

## **No Longer Business as Usual in REO Property Preservation**

*By Paul Dauterive, President, First American Field Services*

Overwhelming volume, market-forced changes to core property preservation philosophies, maxed-out resources, and more educated investors and consumers have dramatically changed REO asset management. Industry forecasters continue to predict an ever-increasing default rate which means the REO property management arena will continue to change to meet unique market pressures. Here's what we know today...

### **Eviction, Education and Evolution of REO Management**

Almost daily we read about slowing real estate sales and exploding mortgage defaults and foreclosures. The eviction rate for the properties our company deals with has grown from an average of 20 percent to almost 40 percent over the past year. Shops across the nation seem to be experiencing this exponential growth as well.

Market conditions and REO management pressures are changing the final eviction process. Beyond enormous volumes, a key factor is heightened consumer knowledge regarding evolving field services procedures - including necessary eviction.

A new reality is that ever-growing REO inventories just cannot be managed with existing lender resources. Institutional owners are employing more property preservation techniques to effectively meet the demand to maintain property values and prepare them for sale. Many shops simply do not have the financial or human resources to handle today's massive REO quantities.

Challenges in handling the volume include increasing up-front cash outlays to repair contractors that are not recouped for some time, as well as up-front expenditures for large lock-out service crews. For each lock-out there is a dizzying array of local laws that must be understood and strictly adhered to for each eviction process in each city across the nation.

Some local laws, for example, allow property contents to simply be moved to the curb during eviction. Other local laws, however, stipulate that contents be kept in storage for a specified period of time. Today's lender relies on service providers that understand these local laws and can make sure they are executed correctly.

In addition, there is a definitive increase in consumer knowledge regarding the eviction process. As the foreclosure crisis has deepened, press coverage and word-of-mouth education has grown in step with foreclosures. As a result, lenders must revisit their methods to get a foreclosed property to market on behalf of the investors.

As a strategic loss mitigation effort, relocation assistance has become a more frequently used method to clear a property quickly. Our success rate with this technique has doubled over the past year. The sheer number of properties and the fact that every day a property

is not on the market is a day that costs the lender carrying costs is creating more and more acceptance for such options.

### **Market Glut Changes Repair Philosophy**

The surplus of properties on the market, the increasing difficulty in obtaining buyer financing, the apprehension of cash investors, and the extended time properties take to sell is changing the way property preservation and field services are used by institutional owners.

A year ago the average time our company maintained an REO property on the market was around 90 days. That property preservation timetable has now grown to approximately 130 days and counting. In some areas of the nation, properties are losing almost three percent in value each month. That open-ended loss potential has certainly caught the attention of asset owners holding depreciating assets in a potentially declining market.

Before the default explosion owners primarily ordered repairs where there would be a direct and tangible potential return on investment. Market conditions have forced owners to recognize the value in making sure that the property is maintained to a higher level to help an REO asset sell quicker. The better condition a property is in the better it fares against other REO for-sale properties, the easier financing is to obtain and the faster it sells.

Utilizing property preservation professionals and independent marketing professionals (real estate agents) simultaneously, the seller is assured of two totally independent views of the subject property and two sources to rely upon, each expert in their areas respectively.

A crucial key to maintaining asset value is to utilize professionals who ensure that repairs are made, made correctly by licensed contractors and are undertaken with the directive to help move a property off the books as quickly as possible. Shoddy, cosmetic-only repairs can appear just as complete in a photograph a lender receives as a professional, permitted repair. Any poor repair or property flaw could possibly stall sales and put owners at risk for higher losses.

Lenders have recognized that a properly maintained property can make the difference between an idle asset and a REO sale. Today's current buyer may no longer be a speculator or cash investor. The typical investor, cash-type buyer is now often unable to invest in additional REO properties because their resources are tied up in their own inventory that they are unable to sell or even rent.

Individual buyers looking specifically for move-in ready property are growing. These buyers face increasingly strict financing requirements and a drying up of financing alternatives. Vehicles such as 100 percent financing are scarce. Credit is tight. It takes longer to qualify and more cash is required up-front than in recent years. Individual buyers are using their funds to get into a property which means fewer available funds for

renovations and improvements after purchase. That, of course, takes us back to the need for move-in ready REO asset condition.

### **REO Auction and Lender Landlords?**

Inventory backlogs are continuing to grow and if the assets are not maintained it creates a lose/lose situation. A property in disrepair not only drains lender funds while sitting idle but it also takes longer to sell based on overwhelming competition for buyer dollars. When it finally does sell, the core asset value can be lost through the diminished sales price as conditions and pricing deteriorates. Even with the most pristinely preserved REO properties, institutional owners are looking for alternative ways to dispose of their growing inventories.

Lenders are pricing REO properties much closer to current market value rather than waiting for premium prices. This pricing trend spans properties in all price ranges. In the case of lower-end properties, lenders are now much more willing to take reductions when selling just to clear inventory. In addition, many lenders are making price reductions more quickly than ever to move properties.

Another by-product of the booming foreclosure market is the rebirth of auction houses. Dormant just a few years ago, lenders are now changing the way they view this sales avenue and are much more aggressive about the properties they put into an auction. Newer properties, higher-dollar properties and the shrinking timetables lenders are taking to put a property into auction are fast growing trends. Some lenders, in fact, are moving selected properties to auction the first day they are on the market.

Additionally, some lenders are exploring the options of renting REO properties while they await sale. While the concept of lender/landlord does open up an entirely new area of liability and responsibility for lenders, it shows that they are earnestly exploring all avenues to try to recoup dollars lost while a property is not producing income via occupancy or sale.

Today's evolving market conditions will likely continue to impact and revise REO asset management and disposition for the foreseeable future. Innovation and dependable service performance in preparing properties for sale and maintaining them cost-effectively through disposition will be keys to mitigating losses in these turbulent times.