Lenders Holding Dreaded REOs Are Now Finding Lucrative Relief by Using REO Auction Vendors

Although consumers have the off-kilter perception that lender/servicers are out to foreclose on their homes without provocation, the reality, as most in the industry know, is quite the opposite. If a home does not sell at a foreclosure auction, then the property often becomes a costly albatross for lenders that struggle to recoup their losses.

Although the concept has been around for a while, REO auctions have picked up traction over the past two years as a viable alternative to the traditional method of listing a foreclosed property and hoping it will sell.

First Magnus Financial Corp has become a firm believer in the value of REO auctions after beginning to use the technique in April last year when it met executives from Tulsa-based Williams & Williams Auctioneers at a conference.

“What caught our attention was that we could dispose of property in a 40- to-60-day period,” said the lender’s REO specialist Anna Stark. This means First Magnus can turn REO properties so fast that its costs associated with the home become “nearly negligible.”

**High Value Avenue**

The lender only uses auctions for REO properties valued at $700,000 or more, since they are more costly to carry and maintain. The lender has to pay taxes on the REO, as well as carry forced placed insurance that is often double or even quadruple the price that typical homeowners pay since the risks to the properties are so much higher.

That is why it is important to Stark to have quick turnaround times, which also shorten the temptation window for those people who get a kick out of breaking windows, stealing copper plumbing and pulverizing toilets. Vandalism is a major expense for lenders since REOs can sit empty for months.

Also, Stark likes it that the auction process is almost hassle free. “It is the ease of the way we can assign property and they [Williams & Williams] take it once we assigned it. Two months later we have a net proceeds check in hand,” she told us.

**REO ROI**

The great concern among lenders is that they will take a huge loss on a home, but in the 15 months First Magnus has used REO auctions, they have been “very pleased” with getting all their money back on the properties.

Williams & Williams, in consultation with the lender, uses origination appraisals and broker price opinions to come up with an auction target value. “In our case, it has always been far and above what we expected, which is why we think it has been so successful,” Stark said.
Although the auctioneer’s track record has consistently produced better than expected proceeds, Stark is not worried that its run of success will suddenly end. She cited one recent case where the auctioneers were assigned a Florida property hoping to get at least $650,000, but instead got a cash offer of $900,000. “We were jumping that day. I couldn’t tell enough people quick enough about our good fortune,” Stark said.

The lone exception to that run of success came last year when a Kansas property went up for auction in December and the lender had to decline the offers. But when the home was re-auctioned this spring, First Magnus got a much better price.

**List or Not To List**

First Magnus is an originator, through its retail-lending arm Charter Funding, but it sells 100 percent of its loans and does not have any servicing. So unlike a servicer, the lender’s REO inventory of about 50 properties, which it has to buy back under certain conditions, is relatively low.

The REOs valued less than $700,000 are still listed with a traditional REO vendor, although Stark is considering disposing of those properties via REO auctions.

“We’ve gone back and forth about assigning the entire portfolio, but it is very small. We don’t have thousands of properties, yet,” Stark said.

First Magnus is “bracing” for an increase in REOs coming into its inventory, but the specter of escalating foreclosures was not a factor in deciding to use REO auctions.

Yet, Stark expects to be assigning more properties to the auctioneers, as well as to their traditional listing REO vendor. It is unlikely she will assign the entire REO portfolio to the auctioneers unless the volume grows to where aggregate carrying costs have to be reduced, she said.

First Magnus is getting 90-95 percent of its list price on non-auctioned properties, although some areas of the country, such as Denver and Kansas City, have a glut of foreclosed homes that make REO disposal difficult.

In Detroit, the situation is so bad, some foreclosed homes have been extensively vandalized and are now drawing vagrant squatters, prompting the city to threaten to demolish them as uninhabitable. Despite those REO headaches, Stark remains “delighted and surprised” with Williams & Williams. “[REO auctions] have been very lucrative for us and that is why we will continue to do business with [Williams & Williams],” she said.