sold to the highest bidder.

At the time of the sale, the successful high bidder must post with the Clerk's Office a nonrefundable deposit of 5% for the successful bid. Payments for deposits may be made in the form of ACH (electronic check), bank wire transfer, U.S. cashier's check, or cash. The remainder of the bid plus court registry fees is due by 5:00 PM CT on the day of the sale.

Upon payment of the remainder of the bid in cash, cashier's check or verification of a bank wire transfer, the Clerk will issue a Certificate of Sale.

A Certificate of Title may be issued by the Clerk of the Circuit Court after ten (10) full days have elapsed from the issuance of the Certificate of Sale and provided there is no other action relating to the subject proceeding. If no one is the successful bidder and the bank is awarded the property, it is now considered REO.

DEED IN LIEU OF FORECLOSURE occurs when a person defaults and instead of going through the foreclosure process and simply gives title to the lender. Before accepting title, the lender should first check for other liens that may remain with the property. Deed in lieu of foreclosure is a non-judicial proceeding.

REO properties are managed by the lender's REO department’s manager. Their role includes:

- Marketing the properties
- Reviewing any offers
- Preparing regular reports on the status of properties in the bank's portfolio
- Securing clear title

The REO managers also works closely with the lender's in-house or contracted property manager to ensure properties are secure and winterized or to prepare a property for vacancy. The REO managers undertakes these job functions to help the bank liquidate its properties quickly and efficiently.

REO managers often contract the services of local real estate agents to list the properties in the Multiple Listing Service (MLS) so they get more exposure. Listing properties in the MLS ensures that potential buyers who real estate websites, as well as sites like Realtor.com, Redfin, and Trulia, will see the listings. REO listing agents bring any offers they receive to the REO manager.

Real estate agents negotiate the commission they receive for selling REO properties with the REO manager.

C. <u>Advantages vs. Disadvantages of REO Properties:</u> REO properties can be attractive to real estate investors and homebuyers because they're cost-effective investments. Banks may often sell them at a discount to their market value since selling such properties is not typically their primary business line. Many properties that come through the foreclosure process don't just have outstanding loans, there may also be other defaulted payments on them. This can include property tax payments and other debts. The point of foreclosure is to remove any liens from the property and sell it. Purchasing an REO means they come lien-free, so there are no defective titles and no outstanding debts.

The majority of lenders don't want to hold onto REO properties. Keeping them on the market means they lose money. As such, they're usually more motivated to unload the REO property than a regular seller would their own home. Instead of doing the back-and-forth, lenders may be more willing to negotiate, which means buyers can often walk away paying a better price.

On the other hand, lenders typically sell REO properties on an as-is basis. This means they will not make any (major) repairs or renovations prior to selling. These properties are often in disrepair, so it's crucial to have thorough home inspections and be prepared to make (and pay for) necessary upgrades and renovations that may be needed. A highly neglected or damaged property may require extensive repairs and upgrades in order to make it habitable again. The cost of repairs can often negate any savings buyers have on the actual purchase price.

Although single-family home occupants may be evicted prior to listing, multi-family homes may still be occupied by tenants. This means buyers may end up becoming landlords, even if they never intended to take on that role. Buyers will have to take precautions to ensure they are compliant with local and state landlord-tenant laws by honoring existing leases.

D. Short Sales: Short Sales dominated the landscape from 2007 to 2012 because of sub-prime lending practices. People could purchase a property with little or nothing down and did not have to show job security, income, or anything else except a good credit score. Foreclosures were inevitable! In today's economic condition, short sales may not play a big role, if any.

The short sale process can be confusing to some home buyers and sellers. It can be difficult to explain how a short sale originated, and the process of receiving approval from a lender can be lengthy.

A seller and home both need to meet certain criteria to be sold short. All information regarding the seller's finances and the home's value will need to be gathered and presented to the lender along with other items in a packet, as well as having a prospective buyer.

When a lender approves a short sale, they agree to sell the property for less than the outstanding mortgage balance against it. Lenders will generally only approve short sales when foreclosure appears to be inevitable. With a short sale, the lender doesn't have to take the property back and bear the expense of maintaining it until it can be sold. They'll also avoid risking that the property won't sell again at a price high enough to recoup their losses—as it more than likely would in a foreclosure.

This is the typical short sale process from the bank's end of things, once it receives the seller's package:

- They acknowledge receipt of the file. This can take longer than 10 days; sometimes, it is a month or more.
- A negotiator is assigned, which might take up to 30 days.
- A broker price option (BPO) is ordered, where a broker generates an educated opinion on the value of the home.[2] Banks generally will refuse to share the results of the BPO. A BPO is really nothing more than a CMA.
- A second negotiator might be assigned, taking an additional 30 days.
- The file is sent for review based on the pooling and services agreement. This can also take up to 30 days.[3]
- The bank might then request that all parties sign an "arms-length" affidavit, which is a document signed by the buyer and seller stating that neither party knows the other, nor is there any type of pre-existing relationship between the two.[4]
- The bank will then issue a short sale approval letter if the sale is approved.

While there are more than a few requirements to qualify for a short sale, banks generally grant short sales for two reasons. One, the seller must be experiencing financial hardship, and two, there isn't enough equity in the home to pay off the mortgage after closing costs.

Some examples of hardship include reduced income from unemployment, divorce, a medical emergency, bankruptcy, or the death of the sole income provider. The seller must prepare a financial package for submission to the short sale bank. Each bank has its own guidelines, but the procedure is similar from bank to bank.

A seller's short sale package will most likely consist of:

- A letter of authorization for your agent to speak with the bank.
- A preliminary closing statements.
- A completed financial statement or request for mortgage assistance (RMA).
- A hardship letter from the seller.
- Tax returns for the previous two years.
- W-2s for the previous two years.
- Payroll stubs for the last 30 days.
- Two months of bank statements.
- A comparative market analysis or list of recent comparable sales in the area.[6]

E. <u>Steps in Buying a Short Sale:</u> As a buyer, ask your agent for a list of comparable sales before you write a short sale offer. The bank will want to receive an offer as close to the amount owed as possible.

The short sale listing price might not reflect market value. In fact, the property might be priced below comparable sales in an effort to encourage multiple offers. Some short sales can begin prior to an offer but banks will most often start the procedure upon receipt of an accepted purchase offer.[7]

After the seller accepts the offer, the listing agent will send the listing agreement, the executed purchase offer, the buyer's pre-approval letter, a copy of the earnest money check, and proof of funds to the bank. They'll also submit the seller's short sale package.

The short sale process will be delayed if the package is incomplete. They may not send it back to you, attempting to reduce as much of the cost for themselves as possible. Buyers might wait a long time to get a short sale response from a bank. It's important that the listing agent call the bank regularly and keep careful notes of the progress.

Some short sales get approval in two to eight weeks. Others can take 90 to 120 days on average. A top short sale agent can help to speed up the process a little by keeping informed of the offer's progress and holding the bank accountable.[9]

Checking in with the bank at least once or twice a week is imperative. Recognizing the behavior of incompetent negotiators and requesting a replacement is often necessary as well. Never be afraid to advocate for yourself or escalate your actions up the management chain of the bank.

It should be remembered; Buyers might become tired of waiting for short sale approval and threaten to back out if they don't get an answer within a specified time period. The process can be frustrating—both buyer and seller agents may need to work to reassure the buyer and seller that patience is necessary, as the wait can be lengthy. A listing agent will often have some idea of when approval will arrive as the file is sent for final review. At that point, buyers might want to start the loan process and other due diligence, so they've got a head start in case the bank allows only a few weeks to close.

You can expect the short sale process to take a few months, but the exact timeline will depend on how long each step takes. You can expect to spend up to 30 days waiting for the bank to receive the file, up to 30 days with each negotiator you need to work with, and roughly two to eight weeks waiting for final approval. Any step in the process could be extended by complications, such as application errors, but it could also go faster under more favorable conditions.

IV. Marketing Tips for Distressed Real Estate

Here are some tips on locating and marketing distressed real estate:

1. Marketing like a Pro:
   - You must be the "Pro" if you want to succeed.
   - Your websites and all of your marketing must be focused on your ability to resolve problems with distressed real estate.
   - Have a listing presentation designed for distressed properties. Be prepared to set open houses.
   - Understand investor needs and criteria on the selling side

2. Rundown or deserted properties:
   - Drive the neighborhoods looking for rundown and/or abandoned properties.

3. Pre-foreclosure properties:
   - Advertise on your website as a distressed real estate Specialist. You need to know everything there is about the types of distressed properties, defaulting on the note, legal filings on defaults, the equity of redemption period, and the public auction.
   - **Search every morning on public records in the counties of interest all Les Pendens that have been filed.** Locate and make an appointment to visit with the owner. Have a marketing solution to help them sell that property. Price it to sell. Banks will not wait in most cases. Once the property is listed, contact the lender and let them know who you are and what your marketing strategy is.

4. REO Properties:
   - Contact all local and reginal bank's REO department. Make an appointment, if possible, to talk about what they have and how you can be part of selling what they have. Bring your best listing presentation with you. You must convince the REO manager you have the expertise and resources to get the job done. And what is that JOB? To get the most money possible in the shortest amount of time possible. "List one property with me and you won't regret it. In fact, you will want me to sell more" But don't write a check you can't cash!

CONCLUSION

There will be opportunities during a recession and hyper-inflated real estate market.