

## What to Watch Out for When Buying a Foreclosure: Help Your Clients Know Which to Buy...and Which to Walk By

By Dan Steward



RISMEDIA, April 7, 2011—The economy is improving overall and, as a result, some bright spots are showing up in the real-estate market. However, the foreclosure spike, which began around the same time the recession did, isn't a distant memory just yet. In many areas, foreclosures are still happening; in some areas, those numbers have increased. Surprisingly, foreclosures have even encroached into some key cities that were formerly thought to be unshakable real-estate markets — like San Francisco, where foreclosures actually rose in 2010 (including in luxury neighborhoods like Pacific Heights, where a condo that sold in 2007 for \$2.3 million recently sold for \$1.44 million as a foreclosure).

This “second wave” of foreclosures – combined with the fact that many people's 401(k)s have bounced back with the stock market, and most economists agree that the bottom of the recession has hit – means that competition for these foreclosed homes is, in many cases, fierce. There's a renewed, final dash to get in on what some perceive as the best real-estate deals they'll get in awhile. But how do you know which foreclosure is a good buy, and which to walk by? Here are some tips to help guide your clients:

**Get it checked out by a pro.** Perhaps the most essential point: Never go by looks alone as an indicator of whether a foreclosure is a good buy. A \$2 million mansion may look gorgeous on the surface but might have toxic mold hiding beneath, which will require extremely pricey, lengthy repairs. On the other hand, a Mission fixer may look dilapidated but may have excellent bones and can be repaired at reasonable cost. Stipulate to your client that a certified professional home inspector must be contracted to check out a property before making a deal on it, to determine what repairs need to be done — so they can truly assess whether it's worth it for them. Don't rely solely on previous inspections, even if relatively recent – a vacant home can deteriorate quite a bit in a short time, especially in an area with climate extremes.

**Don't abandon common real-estate logic.** Too many people, when shopping for a foreclosure, abandon their real-estate sense and focus on price alone. Remember, things like a sub-par location, poor light, terrible view, below-average school district, high local crime rate and other negatives might be part of the reason why a home went into foreclosure in the first place. Don't assume that financial problems of the previous owner are the main reason for every foreclosure. The last owner may have bought the home ignoring some of the aforementioned problems, and seen value sink because of them. Don't ignore those problems, especially if your client is considering selling in the next 5 to 10 years. Let your client know how long the home has been empty; the longer it has, the more of a chance this isn't a good deal. Also, if there are plenty of other foreclosures nearby, that's also a bad sign.

**Skip – or, at least, very strongly rethink – the flip.** “House-flipping,” i.e., buying at bargain-basement pricing, updating, then selling for much higher – is very 2006... and hasn't exactly been hot since. Even if a house looks like an incredible flipping opportunity, beware of this temptation unless your client is a pro, with incredible contractor connections. Tell them to automatically triple the amount they think they'll be spending to fix up the home. Clients should avoid the temptation to make fast money unless they think it through and talk to their real-estate professional, a home inspector, contractors – and possibly even a therapist!

**Go over the budget.** A fixer-upper means nothing if you can't afford to fix it up – and that's especially true for foreclosures, where those fixes can cost a pretty penny. Before buying, make sure your client has an ample budget to

do all the repairs needed, after truly taking stock (with the help of a home inspector) of what those needs are. Make sure they have at least half of that money in cash, and preferably all of it. They don't want to take more loans than needed, especially private loans, which shouldn't be taking at all – the interest on them will, little by little, chip away at the initial foreclosure bargain.

**Do your homework on lenders.** Fewer people are getting financing for home-buying than they did before the recession, but good financing is luckily still available to many qualified buyers. Just make sure, as with regular home buying, that you enlist a reputable lender. A good lender will take the time to do a review of your client's financial life and long- and short-term goals, to truly pick the best solution for them, rather than just spitting out options. Also ask about hidden costs, rate locks, prepayment penalties, origination fees and whether underwriting is done in-house. Make sure everything is explained to them clearly, and recommend that they review all of the answers with a real-estate attorney, who will also be able to check out the lender's overall reputation. These are things that many people do during the standard home-buying process, but might gloss over when lured by a low foreclosure price tag.

**See it in person.** Finally, advise buyers never to buy a house without going in person to see it. Ever. Foreclosure or otherwise.

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