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January 11, 1999
REVISED: March 26, 1999

Honorable Raymond Olivarria
Amador County Assessor
500 Argonaut Land
Jackson, California 95642
Attn: Mr. Jack Quinn

Re: Application of Rev. & Tax. Code Section 110 presumptions to property sold at execution and/or foreclosure sale.

Dear Mr. Quinn:

This is in reply to your phone request of December 2, 1998 for a brief summary and the transmittal of any legal opinions and relevant documents concerning the application of the "fair market value presumptions" in Section 110, including the recent amendments thereto (on the treatment of unpaid improvement bonds). Specifically, your questions relate to estimating the fair market value of property sold at execution and/or foreclosure sales.

As we understand it, the reappraisal of a largely undeveloped subdivision in your county has resulted in an appeal by the property owner on the grounds that (1) the assessed value significantly exceeds the purchase price paid at the foreclosure sale, and that (2) the purchase price is the fair market value of the property for assessment purposes. Your office believes that the correct assessed value of the property is the "fair market value" consistent with Section 110, which is appropriately derived in the instant case from the comparative sales approach methodology under Property Tax Rule 4.[1] The appeal raises two possible questions regarding the fair market value presumptions under Section 110. First, would the price paid at a foreclosure sale be or be "presumed" to be fair market value. Secondly, would the rebuttable presumption that the purchase price already reflects the value of the unpaid bonds apply. For the reasons explained in the attached documents, the answer to both questions is no.

Since 1989, section 110 has generally provided that, for real property that was purchased in an open market transaction, "full cash value" or "fair market value" is rebuttably presumed to be the purchase price—that is, the cash value of the total consideration exchanged for the property. Thus, in general, where real property is purchased in an open market transaction, an assessor who sets fair market value at something *other than* the cash value of the total consideration exchanged for the property bears the burden of proof in an assessment appeal. The express language of the presumption, however, authorizes the assessor to *presume* fair market value from a property's purchase price **only** in an open market transaction that is not influenced by the exigencies of either buyer or seller. Moreover, even where the presumption does apply, it may be rebutted by evidence that the fair market value of the property is otherwise. (See

[1] Apparently your office did not use the "subdivision development method" described in Assessors' Handbook 501, *Basic Appraisal,* page 68 (enclosed), since reliable data were available to apply the comparative sales method.

Letter to Assessors No. 90/30, *Dennis v. County of Santa* Clara (1989) 215 Cal.App.3d 1019, copy enclosed.) [2]

The prerequisites necessary to raise the presumption are plainly stated in the provisions of Section 110(a) and (b) as follows:

> "*full cash value or fair market value* means the amount of cash or its equivalent that property would bring if exposed for sale in the open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other, and both the buyer and seller have knowledge of all of the uses and purposes to which the property is adapted and for which it is capable of being used and of the enforceable restrictions upon those uses and purposes"; and that
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> "*purchase price*" means "the total consideration provided by the purchaser ... valued in money, whether paid in money or otherwise."

As to the meaning of an "*open market under conditions in which neither buyer nor seller could take advantage of the exigencies of the other*," the discussion set forth in Assessors' Handbook 501, *Basic Appraisal*, page 85, is highly relevant. Of the long list of conditions which must be met, it is clear that "forced sales", like execution or foreclosure sales, fall short of meeting the listed conditions necessary to establish an open market transaction. Further, we have long held that the price paid at execution and/or foreclosure sales does not equal fair market value. For example, in a legal opinion issued on March 29, 1983 (Annotation No. 460.0030) enclosed, the price established as the minimum price for which property is offered at a tax sale and public auction is not *full cash value* or *fair market value* as defined in Section 110, since the provisions of Section 3698.5 control the sale price of such property, not the market place. By definition, an execution or foreclosure sale is a "forced sale" to cover liens or debt within a limited time, and is therefore characterized by "*nonmarket conditions*," including but not limited to, the requirements/complexities of the foreclosure proceedings and the seller's (creditor's) need for cash in a hurry. Such "nonmarket" forces do not shape market value, and cannot be used by the appraiser to formulate an opinion of the property's highest and best use. (The Appraisal of Real Estate, 10th Ed., pages 275-277, 380-382.)

Finally, statutory law recognizes that when a property is sold at an execution or foreclosure sale, it is sold *subject to* various types of debt encumbrances, which are reflected in a discounted purchase price. For example, Section 3712 states that the title transferred to the purchaser in an execution sale is, among other things, (1) not free of unpaid assessments under the Improvement Bond Act of 1915, (2) not free of any federal Internal Revenue Service liens, and (3) not free of unpaid special taxes under the Mello-Roos Community Facilities Act.[3] Based on the foregoing, the price paid at an execution or foreclosure sale is not valid as an indicator of fair market value and should be disregarded; the fair market presumption in Section 110(a) does not apply. (See AH 501, pages 85-91.)

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[2] Regarding *fair market value*, Section 2(a) of Article XIII A of the California Constitution states that "...full cash value means ... the appraised value of real property when purchased...". Revenue and Taxation Code Section 110.1(a) implements this constitutional provision by stating that, "... 'full cash value' of real property ... means the *fair market value* as determined pursuant to Section 110 for ... (2) (A) ..the date on which a purchase or change in ownership occurs."

[3] The provision for unpaid special taxes under Mello-Roos was recently added to Section 3712 by AB 1224 (Thomson, 1997) which became effective on January 1, 1998. See Legislative analysis of amendment enclosed.

For similar reasons, the newly enacted rebuttable presumption added to Section 110 (b), that the value of public improvements financed by the sale of bonds is reflected in the purchase price, does not apply to the price of properties sold at execution or foreclosure sales. Senate Bill 1997, enacted as an urgency measure effective September 23, 1998, amended Section 110 to establish a rebuttable presumption[4] that, where the terms of an *open market purchase* of real property include the purchaser's assumption of debt used to repay bonds sold to finance public improvements, the value of those improvements *is* reflected in the total consideration, *exclusive* of the assumed debt. The amendments made by this legislation mean that if an assessor sets the fair market value of real property purchased in an open market transaction at the cash value of the total consideration actually exchanged (i.e., *including* the purchaser's assumption of debt used to finance public improvements) then the assessor bears the burden of rebutting the presumption that the value of the financed improvements was reflected in the total consideration *excluding* the assumed debt.[5]

Based on the express language adopted however, this presumption does not arise if the property was not purchased in an open market transaction. Since an execution or foreclosure sale is a forced sale as noted above, it is a "nonmarket" transfer, and the price of a property sold at such a sale is not representative of fair market value. Therefore, this presumption does not apply.[6] Moreover, even in an open market transaction, this presumption applies only to the purchaser's assumption bonded indebtedness for improvements financed under 1911, 1913, and 1915 assessment bonds, not under Mello-Roos bonds.[7]

The requirement that is relevant and applicable to the *delinquent payments* under the Mello Roos bonds in instant case is Property Tax Rule 4, which states in part:

> When reliable market data are available with respect to a given real property, the preferred method of valuation is by reference to sales prices. In using sales prices of the appraisal subject or of comparable properties to value a property, the assessor shall:
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> (b) When appraising an unencumbered-fee interest, (1) convert the sale price of a property encumbered with a debt to which the property remained subject to its unencumbered-fee price equivalent by adding to the sale price of the seller's

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[4] Letter to Assessors on this newly added rebuttable presumption will be issued to all counties shortly.

[5] Under the amendments to section 110, "purchase price" means the stated price paid in an open market transaction, unless the assessor can show by evidence that the value of the improvements financed with the sale of the bonds is *not* already reflected in the stated price. To rebut the presumption and adjust the price to reflect the assumed debt, the assessor must show evidence that the value of the improvements financed by the bonds is not already reflected in the stated purchase price. See Legislative analysis enclosed.

[6] As a practical matter this legislation would not shift to the assessor the burden of proving, in an assessment appeal, that the value of public improvements financed by debt assumed by a purchaser in a *nonmarket* transaction was *not* included in the total consideration. That is, in a nonmarket transaction, the assessor may set fair market value without regard to the total consideration paid and the assumed debt.

[7] As stated in Letter to Assessors No. 89/68 and AH 501, pages 70-71, (enclosed), Mello-Roos bonds are similar to a general property tax levy and should be treated as special taxes. Under the language of Rule 4(b), no adjustment of the sale price for the unpaid cash equivalent principal of Mello-Roos bonds is implied, since the principal amount of the Mello-Roos bonds is not tied to specific parcels.

> equity the price for which it is estimated that such debt could have been sold under value-indicative conditions at the time the sale price was negotiated....
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> * * *

Since the rule expressly requires that any existing debt encumbering a property, i.e., delinquent payments secured by liens against the property, must be added to the stated sale price in order to arrive at the actual consideration paid, (i.e., the cash equivalent "purchase price" of the property), delinquent payments under Mello Roos bonds must be treated like any other encumbrances existing on the property on the sale date. That is, delinquent payments (in contrast to future payments) on Mello Roos bonds represent an existing encumbrance or liability which must be converted under Rule 4. Therefore, in order to arrive at the consideration exchanged for the property, it is appropriate to add "delinquent" payments on MelloRoos bonds.

The views expressed in this letter are only advisory in nature, and represent the analysis of the legal staff of the Board based on present law and the facts set forth herein. They are not binding on any person or public entity.

Very truly yours,

Kris Cazadd

Kristine Cazadd
Senior Tax Counsel

KEC:jd
h:/property/precednt/astandiv/1999/01kec.doc

Enclosure

cc: Mr. Richard C. Johnson (MIC:63)
Mr. David J. Gau (MIC:64)
Ms. Jennifer L. Willis (MIC:70)