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I'm Interested in a Particular Distressed Property. What Are My Options for Acquiring the Property?

As some real property owners find themselves upside down on their loans, others see opportunities. There are several different ways to transfer title to these distressed properties, each with its own issues. We've assembled a list of pros and cons of a few of the more common approaches for purchasing distressed properties.

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Short Sale

A short sale is when a property owner transfers title directly to a purchaser for a purchase price which is less than the amount owed on the property. Because the lender will need to release its mortgage for the property to transfer free and clear, short sales require the approval of the lender. Lenders may not have an efficient process in place for approving short sales, which can result in uncertainty and delays.

Foreclosure Sale

Purchasing at a foreclosure sale is another method for obtaining title to a distressed property. When purchasing at a foreclosure sale, the purchaser must usually outbid the foreclosing lender, who usually bids the amount that it is owed. The benefit to purchasing a property at a foreclosure sale is that the purchaser obtains the property free and clear of all junior liens affecting the property. However, this benefit assumes that all junior lien holders were properly notified of the foreclosure action, something that can be easily overlooked. For this reason, it is essential that the purchaser obtain a title insurance commitment before the sale. Further, it is often difficult to obtain access to a property prior to the foreclosure sale, which means that purchasers are often unable to conduct the due diligence they would conduct in a standard real estate purchase.

Purchase from Lender

Purchasing a property from a lender is, again, very similar to a standard real estate purchase. Purchase from a lender would occur after the lender has acquired the property through acceptance of a deed in lieu of foreclosure or a foreclosure action. If the lender acquires the property through foreclosure, the property should be free of junior liens. As is in the case with a foreclosure sale, the purchaser must be sure that the foreclosure action did, in fact, eliminate all junior liens. Again, a title commitment can confirm this. Purchasing from a lender often has timing issues because lenders are not in the business of selling real estate and may not have an efficient process in place to make such transfers.

Purchase of Note and Mortgage

Under this approach, the purchaser acquires the lender's interest in the note and mortgage by an assignment. The purchaser must complete its due diligence on the real property prior to taking the assignment. The purchaser must also, however, complete its due diligence on the loan documentation for the file to make sure the note and mortgage are free of defenses to their enforcement. Once the purchaser accepts the assignment, the purchaser steps into the shoes of the lender. The purchaser may foreclose the mortgage or may negotiate with the borrower for a deed in lieu of foreclosure. Foreclosures can take time. If the borrower mounts a vigorous defense, it might be more than a year before judgment is entered. And once judgment is entered, the purchaser will have to wait an additional three to six months (on multifamily and commercial properties) or six to twelve months (on single-family residential properties) for the foreclosure sale. If the purchaser accepts a deed in lieu of foreclosure, the purchaser will take title subject to all junior liens. For this reason, the purchaser should, before taking a deed in lieu, obtain a title insurance commitment insuring against junior liens.