Win-Win!! Buyers Can Profit From
"Second Chance" Foreclosure Sales

By: Bob Van Galoubandi

As the economy continues to languish, the rate of foreclosures shows no signs of slowing into the foreseeable future. As a result, buyers of commercial real estate have been flocking to foreclosures sales, often involving the sale of significant assets. The obvious attraction of foreclosures is the deep price discount they offer compared to market value. These discounts are largely the result of two phenomena: (1) the manner in which foreclosure sales are conducted; and (2) the lack of significant market exposure. Interestingly, it is for these same reasons that foreclosure can also be a dangerous venture for the unwary. Foreclosure sale contracts contain numerous terms and conditions that are onerous and surprising to the uninitiated. <u>For example</u>, in a typical foreclosure sale, the seller makes no representations or warranties regarding title or the nature of the improvements. They also generally contain no financing or other contingencies, and do not promise possession at closing. Compounding the problem is the fact that, because foreclosures are, by their nature, forced sales, there is often little or no opportunity for prospective buyers to conduct all but the barest due diligence before the sale. And in addition to these risks, there is always the specter of post-sale exceptions, bankruptcy, or other efforts by the borrower to disrupt the sale.

For those same reasons, however, foreclosures can reward the vigilant. But should foreclosures only be for the courageous? What is the prudent buyer to do in order to avoid the dangers, but still reap the benefits? One method of taking advantage of foreclosure sales, while limiting exposure to risk, is through a "second chance foreclosure" i.e., being accepted as a substitute purchaser and acquiring the property sold at foreclosure through the post-sale assignments of the foreclosure bid.

The vast majority of the purchasers at foreclosure sale are the foreclosing lenders, and for institutional lenders, winning at foreclosure sale is a disappointment, not a victory. When lenders "buy in" at foreclosure it means that the lender will need to dedicate additional energy and resources to resell the same property after it acquires legal title. And once the lender takes legal title and incurs the expenses attendant with that process, when the lender resells the property it will undoubtedly require the market price for the property. Thus, the narrow window of opportunity for buyers to accept an assignment of the foreclosure bid is the period immediately following the foreclosure auction, but prior of the passage of legal title to the lender.

In Maryland, there has long been a procedure for the assignment of a foreclosure bid following the foreclosure sale -- the so-called "substitute purchaser" rule. Lenders favor substitute purchaser sales, because it essentially gives the foreclosure sale auction a "second chance." By doing so, the lender is also saved the time that would be necessary to remarket the property for sale, as well as some significant expenses that would be incurred in the resale of the property including brokerage fees and, not insignificantly, the imposition of two rounds of transfer and recordation taxes.

For the unsophisticated buyer an ordinary assignment of the foreclosure bid will result in the substitute purchaser being in no better position than any other bidder at the auction, but opportunities exist to improve the buyer's position. Discerning buyers will find that they are usually in a position to negotiate some concessions from the lender, and will have the opportunity to make the assignment contingent on financing, title, and inspection. Buyers may also be able to negotiate the terms of deposit, the waiver of interest otherwise due on the unpaid purchase money from the date of the auction, the sharing of transfer and recordation taxes, the apportionment of real property taxes, and the right to withdraw from the contract in the event that litigation in the foreclosure case significantly delays closing.

Substituting a purchaser at a foreclosure can also be an opportunity for the foreclosing lender to enhance its position. For example, it may be possible for the foreclosing lender to augment the net sales price charged to the substitute purchaser by charging an assignment fee. And, if the lender has overpaid for the property at the auction, the assignment process is usually flexible enough for the lender to sell the property to the substitute purchaser for less than the price it bid at auction. In such an instance, the purchase price to be paid for the property partially consists of the buyer's cash and partially consists of the lenders "credit" against the debt it is owed.

By doing these things a foreclosure sale can go from a rigid unyielding process, to one where substitute purchasers can gain the benefits of buying at foreclosure, while removing most of the associated risks.

Like all things, the terms of each sale or assignment will depend on willingness of the parties to negotiate, but for potential buyers the lesson to be learned is that there exists an opportunity to participate in the foreclosure sales while negotiating away most of its significant risks.

If you have any questions or if you require any assistance regarding foreclosure sales, please contact any of the attorneys in our workout group:

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