Buying Distressed Properties

Many of the homes for sale today - as many as half in some markets - fall under the category of "distressed properties."

These are homes that have either gone through foreclosure or are being marketed as "short sales." In a short sale, the homeowner can't afford to maintain the mortgage, but the lender - rather than foreclosing - agrees to the sale of the property for less than the balance of the loan.

These types of sales have different dynamics than traditional sales - with more paperwork, often a longer transaction process and, in some cases, more frustration. For these reasons, many buyers shy away from foreclosures or short sales.

However, if you understand the potential pitfalls of purchasing a distressed property - and work with an agent who has a thorough knowledge of this market - you can get a great home at a great price.

This is an outstanding time to buy a home - distressed property or not. With historically low interest rates, and a glut of homes on the market in many areas, there are bargains to be found.

Is a distressed property for you? Here are pros and cons of buying one.

Advantages of Buying a Distressed Property

First, you'll be dealing with a highly motivated seller – either a bank in the case of a foreclosure, or in a short sale, sellers who are in financial trouble and very interested in getting out of a mortgage they can no longer afford.

These types of sales take much of the emotion out of the process. You won't be insulting anybody, for instance, if you make an offer that's lower than the asking price. (That's not to say that the low offer will necessarily be accepted, of course.)

Lenders are extremely interested in getting these homes sold and off the liability side of their balance sheets. Many foreclosed properties can be purchased for only a percentage of what they would have commanded five years ago. (This situation is beginning to change, though; bidding wars are breaking out on some foreclosed properties these days, especially those that are moderately priced.

If you're looking at a short sale, you're not likely to get quite as good a deal as on a foreclosure. But there are definite advantages to purchasing one of these homes. For one thing, since the homeowners want to get the home sold quickly, they are likely to keep it well-maintained and in good move-in condition.

Disadvantages of Purchasing a Distressed Property

If you're looking for a "steal," you're probably not going to find it. The market is heating up, with more and more buyers jumping into the market. If you're purchasing a home to live in, you'll often be competing not only against buyers similar to yourself, but against investors. More competition inevitably leads to higher prices.

The transaction process for short sales or foreclosures often takes longer than for traditional transactions. It's sometimes not clear which lending institution actually owns a mortgage loan, and it can take time to get it all sorted out – especially if there's a second mortgage involved, which is often the case.

Some foreclosed properties are also in rough condition. Many have sat idle for a long time with minimal or no maintenance. The departing owners may have sold off fixtures, or damaged the property.

Purchasing Tips

It's critical to have the home professionally inspected before you make an offer or put down earnest money. The inspector will assess the structure's soundness and may uncover problems that would be very costly to repair. Banks usually sell foreclosed homes as-is, meaning they won't make any allowances for repair. And even in a short sale, they likely won't make any such allowances, because they're already losing money on the transaction.

You should have your financing in order before pursuing a foreclosure purchase. Pre-approved buyers have the best chance of getting the property in case of multiple offers. Also, banks generally aren't interested in contingencies (for instance, needing to sell your current home before purchasing another).

Distressed Properties and FHA Loans

If you're a first-time homebuyer, a federally insured FHA (Federal Housing Administration) loan might be a good option. The FHA has a program to help you repair a fixer-upper. You can get one loan that combines the mortgage with the repair costs. The amount of the loan is based on the projected value of the property once repairs are made.

FHA loans only require a 3.5 percent down payment – compared to 20 percent with conventional loans – and the down payment can come from an employer, family member or charitable organization. FHA loans also have lower closing costs than conventional mortgages.

Since the federal government insures these loans, you'll get a competitive interest rate and lenders may be willing to give you terms that make it easier to qualify for a loan. If you have less-than-perfect credit, it's easier to obtain an FHA loan than a conventional mortgage.

About HUD Homes

FHA-insured homes that go into foreclosure are acquired by the U.S. Department of Housing and Urban Development (HUD). HUD homes are offered for sale through Internet sites managed by management companies under contract to HUD.

Real estate agents who register with HUD can submit offers on behalf of their clients. HUD pays the agent's commission.

HUD homes are sold as-is, without any warranty. HUD doesn't make repairs nor pay to correct any problems. Again, that makes it critical to have homes inspected before making an offer.

In designated revitalization areas, law enforcement officers, K-12 teachers, firefighters and emergency medical technicians can purchase a home at 50 percent off the listing price. (They must commit to live in the property for three years.)