

THINK OF IT AS SALES

BY RONALD JASGUR AND RODNEY CAREY

For too long, servicers have parked their REO properties in the asset-management bucket. It's time to dust them off and treat them as desirable new products to sell.





ould you imagine any product being placed on the market today that consumed as much of a company's resources as real estate-owned properties (REOs) yet received essentially no sales or marketing support? ♦ Let's look at a similar example. Back in the heyday of home building, builders paid for full-page ads in the Sunday newspaper to advertise their lots, communities and standing inventory of individual houses. It was considered money well spent—verbiage, photos and calls to action to entice buyers to take a look, take a tour, make an offer. ♦ And it worked. ♦ After a full-page broadsheet ad ran on a Sunday, the phone rang non-stop Monday morning with potential buyers. They came. They looked. They toured. They bought.

The expense of the advertising was a drop in the bucket compared with what builders pulled in as potential leads and sales. It was the cost of doing business, and one that they were happy to take on. That's because builders do two things very well. They strive to convert every shopper into a customer and they have always proudly considered their inventory—large, small or just right—as a product.

What if banks took the same approach to marketing their REO?

Before dismissing the idea as ridiculous, think about it. According to Truckee, California-based Clear Capital's May 2011 *Home Data Index™ Market Report*, REO properties now account for 34.5 percent of existing homes sold in America.

Foreclosures and short sales—long-sitting inventory that just won't go away—are big news, and they've become big business.

For REO to be viewed not only as a bank asset but a product that builds the bottom line, industry executives must embrace the idea of REO as product and sell it as such.

Long considered the red-headed stepchild of the banking industry, REO was something to deal with, to manage, to sweep under the rug until it went away. And it always did. When REO inventory was a pittance, banks could afford to hide it because the cost of promoting the few properties they had on the books far outweighed the eventual cost of cutting them loose.

Not so today. Most banks today hold more inventory in REO than builders ever did.

According to U.S. Census Bureau statistics, completed new-home inventory for sale was 78,000 in January 2011. Compare that with numbers from the end of last year: Fannie Mae/Freddie Mac/Federal Housing Administration (FHA) REO inventory totaled 295,307.

Today, rehabbed foreclosures are nabbing buyers more than new builds.

According to Bruce Eck, building inspector supervisor, West Bloomfield Township, Michigan, rehabilitated foreclosures provide owner-occupant buyers a home that is in better shape and up to current building codes and

neighborhood standards, unlike most other existing homes on the market—distressed or otherwise.

"The new-home market has all but dried up with the recent recession, but renovated REOs provide better, safer housing options today," claims Eck.

While rehabbing REOs is not an option for all banks and servicing companies (see sidebar), it does demonstrate that with proper focus, these properties can regain market appeal.

Tripping down Memory Lane

"There was always a stigma around a foreclosed property, even though there's no difference between a foreclosed house and the other houses on the same street," says Dale McPherson, chief executive officer of Field Asset Services Inc., Austin, Texas. McPherson has spent 36 years in real estate services, including six years in nationwide REO marketing and sales.

"The banks started that stigma by taking a position that they would not lend again on a property they had foreclosed on," explains McPherson. "There is so much inventory that's foreclosed, they've had to lose that school of thought," he says.

Back in the good old days, home appreciation was a given and borrowers could refinance their way out of troubling situations. The best way for lenders to mitigate loss used to be to "out-originate" the losses they experienced. Loans moving toward foreclosure were a fraction of the overall mortgage industry universe, and there was simply never a compelling reason to alter the handling of REO in the past.

Seemingly overnight, the credit market seized up and borrowers began to default at record pace. Banks and lenders were slow to react, and soon the decades-old way of selling REO wasn't appropriate for moving the new inventory levels at a traditional pace while dealing with the velocity at which prices were declining. The old system worked for the volume and the market of years past, but it doesn't work in today's changed industry.

No longer able to refinance these borrowers, and without the human capital to deal with REO inventories that shot from dozens to hundreds to thousands, many

institutions were ill-equipped and lacked proper training to effectively mitigate loss and handle the disposition of brick-and-mortar assets.

Then, the government stepped in with a series of well-intentioned but poorly executed directives. The Home Affordable Modification Program (HAMP), Home Affordable Foreclosure Alternatives (HAFA) program, Fannie Mae's Deed-for-Lease™ Program and other programs were designed to keep homeowners in their primary residences as long as possible.

Not surprisingly, these programs quickly turned

Investors, Step Aside

It seems that many of the rental or rehabilitation solutions proposed to address the bloating real estate-owned (REO) inventories continue to be hampered by institutional owners who either cannot or will not advance the funds necessary to turn the most aged and dilapidated assets into saleable properties.

Here's an idea: Use the U.S. Treasury to create an investment fund to acquire assets at current market prices that would benefit from rehabilitation and modernization. Once an REO passes a period of time (90 to 180 days) without being sold, it is easy to identify which properties could best benefit from an extensive remodel in order to attract an owner-occupant buyer.

Determine the true market value for the distressed asset and get Treasury to advance the funds to pay off the investor, thus eliminating the investor impediment. The servicer would be retained by Treasury to ensure proper care and preservation of the asset.

The servicer can then leverage its vendor network of Realtors® and contractors to make the property marketable, and Treasury could recoup its funds from the subsequent sale of the updated property.

Alternatively, without fronting the funds to renovate, a new Federal Housing Administration (FHA) program similar to the 203(k) loan could be developed, which would eliminate the hassle and confusion of obtaining quotes and bids for the renovation of a property.

The new FHA program would combine the property acquisition and the renovation into one package using the servicer's approved contractor relationships. It could be a two-time closing, with draws to allow Treasury an exit when the renovation is complete.

Taxpayers wouldn't be on the hook for any length of time, and the monies would be going to good use toward helping owner-occupant buyers with a demonstrated history of credit performance. A program like this would help stabilize values and put many people back to work. It's truly a win-win.

from helping distressed homeowners to instead fostering a sense of entitlement for the masses. The truly struggling borrower desperate for modification assistance has been lost among strategic defaulters looking for lower payments.

The government programs have done what they were designed to do: effectively delay foreclosures. When the crisis began, it was expected that defaults would be limited to the exotic and subprime loans of recent vintage and that the problem would correct itself fairly quickly.

But then prime loans caught the bug and here we are, five years later, still trying to figure out how to stem losses, handle the increasing inventories of REO and sort through the unbelievable number of underwater borrowers that, combined, continue to stifle any hope of a housing turnaround.

We should have expected that while the homes in foreclosure are averaging 549 days delinquent, according to Jacksonville, Florida-based Lender Processing Services' (LPS') March 2011 *Mortgage Monitor* report, truly viable disposition solutions would have emerged to soften the housing crash for the bank. Unfortunately, REO is still a dirty word laden with perceived expectations of discounts, poor property conditions and sad stories of families thrown out of their long-held homes by large, insensitive banks.

Changing the mindset

Banks have their own established processes and disposition strategies. But to employ them for the best sales results, we need to change the mindset: embrace REO and treat it as a product. Efforts need to be made to market these properties. And throw the stigmas and taboos of yesterday out the window.

At our company, when we meet with clients, we are always amazed that virtually no one views their REO disposition group as a sales team. Without fail, each shop is set up to manage the property while it's in REO.

To get the best results on each sale (disposition), strategy, goals and expectations need to support the intended result—which is to sell the property. Your process must support sales expectations for your product, with a constant reminder to your staff that their goal is to sell the product in addition to managing the property.

There is no product today that can achieve its manufacturers' sales expectations without the support of the entire company. Each product's success is a direct reflection of the resources and expectations that are assigned.

If we can change perceptions and expectations (both within banks and among the buying public), we'll seize an unbelievable opportunity that will build bottom lines. Experts predict the housing crisis will endure for at least another decade—not in every market, but in markets such as Las Vegas where leading research shows nearly half of all homeowners are underwater and job growth has come to a screeching halt.

Remember that innovative marketing inspired by the builders of the 1990s? They're back on track, leading by example: Builders have started to acquire REO for rehab and rentals, recognizing the inherent opportunities

in rebuilding. Atlanta-based Beazer Homes USA Inc., one of the country's top-10 home builders, announced in April that it is expanding beyond new-home sales with the introduction of its Pre-Owned Homes Division. Beginning in the Phoenix market, the new division is charged with acquiring, improving and renting recently built, previously owned homes within select communities in markets in which the company currently operates.

Private investors are plunking down cash for property because they know money can be made fixing and flipping foreclosures. Refurbished and repurposed REO are commanding top dollar around the country, so savvy investors are snapping up distressed properties in the right neighborhoods, making improvements and selling them for top dollar in short time, making serious profits. The private investor has realized the power of shifting the perception and stigma of a previous REO into a premium product.

Always be selling

Rather than asset disposition, it's time to think sales. Rather than mitigating loss, think profit potential. Management has to realize that they are no longer dealing with preserving asset quality; it's time to focus on sales metrics, marketing and cross-promotion.

As an example, our OfferSubmission REO sales negotiation platform generates more than 5.5 offers for every REO property sold. That means there are at least five lending opportunities for an originations team using REO as a lead source; four to five buyers who don't get to buy that particular REO but are still in the market to purchase a home right now. That's four to five buyers who may very well be interested in another REO that is still on your books but may not yet be on the market.

How about sales force incentives? We repeatedly find that increasing a commission by 1 percent is overwhelmingly more effective than a 5 percent price reduction, yet most of today's REO disposition efforts automatically call for price reductions every 30, 60 or 90 days.

Many REO sellers today are willing to spend a few hundred to a few thousand dollars on cosmetic upgrades in hopes of making a particular property more enticing to a buyer. Sometimes a property moves quickly and the investment is deemed sound; other times it's like putting lipstick on a pig, which doesn't fool anyone.

In Woodward Asset Capital's own Wholesale Acquisition Division, inventory, we've proven again and again that truly renovating a tired, stale property that has languished for months with the upgrades today's buyers demand will generate quick sales at the highest possible price. We also have seen that for every dollar invested, we can expect approximately \$2 in return.

With the high volume of distressed inventories in the marketplace, we specifically aim at making our properties the most desirable in the community. Whether we acquire properties in bulk or individually, we typically make the improvements necessary so that the homes we offer for resale are a better value and more attractive than homes offered by private sellers. Here in Michigan, that usually means that in addition to new roofs, new furnaces, new flooring and paint, we include upgrades like new bathrooms and new kitchens with granite counters—those “bling” items that set our inventory apart.

A common transaction moves from purchase to renovation to closed resale in five or six months' time, and normally ends with multiple quality offers at or above the price expectations we set on day one. As an example, we recently spent approximately \$70,000 to update a traditional 1970s four-bedroom colonial home in suburban Detroit that we acquired for \$100,000. It was resold for \$255,000 after receiving multiple offers over list price, while privately owned, non-distressed listings in the same neighborhood continue to sit on the market at lower prices without much hope.

Not everyone can plow more money into their inventory, but making REO properties more desirable to buyers also involves doing other things we can control with training and common sense. Such extra efforts include

responding to offers quickly and being transparent regarding any delays in the sale process. Or, remembering that on the other side of every REO transaction is a buyer waiting to spend hard-earned money on your inventory, and treating that borrower with the respect he or she deserves.

In real estate sales, it's all about the money you retain and how the customer feels about your company after leaving the closing table. The borrower won't be rushing to open a savings account in one of your branches if he or she was treated poorly while trying to buy one of your properties.

Doing things the old way hasn't improved the REO inventory situation. So it's time to adopt some changes. Let's borrow from industries like the homebuilders or customer-centric companies like Nordstrom and Ritz-Carlton that have all mastered the ability to successfully market a product. Let's take a page from some of the leading companies that have perfected the art of sales. It is bound to make a difference. **MB**

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