MACK INVESTMENTS

Getting creative in a lower inventory environment: Four ways to adjust

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Completed foreclosures are at a 32.6 percent year-over-year decline, and the song we can hear professionals associated with distressed assets crying nationwide is the power ballad "Without You."
Without inventory, without a direct line to the banks, without a surplus of listings, many brokers find themselves looking for new means of living both in and out of real estate. Well, turn down the Mariah Carey and give it just a bit more time, because although inventory is low, the dance isn't over and the strong can survive. The unprecedented number of foreclosures incurred by homeowners during its peak from 2008 through 2010 revealed new opportunities for investors, and the journey was truly thrilling for many of us as we started working almost exclusively in the distressed market. With
conditions so rife with opportunity, Wall Street took notice and institutional investors began swallowing up hundreds of thousands of distressed homes. In 2013, when single-family rental income became securitized for the first time in history, we knew the investor demand was strong and the institutional players were here to stay.

The REO-to-rental industry grew exponentially and became the ride everyone was jumping on, often without having to spend anytime waiting in line for inventory. The ability to adapt to the distressed environment brought the first stretch of track on the roller coaster that brought unimaginable peaks. Today, we find ourselves not in a terrifying descent, but rather in a horizontal stretch of track where it is neither exhilarating nor frightening. We're simply passing time until the next loop. And why? In a word – "inventory."

According to CoreLogic, in August of this year, 11 percent of total home sales were distressed sales, which is the lowest level since December of 2007. The National Association of Realtors reported total housing inventory fell 1.3 percent at the end of September 2014 to a meager 2.3 million existing homes available for sale. These conditions make it difficult for investors, brokers, and other industry players to carve out a business in either sector. So, with fewer foreclosed homes coming to market, how can REO providers find adequate supply? Following are a few basic methods that can help you gain access to available distressed inventory, in both good times and in bad:

BUILD A RELATIONSHIP WITH A COMMUNITY BANK

Unlike the large retail banks, community banks have a local focus, and therefore, local expertise. Community banks understand the local economy and are actively involved in the local housing market. For agents representing buyers looking in a particular neighborhood, the in-the-trenches intelligence held by community banks is extremely valuable in knowing which distressed properties are–and those that soon will be–available on the market.

But the decline in distressed inventory affects both retail and community banks alike. A report by BankDATAWORKS states that single-family REO inventory has dropped by 36 percent – from $10.28 billion in March of 2012 to $6.57 billion in March of 2014. While ample inventory still exists, much of it is still part of the so-called "shadow inventory" held by banks and not yet available for sale. Knowing when properties will be made available before the rest of the market is a critical advantage in a climate where REO providers are competing for limited supply.

To establish a relationship with a community bank, consider it like any strong relationship in that it must be mutually beneficial. Think about what you can do for the bank, how you can earn the bankers' trust, and how you can inspire its personnel to reach out to you regarding available properties before they become public. The first step toward this goal can be as simple as opening a corporate account, allowing them to get to know you and your business. Or, it can be through client referrals, suggesting a particular community bank be considered as the source for a mortgage loan.

In our case, we're able to offer property management services for upkeep of vacant distressed properties that, while they are still on the books but not yet on the market, are a burden to a bank as the properties often become eye sores, magnets for crime, and negatively impact property values in the surrounding area. Community banks are committed to the neighborhoods they serve and do not wish for these properties to blight an area or become a concern for residents. Although offering property management may not be a highly lucrative effort, it is certainly an effective way to pay it forward and demonstrate good will for the bank and the community it serves.

ATTEND JUDICIAL AUCTIONS.

Attending a judicial auction can seem like a very foreign experience for most brokers and investors, as the process is unlike a typical home sale, whether it's for a distressed or nondistressed property. These auctions are a steady source of distressed inventory, but operate in less of a relationship-based environment and require a bit more research beforehand.

Although not all judicial in inventory, organizations like Hudson & Marshall or Auction.com are good sources for distressed inventory in many markets. Signing up for email alerts with these providers is always a good start, but be aware that thousands of others are receiving those same email alerts.

Perhaps the biggest caveat to buying a foreclosed home at auction is that you will be purchasing the property without an opportunity to tour the interior beforehand. This makes market analysis and having a firm financial assessment extremely important. Additionally, some of the auctioned properties may be tenanted, and without the ability to run credit or rental background checks, it is difficult to make accurate estimates for your bid. However, these properties are ready and available for sale, and some have the potential to yield significant returns.

But the auction process itself is perhaps the most unique aspect compared to other home purchases. As noted by Kevin Kennedy of Kennedy Connection Realtors, the best way to understand the auction market is by attending an auction. Experiencing the process, understanding who is attending, how offers are being made, and how offers are being executed is valuable knowledge before attending an auction with cashier's check in hand. Additionally, it is imperative to establish your pricing thresholds prior to making an offer. The environment can be competitive, but the ability to walk away when the numbers don't work is critical.

GET ON THE RADAR OF AN OLD-FASHIONED PROVIDER.

Technology has dramatically changed the real estate industry, and nowhere is this more evident than in the home-buying and selling process. There are still a number of providers who conduct home-purchase offers the oldfashioned way by literally knocking on doors and asking if the homeowner would be willing to sell. Although this approach has decreased considerably over the years, some providers locate potential homes for sale through direct, unsolicited outreach, and then connect investors with these homeowners. In many cases, these home-finding sources will contact investors who have bought a number of homes within a certain area. But introducing yourself to them can be an easy way to get on their radar and be notified when a property will be available for sale. As an intermediary between you and the homeowner, establishing a working relationship with a home-finder can result in a first look at a property that otherwise would not be accessible through the MLS or other means.

PARTNER WITH A NON-PROFIT.

There are a number of non-profit agencies that work with retail and community banks to ensure that distressed properties are managed in the most appropriate way, bringing the greatest possible benefit to the community. It's a positive way for banks to relinquish distressed properties from the books while providing the non-profit organization a means to assist the community or segment of people it serves. But most non-profits are not able to specialize in each step of the acquisition, redevelopment, and rental or sale process of these distressed properties.

REO agents should consider offering brokerage services to appropriate non-profit organizations. Establishing a partnership can help the agency streamline the execution of its mission while providing you with an opportunity to deliver your REO services. Additionally, the more you or your firm's name is associated with the successful disposition of a home on behalf of the organization, the greater the likelihood that the participating bank will come to know and trust you as well.

With an estimated five million American homes lost to foreclosure since 2008, this major surge in inventory created significant opportunities for the real estate industry, particularly for those in the investment and brokerage communities. But as the market improves and inventory decreases, creativity is required to access the bank-owned housing that still exists. A return to the fundamentals is often the most effective means to capturing those opportunities.

The most fundamental truths in any industry is that businesses are built on relationships, and every industry will experience periods of growth and decline. It is critical to be flexible when considering how to nurture a relationship, whether it's providing assistance in renting a property, helping someone sell a home to be flipped, or any other endeavor that may not be part of the company's core mission nor yield the highest returns. The long-term payoff created through good will is immeasurable, especially when times are bad.

Although there will always be inventory in the market, being able to find it is the key. The primary way to be first on the call list is through the constant nurturing of existing relationships as well as cultivating new ones. Some of these business partnerships will be stronger than others, but like any investment, diversification is critical to sustainability in all economic climates. The market might be slowing down, but it's not going anywhere, so this is the time to test investors that rode the wave in against those who are here for the long haul.

So which will you be? Is there another sad song on your playlist, or will Freddie Mercury convince you that "The Show Must Go On"?

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Mack's management portfolio has grown to 1,500 homes this year, up from about 1,200 in 2013, said John Gutman, the company's vice president of sales and acquisition. He said Mack faces more competition from new, smaller investors.

"A lot of people are buying one or two homes and trying to get into the rental market," Gutman said.

Housing experts say the continuing climb in single-family rentals is a sign that the renting ranks are here to stay and that the Chicago area likely won't see the homeownership rates return to pre-housing crisis levels anytime soon.

SIGN OF TRANSITION

"We're at a transitional point where we're seeing investors pull back but we're not quite ready to say people are rushing back into homeownership," said Geoff Smith, executive director of DePaul University's Institute for Housing Studies. "The economy has improved in some segments but not broadly for all types of households."

The Chicago metropolitan area's homeownership rate stood at 67 percent in the third quarter, down from 68.1 percent a year earlier and well below the 70.4 percent hit in the third quarter of 2007, according to the U.S. Census Bureau. A key indicator of home-buyer confidence, the local homeownership rate peaked in 2006 but fell once the housing market turned. Many homeowners were forced into renting once the foreclosure crisis took hold.

Rental patterns varied from county to county. The surge in rentals was strongest in Cook and Kane counties, while the number was flat or fell slightly in Lake, McHenry and Grundy.

In Lake County, the number of rented homes ticked down 0.4 percent this year to 1,626. The drop could reflect the fact that some high-end and so-called accidental homeowners now are opting to sell as prices recover in many areas, said Wayne Paprocki, board president of the North Shore-Barrington Association of Realtors.

"One of the strongest areas is the high-end market, and they're starting to sell," Paprocki said.

Many housing experts don't anticipate the number of homes rented to fall back to pre-crisis levels until more people get jobs that pay well enough to obtain and commit to a mortgage. The people forced to sell their homes for less than they paid are probably going to have to rent for a while, said Paprocki.

"The bottom line is we've lost a lot of people who used to be homeowners," he said.

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