

Riding the housing bust

Investors are scooping up foreclosed properties, afraid of missing the real estate opportunity of a lifetime. Want to join them?

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(Fortune Magazine) -- If you want to mark the moment when real estate morphed from every American's dream investment into every American's nightmare, try the third quarter of 2007. That's when the foreclosure rate, which had been slowly creeping upward for three decades and was flat all spring, suddenly leaped 32%, from .59% to .78% of all mortgages.

Most were surprised, but as always, a few saw it coming - among them, Rob Friedman and Jeffrey Frieden, co-founders of Real Estate Disposition Corp. (REDC) of Irvine, Calif., the nation's largest foreclosure auction house. Launched during the last real estate downturn in 1990, REDC focused on its other activities, like land auctions, during the boom years. Then, in late 2006, Friedman got a call from some former clients at Bear Stearns who were tracking early signs of acute distress in the housing market. A new wave of foreclosures was about to crash. (This was at least six months before Bear's own subprime blowup.) "C'mon guys," was the word the auctioneers got from the bankers at Bear. "Time to go!"

REDC held its first auction of the new era on May 12, 2007, and on that day sold 76 properties for \$29,490,300. And since then? One hundred eighty-nine auctions coast to coast, 21,191 foreclosed properties sold, \$3.6 billion in winning bids.

Welcome to the other side of the housing bust. As home prices continue to skid and foreclosure rates soar (up a further 38% since the third quarter of 2007), something else is happening: Across the country, shrewd investors alert to outrageous bargains are beginning to stir. In California and Florida, thousands of small investors are crowding auction venues; in places like Phoenix and Las Vegas they're grabbing seats on foreclosure bus tours featuring free champagne and onboard massages.

The opportunists range from first-time homebuyers to the most sophisticated of investors; billionaire John Grayken of Lone Star Funds, who made a fortune during the S&L crisis, snapped up \$6.2 billion in distressed mortgage-backed securities from Merrill Lynch in July.

Make no mistake, it's likely that we have not bottomed out yet. According to the latest figures from the National Association of Realtors (NAR), the median existing-home price was \$183,300 in October, down 11.3% from a year ago. That's the sharpest yearly price drop since NAR began reporting such figures in 1968. For the third quarter, the closely watched S&P/Case-Shiller national home-price index posted a 16.6% decline in home prices from a year earlier, worse than the 15.1% drop posted in the second quarter. Across the board, experts predict further declines in 2009.

But more than Hank Paulson, Sheila Bair, or Ben Bernanke, it's this first wave of bargain hunters who will tell us when a housing recovery will happen. They're the ones diligently buying down

excess supply, restoring order and balance to a dysfunctional market. So let's visit the front lines and see what they're up to.

Here we go: to a raucous house auction in L.A.; a meeting of a real estate investors' club in Broward County, Fla.; and along for the ride on a limousine tour of foreclosed properties in and around Phoenix. No doubt some of the people we'll meet will wind up losing their shirts. But just as surely, among them will be those who will profit - spectacularly, and before anyone else does - from the recovery that one day must come.

SOUTHERN CALIFORNIA AUCTION FEVER

Ever been to a foreclosure auction? No, probably not. Okay, you'll need a driver's license or another government ID, a \$5,000 cashier's check, and a personal checkbook to cover the balance of the 5% deposit on your new home (unless the five grand does it; plenty of houses sell at auction for less than \$100,000). And if I were you, I'd bring earplugs.

On a Sunday afternoon here at the dowdy, vaguely Moorish expo center adjacent to the historic Shrine Auditorium in Los Angeles, the public-address system is cranked way, way up. That's Jeffrey Frieden - REDC's 6-foot-6, tuxedoed CEO - at the podium, flanked by a pair of giant screens displaying fuzzy, washed-out images of the merchandise. A trained auctioneer, Frieden is sprinting down the list at a 30-sales-per-hour clip. Two big floor fans are blowing at his backside, but still he sweats.

In front of him are row upon row of folding chairs filled with bidders, 885 of them officially registered, their ranks swelled fourfold by spouses, co-workers, babies in strollers, and assorted posse members. All ages, all races, of all apparent means; a motley collection of "end users," as they're known in the trade, as opposed to wholesalers, landlords, and other pure investors. They balance in their laps bid cards, auction catalogs, and platters of nachos from the concession stand.

"Auctions are a pretty simple game," Rob Friedman, REDC's chairman, explains to me during a walk around the block to escape the noise. "The more people that you get to see your ads, the more people that will go to your open houses. The more people that go to the open houses, the more people that will show up at your auction. The more people that show up at your auction, the more competitive the bidding, and the more we sell."

Even brokers who compete with REDC admire the privately held company's rapidly growing reach (licensed in 40 states, up from fewer than 20 at the beginning of the year), its marketing prowess ("We do a lot of TV because we think it really gets to the masses"), and its "silver platter" approach to facilitating fast sales. "We have the lenders, we have the escrow, we have the title," says Friedman. "It's a turnkey buying package."

According to DataQuick, California was averaging 2,000 new foreclosures every business day until a recent procedural change took effect. The way Friedman sees it, REDC has an important role to play in restoring sanity to the market - by "blowing through the inventory" and putting families back in houses. "There is nothing good about having them empty, and everyone knows it," Frieden says. "The banks know it, the government knows it, we know it. Getting this stuff moved through the system is all good."

Current renters Ray and Jaelyn Attefat (he's a jewelry salesman, she teaches ballet) have their eyes on a three-bedroom, two-bath ranch on a sub-quarter-acre lot in Glendale, "previously

valued" at \$930,000. Starting bid: \$290,000. Like so many who were priced out of the market in the past few years, the Attefats, who have two young children, are hopeful that their time has come. Alas, not today. Their limit is \$400,000. When the gavel drops on this one, it goes for \$560,000 (plus a 5% buyers fee payable to REDC). That's okay, they seem to be telling each other with their eyes. And they pack their strollers and push toward the exit.

Standing nearby is Hector Alvarado, a broker, here to observe the bidding on several properties he's been showing but so far hasn't been able to move. If they sell today, REDC will cut him a piece of the commission from the bank; if they don't, he'll keep trying. Seven out of ten sales that Alvarado brokers these days are bank-owned properties (statewide in California, the latest official figure is 51%). Recently the *New York Times* reported that old people are having to delay moving into retirement communities because, like everybody else, they can't sell their homes; all that's selling are foreclosures. "This is what's going to help get me through this nightmare," says Alvarado. "The new sellers are the banks. They're my best friends."

Behind the big blue curtain that separates the auction floor from the dimly lit staging area, I find Frieden sitting alone with a sandwich while a colleague spells him at the gavel. "So what about you?" I ask. "Are you buying?" He looks at me like I'm crazy. "I am not a residential real estate investor," he says; then he says it again. "I am not. Under any circumstances. I am not at all tempted."

SOUTH FLORIDA VULTURES STIRRING

The International Game Fish Association's Hall of Fame, hard by I-95 in Dania, Fla., claims to house the world's largest collection of angling artifacts. On the first Wednesday of every month, around dinnertime ("Finger food will be served as usual to the first 200 attendees - so get there early!"), it starts filling up with a different kind of artifact: South Florida real estate investors.

Dade County, Broward County, Palm Beach County - not many places in America got hammered harder than those places did. The average price for an existing single-family home in Fort Lauderdale, for instance, was \$354,000 a year ago; today it's \$252,500. Condos? You don't want to know. But the same thing is happening here as in other distressed markets: People are buying, be they brave or foolish, even as prices continue to drop.

On a recent night the mood in the packed room is hopeful. Everybody's looking to get back into the game, but recognizing that the rules have changed. Flipping is no longer an option, says attendee David Dweck. "Those are the people who are in trouble, because their only exit strategy was appreciation," he says. These days it's all about cash flow: How soon can you turn it over? How fast can you make it habitable? Can you make enough rent to cover the carrying costs?

Bill Leon, president of the Broward Real Estate Investors Association, is setting up the sound system for tonight's featured speaker, a widely feared local tenant's attorney who has promised to teach novice landlords how to write a bulletproof lease. Leon is a wholesaler, meaning he looks for steep bargains he can resell in a hurry to landlords and rehab specialists. "I buy 'em one at a time, and I sell 'em one at a time," he says. He has a phone number, 1-800-PAYCASH, that he advertises on TV. "Let's say I can buy that \$100,000 house for 60. I sell it for 70, let an investor make 30. I always have to leave enough on the table for the next guy."

Leon's been doing this for 20 years, through up markets and down. Never before has he witnessed such desperation. "We're seeing buys that are unprecedented," he says, "people that are afraid not

to sell because they don't know where the bottom of the market is." Leon doesn't know where that bottom is, either ("and I live in it," he points out). But he's seeing movement. Six months ago he'd look at 20 to 30 deals to get a good one; now, he says, he looks at ten. "I'll tell you, someone wants to be an investor in this market, you'll not see this again for many, many, many years."

The next day I go riding with Dweck, whose business card identifies him as a RE/MAX broker, a wholesale buyer (Houses Bought Cash, LLC), and a hard-money lender - that's a guy who'll give you cash to buy a home when a bank won't, fast, at 15% interest plus points. We take a turn around Parkland, Fla., a bedroom community of 22,000 in a remote stretch of northern Broward County adjacent to the Everglades.

We're hunting for foreclosures, and they're easy to spot - the empty driveway, the uncut grass ("There are snakes," Dweck says), the swampy, fluorescent-green water in the swimming pool. We turn into the Parkland Golf and Country Club, 790 super-exclusive gated acres (Olympic swimmer Dara Torres lives here) enclosing what Dweck describes as "a significant amount of pain." He shows me a thick sheaf of printouts: 44 current listings, some asking for as much as \$2 million, nearly all of them "contingent on third-party approval," meaning they're short sales (a negotiated form of preforeclosure) or are already in foreclosure.

Dweck has a friend who bought here on spec, putting down \$100,000 on a \$1.6 million home just before the bottom fell out. Dweck says he told his friend to renegotiate the price down to \$1 million or walk. "You sure don't want to close on that," he says. "That would be financial ruin, guaranteed."

So where does Dweck look for bargains today in South Florida? "Workforce housing," he says, in ethnic neighborhoods in older towns like Pompano Beach. He shows me tiny bungalows on small lots that once sold, incredibly, for \$300,000 but can be had now for as little as ten cents on the dollar, then fixed up and sold at a profit or rented in a heartbeat. "People have been beaten down by fear, negativity, constant media bombardment," says Dweck. "There is a silver lining. The future looks bright."

PHOENIX, ARIZONA DESERT DEALS

"Dead-dog smell," says broker Sheresa Pompay, standing in the kitchen of 4514 West Mitchell Drive with her sunglasses on.

Whoever was living here obviously left in a hurry. There's a box of Cocoa Puffs in the cupboard, an open bottle of shampoo in the shower, a bunch of what used to be grapes on the kitchen counter - now they're raisins - and an unopened letter by the light switch at the back door. It's from the local elementary school, addressed "To the parents of ..." And that smell. Not an actual dead dog, I don't think. Just a very strong odor of decay. According to Pompay, that's a good thing. "The more it smells," she says cheerfully, "the better deal you're going to get, the more money you're going to make."

Pompay's partner, Derek Turner - one of half-a-dozen lenders, brokers, investors, and contractors along for the tour today in Pompay's rented limousine - wants to buy this place. The bank lists it for \$92,900. He thinks he can get it for, "like, 30, 35 thousand," or slightly less than he paid not long ago for a nearly identical bungalow next door.

"This is basically what our template is," Turner says, leading me through the one he bought. "We come in, we just paint, put in a new baseboard, put in raised-panel doors instead of those flat-panel doors. These old windows, they're single-pane, so we just replace all the broken glass, polish up the steel, paint 'em up, make it clean. And then the floor and new cabinets and stuff." He'll accomplish all that for about \$12,000 - "That's with landscaping and everything" - and then he'll put the property back on the market and try to sell it for \$80,000. Already he has two potential buyers lined up.

After the tour disbands and the limo goes away, Pompay and Turner get in my rental car and we keep driving, north to DC Ranch, a fancy new subdivision on the outer limits of Scottsdale. Stucco mansionettes with orange tile roofs and heavy front doors, tight lots, curvy streets, a park in the middle with a playground set.

The house they want me to see sold for \$765,000 in 2007. The bank seized it in August, but not before the previous owner, ruined and angry, exacted his revenge - a not uncommon phenomenon these days. "This house has been stripped," the offer sheet warns. I don't know what that means ... until I step inside. He took the dishwasher, the stove, the refrigerator, the carpets, the kitchen cabinets, and the tile backsplash. Also the light fixtures, the switch covers, and every last interior door. He even ripped the whirlpool assembly out from underneath the hot tub in the master-bedroom suite. The bank wants \$369,900: "Sold as is, seller at this price will not make any repairs."

Discouraged? Good, says Pompay. "I love the people who read about all the gloom and doom, because they stay on the sidelines and go, 'It hasn't hit bottom.' Whatever. By the time everyone jumps back in, we'll be out and doing something else." She sighs dreamily. "I just want to buy," she says. "Everything out there. I just want to go out and buy it all."

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Have you bought a house recently? If so, send us your story and photos to realstories@cnmmoney.com. You could be featured in an upcoming article. ■

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