Real Estate: Taking a look at the Real in Realty

By Christina Gray, Investor Relations Manager, Stonecrest Managers

Probably the most common, single investment we make during our lives is buying a home. The strengths and weaknesses of the real estate marketplace have always been reflected in our economy. As one crashes, rebounds, or thrives, so does the other. And no two topics have so completely dominated our headlines for the last several years as the housing crash and our resulting – or underlying – economy.

In a November 18th, 2011 Wall Street Journal article titled *Housing Data Show Woes are Easing*, author Nick Timiraos reported that the "…share of households delinquent on their mortgage payments has fallen to the lowest level since the end of 2008…" He goes on to say that a slight shift in job gains has stemmed the free fall of the housing industry – after all, people who get paychecks can pay their mortgages. But, while the number of borrowers who were delinquent in their mortgage payments declined slightly during the first three quarters of 2011, 4.4% of all borrowers representing over two million loans were in foreclosure – the highest foreclosure rate during this recession. Mr. Timiraos states "… many markets must still digest an enormous backlog of bank-owned foreclosures over the coming years…". The Mortgage Bankers Association reports that "Nine of 10 states with foreclosure rates that exceed the national average are judicial states, where banks must process foreclosures by going to court." Judicial states have laws that are written to offer additional protection to homeowners. An unintended consequence of these laws is that foreclosure rates are understated due to the administrative delays caused by lengthy court proceedings. (Note: California is a non-judicial state.) Another repercussion of current real estate market conditions is its significant impact on the construction industry, which is building new homes that have to compete with undervalued, underpriced foreclosed homes. Add this to the fact that about 25% of homeowners are underwater on their mortgages, and the picture gets even bleaker.

Most experts agree that it will take three to four years for foreclosure levels to return to "normal" and for the glut of foreclosed properties on the market to be absorbed. But, in addition to the above referenced administrative delays underlying the coming influx of foreclosures, there is an additional distortion occurring in the industry that may postpone residential recovery for a bit longer. This distortion comes from the increasingly common bank trend of selling delinquent and non-performing notes in order to avoid foreclosure. This trend creates the false impression that foreclosures may be dropping and that the market is stabilizing.

But the news is not all bad. This real estate marketplace is ripe with opportunities on which investors can capitalize – if they do their research.

Many banks and other lenders sell foreclosed properties in bulk at a fraction of their real value in order to quickly recoup some of their losses. The majority of REO's (Real Estate Owned) are located in inner city and rural settings and many are in need of some repair.

Companies buy these REO's on behalf of their investors who finance the purchases through a fund. When researching REO fund opportunities, look for a diversified portfolio containing a variety of residential properties located across several geographic locations. The fund management team should have a strong, trusted network of other professionals in place at the local level, where the homes are located, who know the market and can close sales on a retail or wholesale level. Consider the fund managers experience dealing with the REO marketplace and look at their history of returns – does the fund management select properties that will yield a target return and are returns stable? How does the management team qualify the buyers to ensure that the notes remain performing when properties are financed? Typically, at the end of the portfolio's term, the portfolio's assets will be liquidated and distributed to investors. But, investors are not the only winners in this scenario. For example, Stonecrest often sells its foreclosed homes to those who ordinarily could not qualify for or purchase a home. These people become property owners with little money down, paying reasonable interest rates, and with mortgage payments at or below rental levels for the same neighborhood. So everyone wins. The banks recoup some of their losses, investors get a stable and attractive return, and the retail purchaser gets a home they could not have previously afforded.

It's important to get the underlying story – the real story in real estate. Finding opportunities for investors is one way to balance the darker side of the story and generate some badly needed returns.

For more information about Stonecrest products, contact Christina Gray at cgray@stonecrest.net or 650-492-1874, or visit stonecrestmanagers.com.