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U.S.

A Decade After the Housing Crisis, Small Investors Try to Bring Busted Mortgages Back to Life

Schooled by seminars and YouTube, individuals buy nonperforming loans—often written off by banks—and push the borrowers to start paying on them again

By Ben Eisen and Cezary Podkul

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Sándor Lau, once a filmmaker, found his calling on YouTube when he came across instructional videos about how to buy seemingly worthless home loans.

Mr. Lau, of Portland, Ore., started accumulating mortgages, some of them delinquent for many years, dating back to the housing bubble. He owns more than 100 now, he said, with millions of dollars in payments owed to him. His full-time job is trying to collect.

A decade after the financial crisis, there is a new breed of risk-takers in the U.S. housing market. During the boom before the bust, lenders made mortgage loans to countless buyers who couldn't afford them. Lenders later wrote off many of the loans, but borrowers' obligation to pay remained. Today, in an improved economy, a rag-tag group of individual investors, plus some Wall Street giants, is buying these old loans and trying to tease value out of them.

The trade goes like this: Buy mortgages available for very low prices because no one has made a payment on them for months or even years—nonperforming loans, they are called. Track down borrowers and let them know they have a new creditor. Tell them they need to resume payments, at least at a partial level, perhaps offering to modify terms. Threaten foreclosure if necessary. If all goes well, collect on the debt or resell the mortgage as a now "reperforming" loan.

The process marks a new chapter for hundreds of thousands of crisis-era borrowers who often had heard nothing about their unpaid loans for years and thought the debt had been disposed of. For investors, legal wrangling with such borrowers is common.

The small-time investors, who by some estimates number in the thousands, operate alongside major financial players such as Goldman Sachs Group Inc. and Cerberus Capital Management LP. Individuals find their way into the business through video tutorials, seminars and hotel-room conferences that pitch delinquent-loan investing as a route to stable income.

Mr. Lau said he once lost $46,000 he paid for a second mortgage when the first-mortgage holder foreclosed. But he also once made $70,000 on a loan he had purchased for a dollar.

“You can do incredible returns in this business,” he said, “and you can lose your shirt, pants and everything else if you do it wrong.” He wouldn’t say how much he has made, only that he no longer sleeps on the floor of his office.

The investment opportunity exists because as the U.S. economy slowly recovered from the 2008 crisis, government agencies and financial institutions wanted to clean up their books and auctioned off billions of dollars of misbegotten credits.

Today there are nearly 800,000 nonperforming loans—defined as those delinquent for 90 days or more—on single-family homes, reflecting $135 billion in unpaid principal, according to loan-data provider Black Knight Inc. “It’s a market that really is the result of the financial crisis,” said Andy Walden, the firm’s director of market research.

Some financial firms buy and sell such loans without making an effort to collect from borrowers. Others use loan servicers to try to get mortgage payments restarted so they can feed the loans back into the Wall Street mortgage securitization machine. Investors pooled and resold over $15 billion of reperforming home loans in residential mortgage-backed securities last year, more than triple a year earlier, according to Fitch Ratings Inc., which tracks only rated deals. The top tranche has often received a sterling triple-A grade from rating firms.

Greg Paulus coordinated loan sales over the past two years as a consultant to Urban Partnership Bank, a Chicago-based lender to low-income communities. He said he received 10 to 15 emails a week inquiring about delinquent loans for sale, sent by investors ranging from small-time buyers wanting just one loan to financial firms with millions to spend.

“Everybody and their brother is getting into the business,” Mr. Paulus said. After speaking at a June conference for investors in Dana Point, Calif., Mr. Paulus was swarmed by people looking to make deals. An after-party featured the CEO of a title company playing a retired pro basketball player in a timed chess match.

Gail Greenberg of suburban Philadelphia embraced the nonperforming-loan trade to build up her retirement savings, which took a hit in 2008. She started in 2016 with a loan in Flint, Mich., she bought for $15,000.

"I only owned it for nine weeks and the house burned down," Ms. Greenberg said. Thanks to an insurance payout, though, she said she made a profit of $27,000.

Ms. Greenberg took that as a sign she should make loan investing her day job. She now owns 58 mortgage notes, as they're often called, totaling more than $2.4 million in unpaid principal.

Paige Panzarello of Simi Valley, Calif., organizes workshops for aspiring investors, charging $697 to attend. In a session at one of her conferences in Costa Mesa, Calif., people role-played conversations with real-estate agents to get comfortable gathering intelligence about local markets.

Ms. Panzarello, who calls herself Cashflow Chick, got into nonperforming loans after nearly two decades in real estate. "For me, angels sang, honest to God, when I got into this space," she said.

Part of the agenda at the June conference where Mr. Paulus spoke was a session on tips to keep payments from homeowners coming. Speaker Terry Vaughan suggested bringing in repossession professionals to scare them. "If you do it right, it's not illegal," he told shocked attendees.

Regional meet-up groups, where investors network and share advice, have also sprouted.

Mr. Lau is a regular at such gatherings. He peppers his public remarks with motivational phrases and calls himself "chief inspiration officer" of his investment shop in Portland, which has two full-time employees.

"There are no bad loans, only bad prices," he said.

Mr. Lau grew up in a trailer on a 37-acre plot in eastern Colorado. His mother operated a sewing business out of their home and the family of four slept in one bedroom. Mr. Lau said this modest childhood gave him a nose for bargains.

After cycling through jobs in filmmaking and journalism and living for a while in New Zealand, Mr. Lau bought rental property, but couldn't always profit. Between 2013 and 2015 he often slept in a sleeping bag on his office floor so he could rent out his house on Airbnb. That was when he found his way into nonperforming loans.

On a recent Thursday afternoon, Mr. Lau, 43 years old, hovered over a standing desk staring at a color-coded spreadsheet with data on about 40 delinquent home loans. They were second mortgages, holding a secondary claim on homes after someone else's first mortgage.

He scanned information on the homes and the borrowers, including social-media profiles, ages, neighborhood details and property values. Some properties he deemed worthless, such as one in Oregon that had been foreclosed on by another lender. A Florida loan looked promising because the borrower was a man with a LinkedIn profile, a sign he cared about his career.

Sándor Lau started investing in delinquent home loans after running across some instructional videos. PHOTO: ERICA BERENSTEIN/THE WALL STREET JOURNAL

Mr. Lau and another investor purchased the 40 loans for few hundred thousand dollars, a deep discount to the more than $2 million face value of the notes. It was the largest purchase of his career.

After buying, Mr. Lau and other investors typically contact borrowers to try to make a deal, such as with softened repayment terms. If borrowers won't come to the table, investors know their strongest leverage is the threat of foreclosure. Mr. Lau keeps a list of the varying state foreclosure laws next to his computer. He said he has initiated dozens of foreclosures, but completed only a handful.

If investors manage to get the flow of loan payments started again, they sit back and collect the cash as steady income. If the homeowner refinances, the loan investors may get what they are owed in a lump sum.

Salem, Ore., homeowner Rebecca Devereaux had been sparring with her lenders for years when she was contacted by Mr. Lau in 2016. Ms. Devereaux was trying to sell her home for less than the total she owed on her two mortgages—a short sale that requires both lenders' consent. She had been unable to get approval from the holder of her $69,000 second mortgage.

After Mr. Lau bought that loan in 2016—he wouldn't say for how much—he quickly approved a sale of her house for less than the amount Ms. Devereaux owed. He said he made money on the deal. And although her credit took a hit, Ms. Devereaux was happy to be rid of her wrangles with banks.

"I could have closure and move forward," she said.

Michael Cortez, a homeowner in Vallejo, Calif., didn't take Mr. Lau seriously at first. He thought he was being scammed when he unexpectedly received a mailing in December 2016 from a

Rebecca Devereaux had trouble getting clearance for a short sale of her house until Sándor Lau bought the second mortgage and approved the deal. PHOTO: ERICA BERENSTEIN/THE WALL STREET JOURNAL

representative of Mr. Lau's business.

"Call Us! Write Us! Email Us!" the notice read. "WE WANT YOU TO BE ABLE TO KEEP YOUR HOME!"

Mr. Lau was seeking to collect on a $190,000 home-equity loan Mr. Cortez and his wife took out in 2005 amid the housing boom. After Mr. Cortez ignored the mailing, Mr. Lau followed up with a voice mail in February 2017. "You make good money and you obviously have a good job, so call me," Mr. Lau said, according to Mr. Cortez, who is a civil engineer.

Mr. Lau declined to comment on the exchange, citing privacy laws.

Homeowner Rebecca Devereaux was able to do a short sale of this Salem, Ore., house after mortgage investor Sándor Lau became one of her lenders. PHOTO: ERICA BERENSTEIN/THE WALL STREET JOURNAL

Mr. Cortez called Mr. Lau back and told him not to make contact again. He believed the home-equity loan on his five-bedroom house had been forgiven in 2011 after his lender, PNC Financial Services Group Inc., agreed to modify his primary mortgage. PNC stopped sending him monthly billing statements and repeatedly told him his loan had been closed, he said.

A spokeswoman for PNC said the bank books a loss on loans it deems uncollectible and stops billing borrowers, but this doesn't change their obligation to repay. She declined to say how the policy affected Mr. Cortez, citing privacy restrictions.

Records from mortgage tracker ATTOM Data Solutions show that PNC sold Mr. Cortez's debt to a Philadelphia-area note investor, who in turn sold it to Mr. Lau's firm.

In June 2017, Mr. Cortez received a letter saying Mr. Lau's representative would sell his home "AT PUBLIC AUCTION TO THE HIGHEST BIDDER."

In an effort to prevent the foreclosure sale, Mr. Cortez filed for bankruptcy, at one point listing Mr. Lau's firm as a creditor. The case was dismissed, and foreclosure proceedings resumed.

In June 2018, Mr. Cortez filed suit in California state court accusing Mr. Lau's company, called Second Chance Home Loans LLC, of unlawful business practices.

"I don't need a second chance," Mr. Cortez said in an August interview. "This should never have happened."

Messrs. Lau and Cortez reached a settlement in September. Mr. Cortez said he agreed to pay $260,000 and has tapped his retirement savings to help pay it. Mr. Lau wouldn't comment on the figure.

—Jim Oberman contributed to this article.

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