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Auction program addresses "perfect storm of events" driving increase of REO in lenders' portfolios

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Wall St. investment banking firms, banks and mortgage companies throughout the U.S. and in the N.Y. metropolitan area are seeing the level of defaulted loans and foreclosures skyrocket in recent months. Driven initially by the meltdown in the sub-prime mortgage market, lenders' real estate owned (REO) portfolios of 1-4 family homes are increasing dramatically.

Most experts believe that this trend will continue to accelerate as the adjustable rate mortgages written in the last few years reset. Borrowers will be seeking to attempt to refinance in an environment where credit under writing standards have tightened dramatically, where real estate values have declined and they may have no equity in the home. Homeowners in this position are presented with few good options: One, coming up with additional cash (if available) in order to refinance; or two, pay a much higher monthly mortgage payment that could potentially double as the ARM resets.

Unfortunately, many homeowners may have no option but to give the property back to the bank in a foreclosure action. Trillions of dollars of adjustable rate mortgages will be resetting in the two years. The sub prime mortgage crisis, declining real estate values, adjustable rate mortgage re-setting, increasing inventory of homes for sale and tightening credit standards is almost a Perfect Storm of events that is driving the dramatic increase of REO in lenders portfolios.

In response to the growing REO portfolios, lenders throughout the U.S. are utilizing a residential portfolio auction program as part of their overall portfolio management and disposition strategy. A portfolio auction-marketing program provides the lender a number of advantages:

Accelerated Velocity of Sales

An auction marketing program allows the lender to accelerate the velocity of sales in the portfolio. An accelerated sales process allows the institution to avoid costly carry costs including maintenance, taxes, physical deterioration, increasing management costs, and the opportunity cost of the funds. In addition, an accelerated sale of the inventory limits the exposure of the portfolio to declining market conditions. Lenders have used portfolio auction programs to sell hundreds of homes at one time to individual buyers.

Market Focus

An auction marketing program will focus the market's attention on the lender's portfolio. The auction will freeze the sale of competitive product and capture all the buyers in the marketplace. In addition, the auction creates a certain time of sale, where the buyer is forced to make a buying decision. In a softening or declining market, the conventional response to increase the velocity of sales is a systematic reduction in price in order to motivate buyers into the marketplace. The result of this approach is that the message to the buyer is to wait, pricing is coming down. An auction creates a

sense of urgency that does not exist in a conventional sales program. An auction marketing program will produce a level of interest that is not possible in a conventional sales process.

Auction Determines

Value for Buyer and Seller

In a softening or declining market, the competitive bidding of an auction demonstrates market value to both the seller and the buyer, answering the question what price should a buyer pay and what price should a seller accept.

Portfolio Control-Broker

Notification

An auction program has proven to be a very effective component of an overall REO portfolio disposition strategy. Many institutions use the auction-marketing program as an effective tool to accelerate conventional sales of the REO portfolio. Upon identifying an auction portfolio, lenders often provide a notification period to the listing broker that the property is going to be put in the auction on a certain date and that they will be losing the listing. The result is often an increase in the velocity of sales within the portfolio.

Portfolio Sale

An auction allows the lender to offer and sell all portfolio properties simultaneously on a non-contingent basis, obtaining bids on each property and to obtain pricing on the portfolio as a whole. This provides the lender with the ability to accept any and all offers, compare target pricing on individual properties versus the portfolio as a whole, allowing gains and losses to offset, resulting in the sale of more inventory. Additionally, by selling a large portfolio at one time, the lender can evaluate and incorporate the operational cost savings into their pricing model.

A Case Study

Seller: A national mortgage co.

Portfolio composition: 200 1-4 family homes located in N.Y. and N.J. Original auction portfolio 400 properties. Broker notification resulted in the accelerated sale of 200 properties.

Marketing Results: 14,000 open house attendees in three weeks of inspections. Over 3,000 registered bidders at the auction, each with certified funds.

Auction Results: 190 of 200 properties sold absolute for \$20 million. Recovery vs. book: Auction prices corresponded to 96% of seller's book value for the portfolio.

An auction portfolio marketing program has become a key component of a sophisticated lenders overall REO disposition strategy.

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