Second Stage Foreclosures More Profitable
by John V. Kamin

A more sophisticated moneymaker is more interest in second stage foreclosures on distressed property.

First stage foreclosures are where an individual homebuyer cannot keep up the payments, and the lender takes the property back. Or perhaps the lender puts the property up for bid, and the house is bought by a third party, who pays off the lender's loan.

What I call a second stage foreclosure is where the lenders themselves become overwhelmed by too many unpaid loans. Lenders may have foreclosed themselves on many properties, couldn't find buyers, say, because the original owners were without equity in the properties. Then, the lenders violate various lender covenants on their own loans, and are about to go under. So, the big firms the mortgage lender borrowed from require the lender to get rid of the multiple foreclosed properties at auctions. Again, these are lenders getting in trouble, not just the original borrowers.

When a "without reserves" second stage foreclosure takes place, then you can make big money. Example: When the Resolution Trust Corporation (RTC) bailed out many banks and Savings & Loans during the late 1980s and early 1990s, the RTC auctioned off those property portfolios, sometimes one at a time, sometimes a dozen modern homes in a single lot.

Here's where you could make some real money. In Texas, a hard-hit state, the RTC packaged foreclosed homes, where you could buy a dozen modern homes around Dallas in one package for a bid of $100,000…for all 12. Then, you the new buyer, could market those homes one at a time, or rent them out, or occasionally resell one or two out of your package of a dozen or more! Many of those "packages" were great moneymakers. Some of the individual homes might sell for six figures or more.

What Does It Mean To You?
I like second stage foreclosure auctions. I like them much better than first stage foreclosures of individual houses. After all, if someone is in trouble on, say, a $400,000 house, and has no equity, how can you make money foreclosing on that? Commission costs and resale costs will eat up the little or no equity that exists. On a first stage foreclosure you need property with at least 20% equity or so to make decent money.

But on a second stage foreclosure, where properties are "blown out" without reserve, or with very low reserves, then you can make some decent money. E.G. A property such as a small commercial building recently appraised at $800,000 might have the opening bids start at $250,000. Then, there's a lot of room to make some money.

Are We There Yet?
No, not yet. But with the subprime mess, and some lenders getting overwhelmed with repossessed properties, we're getting there slowly.

Prediction: During 2008 and 2009 I expect to see a lot more lender auctions, "blow out" auctions, second stage foreclosure auctions. Those with opportunity money handy can come up with the $10,000 minimum cashier's check to bid, as happened with the RTC auctioned properties during the late 1980s and early 1990s.

But those with only a few $100s deposit will not be allowed to bid.

Added Incentive
Sometimes, at second stage foreclosure auctions, knowing that properties will sell well below appraised value, financiers will show up, eager to lend you money (to buy those properties).

For example, a one-year to five-year loan at 10% on a dozen houses in Texas in the outlying metro Dallas/Ft. Worth areas, would back up a good loan, as collateral, when bought cheap. Even though the 10% interest rate might seem high, you might make a lot of money breaking up that “package” of foreclosed homes, selling them off one by one over the term of the loan, or renting them out for cash flow in the interim, while you re-arrange individual financing. Got it? Another example. During the RTC auctions, after they were over, it turned out that the RTC had averaged 59% of low appraised value on homes and developed properties (small commercial buildings, etc.). In other words, $1 million worth of conservatively appraised properties went for less than $600,000. That allowed lots of room to make money. And since appraisals were purposely set at low values, later on, as properties were improved, re-appraised, and cleaned up, the new appraisals might come in much higher, especially with market gains.

Point is, I like second stage lender auctions and lender foreclosures much better (for making profits) than first stage foreclosures when homeowners have little or no equity.

Build Opportunity Money
Forecast: You still have some time as these creditor-seizures and lender-disposals, second stage foreclosures, have yet to multiply.

Save up some opportunity money so that you’ll be able to participate during 2008-2009 when there should be many more available of second stage foreclosures as the housing squeeze continues into the coming two or three years! With second stage foreclosures, cash talks. And talk without cash is useless, we call it, “no-cash walks” where talk is cheap.

Have fun, make money, in any stage of the boom and bust by taking action decisively, improving your timing, and having opportunity money available to bid!

Financial Expectations vs Market Time Lags
There’s an economic phenomenon that you should know about, because it may benefit you. It’s the speed with which Federal Reserve can help gear up or gear down the U.S. economy.

Certain fiscal tax changes, such as Reagan’s tax cuts, can affect the economy faster. But other government moves tend to transmit very slowly indeed. Among these are FRB rate cuts, changes in joblessness rates, productivity, and the like. Those changes are slow indeed. Also sluggish are the major changes in the real estate market.

This economist could clearly see during 2005 and 2006 that the real estate market would top out. But how fast it would top out was not readily apparent. Top out it did, but it did so during 2007, and the big changes are only being felt now (subprime mortgage mess, market volatility on Wall Street, tighter costlier loans).

The economy itself continues to perk along at a 4.6% unemployment rate, among the lowest rates in recent decades. Car sales are picking up, as are other indicators. Inflation continues its (perpetual?) creep.

Point is, many quick-on-the-trigger market participants see a sudden change ahead in Washington or at the Fed, and they expect big economic changes in the marketplace immediately. That’s not the way it works.

Economic changes can be very slow indeed. E.G. The market crashed in Oct. 1929, signaling the Great Depression was not reached until late 1933, four years later. Jobless rates swelled to 20%. By 1939-1940 U.S. economy was still in a swoon.

The lesson? It is unrealistic to expect small changes on Federal Reserve policy, or tax rates, or new bills from Congress, to turn around or change the economy immediately. If changes come at all, they often come at a slower-than-expected pace.

Big Money From Repos

During 1933, after Roosevelt was elected, banks were failing at rapid rates. Many properties were foreclosed and taken over by the banks and other lenders. A couple of decades ago, doing research, I interviewed a major bank executive at one of America's larger banks, who had been a teller during the Great Depression. I asked him, "What happened to all those properties your bank foreclosed upon in the 1930s? How did your bank make out?"

At first he was startled by the question. But then he said, "I don't know. But I'll find out." Weeks later he got back to me, and said, "The bank made out extremely well. It gradually resold repossessed properties at huge profits."

I thought it was very telling that: A) Even the banks' big executives did not know precisely what had happened during the Depression, and B) That the big banks made huge profits in the years following on the properties repossessed on bad loans.

Further facts should be pointed out. During the 1930s, if you owned a farm or a house, you couldn't get a 15-year or 30-year loan. What you got instead was a three year or five year loan. You had to pay it all back during that time. There was no such thing as "automatic loan renewal". Later on, in the last half of the 1940s, government stepped in, made all kinds of GI loans, farmer loans and other government loans to large groups of people: returning soldiers, anyone who wanted a farm, etc., at low interest rates, long term. This was a big switch from the prior decade. Government. loans were assumable by later buyers.

Foreclosures had dropped during WWII and after, because there was little new housing built in wartime, employment was high due to the war, and govt. was willing to "carry the paper" when people did buy after the war ended.

Another Note of Interest

During the mid-1930s, the banks kept failing and repossessing homes, farms, commercial properties, until they were overloaded. Then, a national moratorium was declared on foreclosures. Net results? The bank could not take your home if you did not pay your mortgage, after the "temporary" national moratorium on foreclosures. This new moratorium pleased strapped mortgage borrowers who couldn't make the payments during the mid-1930s. But it made the lenders helpless because they couldn't do anything with the collateral backing up the loans, where loan payments were not being paid for a while.

Lenders felt helpless, and pulled back on lending (worsening the 1930s depression, and lengthened the economic downturn) making things difficult for new borrowers. Soon after, the national moratorium on foreclosures was lifted, as the economic cycle kept drifting at a very low level.

What Does It All Mean?

Prediction: As foreclosures mount 2007-2008, efforts to halt foreclosures on 0% down or low equity loans could further affect the property markets, make loans more difficult for new borrowers and loan "rollovers".

New Federal efforts to declare a national moratorium on mortgage foreclosures might help borrowers, property flippers and speculators, etc. for a short period of time. But such effects would have to be temporary, not permanent, to avoid further "upsets" in USA markets.

John Kamin is a Consulting Economist and publisher of The Forecaster, 19623 Ventura Blvd., Tarzana, CA 91356, (818) 345-4421. $180 per year. For more money-making ideas, order his latest book ***Active Money Strategies & Hidden Wealth Builder Secrets For Young Adults: What***

They Were Afraid To Teach You In School. If They Ever Knew! $20 + $4 s & h Add $1.65 tax. 95 pages.

Forecaster Money-Letter publishes confidential reports about the future to benefit you, and makes decisions easier. It helps you profit, sidestep losses, enhance lifestyle and creates financial independence.

Send for a 10 issue trial. A $150 value. . . only $59 when you mention the AOA. Mail check to: Forecaster, 19623 Ventura Blvd., Tarzana, CA 91356; or if you wish immediate shipment, phone (818) 345-4421 and put it on your credit card.