The Risks and Rewards of Tax Sale, Foreclosure and Short Sale Investing

On behalf of Dornish Law Offices, PC | Mar 17, 2012 | All, Real Estate Practice

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Just last week, after over a year waiting for a second decision from the Pennsylvania Superior Court, I was able to let my client know that we "won" his lawsuit, and he will be able to keep the $180,000.00 property he bought at a Sheriff's sale for just $60,000.00. Two weeks ago, I helped a client of mine from California who had bought a property in her IRA at a Tax Claim Bureau sale two years ago to negotiate a deal to buy that same property back from another client of mine who had purchased the property at a second tax sale just three months ago. And just yesterday, I consulted with a pair of first time homebuyers who "just loved" a house they wanted to buy in a short sale (or more accurately, short payoff) situation. After we discussed the time, costs and risks of negotiating and closing on the purchase, they went out with their agent to look at other houses before settling on the short sale house.

Everyone hears the stories of great deals people get, and huge profits to be made buying properties at all of these different types of distress sales. It is axiomatic that properties sold in distress can be acquired for less than their full market values. From my own personal knowledge, I have seen clients instantly acquire tens to hundreds of thousands of dollars in equity above the purchase prices of such properties, make huge capital gains on the sales of such properties, and unbelievable rates of return on rentals, like $600.00 per unit per month on a twelve unit property purchased vacant at Sheriff's sale for fifty thousand dollars, less than ten thousand a unit. Even after another thirty thousand in renovations, $72,000 in gross rents per year on a total investment of $80,000 is the type of return any real estate investor with funds available would have a hard time passing up.

As a lawyer who represents a lot of real estate investors, and non-investor buyers of distressed properties to call their homes, however, I also get to see the problems which arise from buying distressed properties without doing enough research on the titles or condition of the properties, and the problems which can arise even if you try to do everything right. I also appreciate that the costs of doing everything right with respect to the distressed properties which you don't ultimately acquire really eat into the profits from the distressed properties which you do acquire.

For those less comfortable with managing the risks to get the rewards of buying a distressed property at a public sale, whether a tax sale or foreclosure sale, and who don't like the costs, time pressure and risks of trying to buy from a current owner without fully paying mortgages against the property, (a short sale) before a public sale takes away that owner's right to sell, another opportunity is available for many such properties. If nobody buys a mortgage foreclosure property at the sheriff's sale, the bank takes it and resells it as an REO property, short for real estate owned by the bank. If a tax sale doesn't sell a tax delinquent property, it may be available for purchase later from the Tax Claim Bureau, the municipality or the owner who didn't pay the taxes. Those purchases have different risks and rewards, and will be the subject of a separate article. For this article, only the public sales and short sales before them will be considered.

Going back to my first example, my client (we'll call him Vic) tried to do everything right when he bought property at Sheriff's sales. Vic took my classes on searching real estate titles and buying at sheriff's sales, he attended seminars and conventions and learned from national experts, buying some programs and carefully studying all of the materials. Vic owned his own business, so he was able to arrange his own schedule to drive by and check out every property listed for Sheriff's sale in the neighborhoods and price ranges which interested him.

Vic diligently devoted many hours to researching the titles of the properties on which he would bid at Sheriff's sales. When he had questions on the results he found during his searches, he asked title searchers to help him, called the lawyers selling the properties for the banks, or even asked me to review some of his findings from time to time.

The one thing Vic didn't do was order a professional title search and title commitment on each property he wanted to buy at Sheriff's sales, as I advise all of my clients to do. Why would someone so committed to buying property at Sheriff's sales that he became a fixture at the sales for years, and who was so careful in every other respect skip that one big step? Simply put, the cost benefits analysis of the searches prevents someone interested in buying a lot of these properties from investing in a lot of searches. If Vic liked ten properties coming up at a sale, he could spend 20 hours and have a pretty good idea of the titles without spending cash. For those same ten properties, he could order searches and title commitments for about $150.00 each, a cost of $1,500.00 per month, or about $36,000.00 per year before he spent a dime on actually buying a single property!

I have told him that although I advise getting the searches, I am relieved that he did not obtain the search on the property on which we went to court through my office, since our professional searchers would have reached the same result he did on his own, we would have issued the title insurance on his transaction, and my title insurance underwriter and I would be paying the legal bills to defend Vic's title, instead of Vic hiring and paying me to go to court.

The moral of Vic's story is that if you are lucky enough after some very hard work to be the high bidder at a Sheriff's sale on a foreclosed property, and you don't have a title commitment for title insurance already, you should (very quickly) get a title search and title insurance. Many Pennsylvania Sheriffs allow a down payment followed by a grace period before you have to pay the full amount of the purchase price. Check the local rules in your county.

In Allegheny County, for example, the Sheriff's sales are on Mondays, bidders must put 10% of the bid price down on the day of the sale, and have until Friday to pay the rest. Many times, high bidders who used their own title work to bid have come to my office immediately after the sale on Monday, and requested a rush title search. Often, but not always, we have been able to get a search back before they pay the rest of the money on Friday. Sometimes, our searches have found title issues and we have persuaded the Sheriff or the foreclosing attorney to set aside the sale so they can clear the title issue.

You definitely should not spend money renovating the property without getting title insurance first. Once your title is insured, you can move forward to renovate and sell or rent the property. Even if the title search identifies a defect after you own the property, many defects can be cleared, so you may spend some time and money clearing title, but be able to preserve most of the good deal you got on the property. Sometimes, however, when we find a title problem after you have already paid for the property, we can't fix the title, the Sheriff and the lender won't set aside the sale, and you have to fold and walk away, losing the money you have paid at the sale. These times become very expensive lessons on why to search titles and get title insurance commitments before you buy property at a Sheriff's sale.

Buying property at tax sales in Pennsylvania is even more complex that buying at Sheriff's sale. Pennsylvania has four different sets of tax sale laws, separate treasurers' sales laws for Philadelphia and Pittsburgh, Tax Claim Bureau sales for every county other than Allegheny County and Philadelphia County, and sales on the old fashioned Writs of *Scire Facias* in Allegheny County outside the City of Pittsburgh. Each of those four different sets of tax sale procedural rules has two phases, an upset sale and a judicial or "free and clear" sale. I teach three different three hour classes on how to understand the different types of sales before you try to buy at any of them, so I can't possibly tell you everything you need to know to safely buy at tax sales in a single article. But for a good start, know how much you have to know before you buy, and don't buy before you understand the process.

The biggest and most common problems with tax sales come from defective service of notice of the sale. Each different type of sale has its own notice rules, but many of those rules leave an owner without personal service of notice that his constitutionally protected right to own real property is being taken away, so judges often set aside tax sales.

Even if the sale hasn't been set aside, the two largest title insurance groups in Pennsylvania, who together account for over 90% of all title insurance sold here, won't issue title insurance on property purchased at any type of tax sale until a year has passed since the sale, and you provide proof there was actual personal service on each owner of the property of notice of the sale. If any owners were missed, we can file a quiet title action, which I have discussed at greater length in another article.

But the issues with a tax sale don't only revolve around setting aside a sale. Treasurers' sales and writs of scire facias in Allegheny County allow redemption by the owner of the property after the sale, with different time periods for redemption in different types of sales. The only tax sales without any possible redemption period are Tax Claim Bureau sales.

So, what can you do to make sure your tax sale purchase doesn't become an expensive lesson for you and another good story for me to tell other investors? First, search the title carefully. Know every lien and judgment against any property being sold at an upset sale, because that type of sale wipes out the owner's interest, but leaves the property subject to all outstanding mortgages, as well as other liens and judgments. Next, check the service on all of the owners of the property just as thoroughly. Any service irregularity means time and money to you to clear the title.

Finally, be prepared not to get title insurance for a year after you buy any property at any Pennsylvania tax sale. Plan to rent the property, or sell it on an installment land contract, so a year passes before you or anyone else needs to get a loan against the property secured by a mortgage with title insurance.

Now that we have discussed some of the difficulties inherent in buying at tax sales or Sheriff's sales, you may be wondering why not to go after the properties with upside down mortgages before the Sheriff's hammer falls, by attempting to buy at short sale before the Sheriff's sale. To do that, you negotiate an agreement of sale with the owner facing foreclosure, but provide that the agreement is contingent on one or more mortgage lenders releasing the property from their mortgage liens for less than the balance(s) due to them.

The first challenge is getting the seller to accept that his or her home is worth less than is owed on it. That was a serious challenge prior to the 2009 mortgage meltdown, but seems easier for many borrowers to accept today. Getting the lender(s) to agree requires more effort. I recommend that a potential short sale buyer be prepared to buy an appraisal and a home inspection after they reach a contingent deal with the seller. Those two purchases create tools to use in convincing the lenders to accept the agreement of sale. A lender usually has an appraisal from the time the loan was made supporting the loan amount. They don't want to accept that their own appraisal was wrong, or that the market dropped significantly after their loan was made. Providing a current, lower appraisal helps to support the agreement you want them to accept. Of course, you would rarely show a lender an appraisal that the property is worth more than they are owed and you are offering.

The home inspection by a very picky home inspector raises further doubts that the lender will be able to take the property back in foreclosure, pay the costs of foreclosure, taxes and repairs, selling commission, grass cutting and snow removal, and still net more than your offer. If the appraisal and inspection report don't get your lender to move on the price, file them away, look for another property to buy now, and wait for the foreclosure to be completed. You know more about the property than any other buyer, you have a relationship with the seller losing his or her property, and all you need to prepare for the Sheriff's sale is the title search. Even if the lender won’t accept your bid at the Sheriff’s sale, as long as the lender takes the property at the sale, you can wait for the lender to list the property, and use the appraisal and inspection report to try to get the price you want one more time.

So, go into your tax sale, Sheriff’s sale or short sale purchase attempt knowing the risks, getting the information you need to minimize the risks, and ready to walk away if you can’t buy at a price which justifies the risks you have to take to buy these types of properties.

(Created March 2012)