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Oakland group buying Contra Costa foreclosures

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Oakland's McKinley Partners is betting that low-end foreclosed homes in eastern Contra Costa County will double in value in five years.

The real estate development company has formed a $6 million fund to buy bank-owned homes in Antioch, Pittsburg and Bay Point.

It aims to spend about $100,000 per home, including rehab, and rent them out for $1,200 to $1,500 a month. Then it hopes to sell them for $200,000 each in five years.
McKinley is emblematic of a major force currently propelling the real estate market: investors and speculators snapping up foreclosed homes. Along with first-time buyers, they are a primary source of increased sales volume.

Some investors quickly flip the distressed homes. For instance, St. John's Capital Group, a real estate investment firm in San Jose, bought about 115 foreclosed California homes in recent months, fixed them up and immediately sold them to first-time buyers for returns of about 10 percent.

St. John's gets deep discounts by buying delinquent mortgages from lenders and finishing the foreclosure process, or by bidding at courthouse-step foreclosure auctions.

"We think the market is still going down, so we are against holding for an extended time," said CEO Edwin Yeh. He is raising a $50 million fund to invest in foreclosures.

Some choose to rent

Other investors like McKinley are renting out homes for positive cash flow and counting on future appreciation for a bigger payout.

McKinley picked the Contra Costa towns because it thinks homes there are bargains and basics such as jobs and transit are strong.

"We've seen an over-correction" in home values there, said Gregor Watson, one of four managing partners. "The rents we get justify $170,000 purchase price, and we're buying for $80,000 to $90,000."

As he toured potential homes to buy last week, Watson emphasized that the company is pursuing a "double bottom line": It aims both to profit and to help stabilize neighborhoods by fixing up vacant homes and finding occupants.

For instance, McKinley paid $84,000 for a three-bedroom, 1 1/2-bathroom home in Pittsburg that sold for $412,000 in 2005. Other than the tell-tale brown lawn of a foreclosure (soon to be replaced with fresh sod), it looks like the other decades-old houses in the long-established neighborhood, within walking distance of shops and transit.

Finding tenant quickly

After spending $9,300 on rehab - fresh paint and carpets, dry rot repairs, a stove fan, replacing jerry-rigged electricity, a new sewer lateral - McKinley quickly found a family to lease it for $1,500 a month.

"We jumped on this one quickly because we perceived it to be a good deal," said Paul Staley, president of Staley and MacArthur Real Estate Services, which has teamed with McKinley to find, analyze, oversee rehab and manage the foreclosed homes.
McKinley's focus sheds light on some market dynamics.

-- It avoids newer homes in cookie-cutter subdivisions. "If they're all around the same vintage of mortgage, then they can all go upside down at the same time," Watson said. Too many foreclosures will hurt rental income and future appreciation. Instead, it concentrates on older homes in neighborhoods where foreclosures are rarer.

-- It avoids higher-priced homes. "As the price point gets higher, rents don't cover (costs)," Watson said. "All of our analysis says it's too risky. Also on the exit, we can easily justify a $100,000 home going to $200,000; that's not that big a stretch. But a $300,000 home going to $600,000 is harder."

-- It focuses on core economic and demographic trends. "We pick neighborhoods that are close to mass transit," Watson said. "We're concentrating on areas with job growth; we looked at Stockton, for instance, but don't see it rebounding. But in the Bay Area we've got such a diverse economy. It creates drivers for jobs in the blue-collar space and back office."

-- It's finding that inventory is limited because lenders are sitting on foreclosures. "Banks own 530 homes in this ZIP code (Pittsburg's 94565) but there are only 15 on the market," said Staley, pointing to a three-bedroom updated home priced at $132,900 that had 22 offers. "It creates a hyper-competitive situation."

Not for small investors

McKinley's model would be difficult for a mom-and-pop investor to replicate. For one thing, it pays all cash, something that makes banks willing to consider low-ball offers, because they are guaranteed to close. (It then refinances half a home's cost to free up cash for more purchases.)

For another, it's labor intensive. Unlike, say, buying an apartment building with 100 units, it buys one house at a time and then must manage scattered rentals. It hopes to get economies of scale by buying some homes in bulk from lenders at a discount.

McKinley hopes to establish new funds to spread its model to other neighborhoods where it sees similar low-hanging fruit, such as San Diego.

"We've built the mousetrap," said Watson, referring to the system for finding, buying, fixing and renting out houses, "now we have to raise the capital."

Staley (from left), Gregor Watson of McKinley Partners and Ron MacArthur evaluate the home.

Paul Staley of Staley and MacArthur Real Estate Services, who works with McKinley Partners, surveys the backyard of a bank-owned house in Pittsburg.

Paul Staley inspects a vandalized foreclosed house in Pittsburg.