

Market Value Principles in a time of Economic Crisis -  
A Draft Position Paper by the Technical Standards Committee for the International  
Association of Assessing Officers

Abstract

IAAO has long promoted market value as the preferred underpinning for property taxation. Our professional standards are replete with references attesting to the importance of this precept. The *Standard on Property Tax Policy* states:

*To maximize fairness and understandability in a property tax system, assessments should be based on current market value of property. (Section 4.2, 2004)*

Current market value captures the dynamics of the economy that are fundamental to maintaining equity in the distribution of the property tax burden. Although property appraisal involves subjective interpretive elements, the principle of market value is objective and rooted in the market place. Arm's-length sales occurring on the open market provide the data from which assessors may develop mass appraisal models to properly estimate market value for the majority of properties that have not sold recently. While this system usually works well, there must be adequate numbers of arm's-length sales to achieve high quality valuation estimates. This requirement may be less likely in times of economic stress for two reasons: fewer sales and increased doubt as to the arm's length nature of sales.

This paper examines some of the effects of economic stress on the market place, especially the effect of financial institution foreclosures and subsequent re-sales of previously foreclosed properties. The fundamental position we will support is that, while such sales may be disregarded when they are a rarity, their influence must be considered in the appraisal process when they become significant or predominant, as in some current markets.

Assessors are advised to screen sales data carefully, determining to the extent practicable all circumstances that may influence sale prices. In addition, oversight agencies may wish to consider the appropriateness of stringent uniformity standards given the increased variability of the current market place. This paper will also review

these issues. However, we strongly suggest that the current economic crisis does not support abandonment of fundamental principles regarding property appraisal, but rather supports adherence to those principles. In short, the market dictates; assessors and appraisers interpret.

## Financial Institution Re-sales *(property that was formerly foreclosed on)*

### **1. Introduction**

The purpose of this paper is to provide immediate guidance from IAAO to its members in dealing with the massive number of financial re-sales as a result of foreclosure problems brought on by current economic conditions. Because of the urgency of this situation and the length of time needed for updating or writing a standard, this paper is being written in the interim. This paper does not address the actual foreclosure or other distress sales but rather the re-sale of the formerly foreclosed on properties (including terminology). The use of these sales in determining market value is a critical problem facing assessing professionals today.

The National Association of Counties (NACo) recently surveyed large urban jurisdictions with populations over 500,000 parcels (*Foreclosure Survey Report* [June 2008]) regarding the economic impact of the recent increase in the number of foreclosures. Twenty-five jurisdictions responded. Some of their findings provide important insight into why IAAO and its membership see this as such a critical issue.

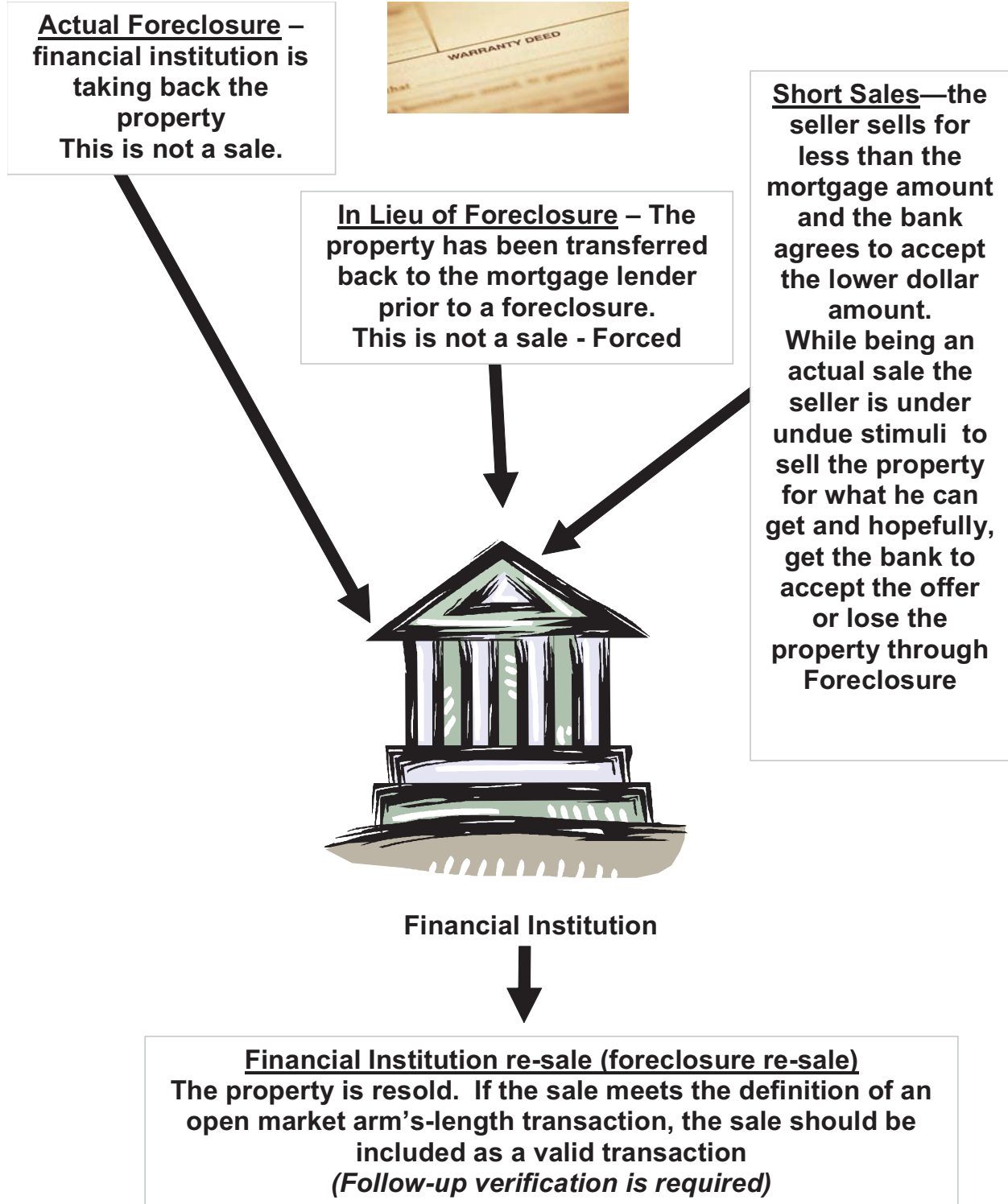
- ninety-six percent of responding counties saw an increase in foreclosures during the last year
- sixty-four percent report increases of up to 50 percent over last year
- thirty-six percent report increases from 50 percent up to 100 percent over last year
- fifty-six percent anticipate foreclosures will continue to increase
- fifty-six percent report foreclosures have created a decline in housing values
- forty-four percent say foreclosures were not the reason for the decline in housing values
- fifty-two percent report they are experiencing revenue shortfalls because of either foreclosures or declining housing values
- fifty-two percent will not be able to offset revenue shortfalls with other county revenues

## 2. Definition of Terminology

For purposes of this paper and future additions to the *Glossary for Property Appraisal and Assessment* [IAAO 1997] the following definitions will apply.

- **Financial institution re-sale**  
A sale of property formerly foreclosed on by the financial institution (the seller will be a financial institution).
- **Foreclosure**  
The legal proceedings initiated by a creditor to repossess the collateral for a loan that is in default; the legal proceedings in which a mortgagee, or other lienholder, usually a lender, obtains a court ordered termination of a mortgagor's equitable right of redemption; the legal process by which a lien against property is enforced through the taking and selling of the property.
- **In-Lieu-of Foreclosure**  
Property transferred back to the mortgage lender prior to foreclosure proceedings
- **Sale**  
The state of being purchasable; offered or exhibited for selling; an agreement (or contract) in which property is transferred from the seller (Grantor) to the buyer (Grantee) for a fixed price in money (paid or agreed to be paid by the buyer)
- **Short Sale**  
A bank or mortgage lender (financial institution) agrees to discount a loan balance due to an economic or financial hardship on the part of the mortgagor; a property sale negotiated with a mortgage company in which a lender takes less than the total amount due.

The definitions are demonstrated below as how they relate to the financial institution.



### 3. Financial Institution Re-Sales

Historically, financial institution re-sales were typically discarded during the sales validation (qualification & screening) process. Due to the current economic crisis, these sales may no longer be ignored for market modeling and/or sales ratio analysis in some areas where they are prevalent. Financial institution re-sales must be carefully evaluated and validated to determine whether or not the sale meets the definition of an open market arm's-length transaction as defined by IAAO and USPAP (see *Standard on Ratio Studies* [IAAO 2007] for definition of market value).

In a highly depressed market where there are fewer traditional arm's-length transactions and a significant number of financial institution re-sales, the consideration for usage of these sales becomes even more critical. Their impact must be evaluated in determining if the following apply.

- Are the financial institution re-sales affecting the value of typical sales in the area?
- Are the financial re-sales the only properties selling in the area?

These sales may be so numerous typical traditional sellers in the area are forced to lower the sales price in order to sell the property. If this is the case, financial institution re-sales have become the market.

The assessing official must determine whether foreclosures should be considered for valuation modeling or sales ratio analysis especially when the number of financial institution re-sales is substantial and possibly affecting the market. This process must be subject to appraisal and assessment guidelines established by USPAP, state/provincial legislation, and rules and regulations. Failure to recognize and consider these sales may cause inflated valuations and an unprecedented number of appeals during the informal and formal hearing process.

Prior to including financial institution re-sales as valid transactions for either market modeling and ratio study analysis, answers to several questions must be researched.

- Was the property exposed on the open market?
- Was there a change in property characteristics?

- Were there any circumstances that cause the sale not to be considered arm's-length?

The seller, the financial institution, will be the most knowledgeable in obtaining answers to these questions.

By developing a list of basic question when researching sales, these questions can generally be answered.

- Exactly how was the property marketed?  
(Listed with a real estate agency, word-of-mouth, newspaper, for sale signs, Internet, Auction, etc). Financial institution re-sales where the property is only offered to a select list of buyers do not meet the definition for open market. Re-sales marketed by word-of-mouth, advertised in the newspaper, for sale signs, offered on the Internet, and auctions require additional questions but those questions are beyond the scope of this paper (see the *Standard on Ratio Studies* [IAAO 2007]).
- How long was the property exposed on the open market?  
Typically, when property is listed and sold on the same day, the real estate agent already has a buyer in mind. These sales should never be included as a valid transaction.
- What was the asking and selling price?
- What was the condition of the property and are you aware of any changes in the property characteristics that may have occurred to the property?  
Condition of the property at the time of sale is extremely important. Owners going through the actual foreclosure process may vandalize or destroy the interior of the improvement prior to being foreclosed on. It is important to determine the extent of the destruction (change). If the dollar amount is substantial, the sale cannot be included as a valid transaction for ratio study analysis if prior valuations are being tested because the property is no longer a mirror image of the property appraised by the assessing jurisdiction; however, these changes should be considered for future

valuations. Determining when the changes occurred is critical in knowing whether or not the sale should be considered.

- Was any personal property included in the sale price, and if so, was the personal property listed separately in the bill of sale or the purchase agreement?

The *Standard on Ratio Studies* [IAAO 2007] states that properties typically sell with refrigerators, ranges, and draperies and an adjustment is not required unless specifically broken out in the contract. If additional personal property is included in the sale price and the amount is known and is considered substantial, an adjustment must be made prior to using the sale (sale price minus personal property amount). However, if the amount appears to be substantial and a determination of value cannot be discovered, the sale should not be considered for use.

Due to current economic conditions in some areas former property owners are leaving significant amounts of personal property which may or may not be removed from the property by the lending institution prior to re-sale.

- Are there any other conditions to the sale that may cause the transaction not to be an arm's-length transaction?

Complete and thorough written documentation of the results of the verification of these financial institution re-sales is of the utmost importance to support validity decisions for both modeling and ratio study analysis. It is highly recommended that comprehensive documentation records be developed and implemented either in hard copy or electronic format. These forms should be completed at the time of verification. Page ten provides an example of such a form. A well-designed and thoroughly documented form will prove invaluable in supporting validity decisions for the individual financial institution re-sales. In addition, a comprehensive set of written guidelines along with special training should be provided to staff given the charge of validating and screening financial institution re-sales.

For computer assisted mass appraisal systems and ratio study programs specific codes can be assigned that clearly identify financial institution re-sales allowing the flexibility to add or extract for future analysis. This may also be helpful when the economy eases back into typical market conditions.

**DOCUMENTATION RECORD**

CO NO	MAP - SEC - SH - QTR - BLOCK - PARCEL	OWN
-------	---------------------------------------	-----

COUNTY: \_\_\_\_\_  
SALE NO: \_\_\_\_\_

**Person Contacted:** \_\_\_\_\_  
 Buyer  Seller (Phone) \_\_\_\_\_  
 Other (Phone) \_\_\_\_\_

Attempt	Date	Time	Result
1st			
2nd			
3rd			

**Person Contacted:** \_\_\_\_\_  
 Buyer  Seller (Phone) \_\_\_\_\_  
 Other (Phone) \_\_\_\_\_

Attempt	Date	Time	Result
1st			
2nd			
3rd			

Sale Price: \$ \_\_\_\_\_ Adjusted Sale Price: \$ \_\_\_\_\_ Sale Date: \_\_\_\_\_  
 Reason For Adjustment: \_\_\_\_\_

COMM / IND PROPERTY ONLY		Was the Price paid for the property a fair indication of Market Value? <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Don't Know	
<input type="checkbox"/> N To Be Owner Occupied		Was the property exposed to the Open Market? <input type="checkbox"/> Yes <input type="checkbox"/> No	
<input type="checkbox"/> F Fully Rented When Sold		If yes, how was the property marketed? _____	
<input type="checkbox"/> P At Least Partially Rented		If through realtor, name of Realtor? _____	
<input type="checkbox"/> V Vacant, but for rent or will be		Was a fee appraisal prepared for Buyer? <input type="checkbox"/> Yes <input type="checkbox"/> No	
<input type="checkbox"/> D To Be Demolished		Was a fee appraisal prepared for Seller? <input type="checkbox"/> Yes <input type="checkbox"/> No	
<input type="checkbox"/> T Extensive Remodeling Req.		Use at time of sale? _____	

0 Residential Sample	4 Interview Unsuccessful	9 Financial Institution Re-Sale	Source Code _____
1 Partial Interest	7 Appeal Documentation		
3 Sales Questionnaire	8 Buyer/Seller/Agent		

**CONCLUSIONS / COMMENTS:**

(Additional Space on Back - Continued on Back)

0 Valid	3 Property Changed After 1/1	7 Technical Criteria	Validity Code _____
X Adj. Sale Price (Valid)	4 Split	8 Date Outside Range	
1 Multi-Parcel	5 Governmental Resale	9 Discounted Vacant Lot	
2 Not Open Market	6 Suspect Conditions		

RESEARCH ANALYST SIGNATURE \_\_\_\_\_

APPRAISER SIGNATURE \_\_\_\_\_

DATE FORM COMPLETED \_\_\_\_\_

Many states/provinces currently have open disclosure legislation wherein a sales verification form must be filed with the recordation, registration, and/or assessment office. The exact number will be disclosed in the final results of the *2008 Ratio Study Survey* [IAAO] conducted by the Technical Standards Committee and is expected to be published in IAAO's *Assessment Journal* in early spring of 2009. IAAO continues to encourage those jurisdictions that do not currently have such a requirement to continue to seek such legislation from their legislature. Without such disclosure, assessing officials continue to work under difficult conditions.

The design of the sales validation questionnaire will determine the amount of follow-up verification required during the sales screening (validation and qualification) process. It clearly identifies those properties as the financial institution is the seller. For a copy of a sales validation questionnaire recommended by IAAO see the *Standard on Ratio Studies* [IAAO 2007].

Early discovery of potential foreclosures may make it possible for jurisdictions to be more proactive in responding to a significant increase in the foreclosure rate and may better prepare assessing officials to proactively incorporate financial institution re-sales in market analysis to determine whether or not the market is changing. It may also make it possible for the assessing official to report increased activity to other governmental agencies for preparation of the effects of the down-market rather than acting after the fact. Public relation programs may need to be prepared and initiated. For more information on public relations see the *Standard on Public Relations* [IAAO 2001].

It must also be noted that in areas where typical market sales have occurred and also a substantial number of financial institution re-sales wherein the typical market has not yet responded to the financial institution re-sales, the equity measurement recommended by IAAO, Coefficient of Dispersion (COD), may fall out of compliance.

It is highly recommended that oversight agencies work closely with local jurisdictions in these changing times to ensure only valid open market arm's-length financial institution re-sales be considered in areas where the market is truly affected by such sales. For the

official ratio study it is encouraged that an informal appeal process be developed for the consideration of these sales when verifiable documentation is provided by the local jurisdiction that such sales are truly influencing the market in any specific area of the jurisdiction. This is especially important when the oversight agency performs an independent validation process.

Fair and equitable valuations should be the goal for both local and oversight agencies. To this end, when financial institution re-sales meet the definition of an open market, arm's-length transaction, they must be considered in modeling and ratio study analysis.

The following participants are recognized in the development of this paper from comments and recommendations.

IAAO Technical Standards Committee Members  
Nancy C. Tomberlin, Chair

IAAO Research Committee Members  
Bill Wadsworth, Chair

Richard Almy

Bob Gloudemans

Peter Davis

### References

International Association of Assessing Officers  
*2008 Ratio Study Survey*  
(To be published early spring of 2009 *Assessment Journal*)

International Association of Assessing Officers. 2001.  
*Standard on Public Relations.*

International Association of Assessing Officers. 2007  
*Standard on Ratio Studies [IAAO 2007]*

National Association of Counties. 2008  
*Foreclosure Survey Report*