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TO COUNTY ASSESSORS:

TREATMENT OF IMPROVEMENT BONDS IN DETERMINING THE FAIR MARKET
 VALUE OF REAL PROPERTY BEING APPRAISED UPON PURCHASE

Chapter 783 of the Statutes of 1998 (SB 1997) amended section 110 of the Revenue and Taxation Code to establish a new rule for the valuation of real property purchased in an open market transaction. Under the amendments, the stated purchase price is rebuttably presumed to reflect the value attributable to public improvements financed by the sale of bonds secured by the purchased real property.

The purpose of this letter is to provide assessors with uniform guidance on the application of the amendments made by SB 1997. Specifically, this letter will

- provide background information about the existing presumption that a purchase price represents “full cash value”;
- further explain the effects of the 1998 amendments to section 110; and
- address certain issues that arise in connection with those amendments.

This letter supersedes LTA 98/34, “Assessment of Properties Subject to 1911, 1913, and 1915 Assessment Bonds,” dated July 2, 1998, to the extent that the discussion in that letter does not reflect the amendments made by SB 1997.

Background

Existing Presumption that Purchase Price is Fair Market Value

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.

Improvement Bond Financing

By participating in the formation of special assessment districts, local governments sometimes assist private parties in financing the development of land. Typically, the assessment districts are formed in order to raise money to pay for streets, landscaping, lighting, sidewalks, and other public improvements. The money is raised through the sale of bonds, the repayment of which is

secured by the parcels benefiting from the improvements. To recoup the debt incurred in selling the bonds, the districts levy assessments on the parcels to which the bonds attach.

Effects of SB 1997

Senate Bill 1997, enacted as an urgency measure effective September 23, 1998, amended section 110 to establish the following:

There is a rebuttable presumption that the value of improvements financed by the proceeds of an assessment resulting in a lien imposed on the property by a public entity is reflected in the total consideration, exclusive of that lien amount, involved in the transaction. This presumption may be overcome if the assessor establishes by a preponderance of the evidence that all or a portion of the value of those improvements is not reflected in that consideration.

This means 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 that assessor would bear the burden of rebutting the presumption that the value of the financed improvements was reflected in the total consideration *excluding* the assumed debt.

Example

Consider a new home that is subject to an improvement bond with an outstanding balance of \$30,000. In an open market transaction, Smith purchases the home for a stated price of \$150,000. In addition to the stated price, and as part of the total consideration for the property, Smith must assume the \$30,000 debt that is secured by the property. Under this hypothetical, what are the implications of the amendments enacted by SB 1997?

The answer is that the value of the improvements financed by the \$30,000 debt is rebuttably presumed to be reflected in the stated price of \$150,000. Thus, under the amendments to section 110, "purchase price" means the stated price of \$150,000 unless the assessor can show by a preponderance of evidence that the value of the improvements financed with the sale of the bonds is not already reflected in the stated price.

Issues

SB 1997 has raised the issue of whether real property that was purchased in an open market transaction involving the purchaser's assumption of bonded indebtedness *before* September 23, 1998 is subject to a different standard of fair market value than real property that was purchased in a similar transaction *on or after* September 23, 1998. The proper resolution of this issue, in turn, provides answers to two related questions: (1) What is the impact of SB 1997, on or after September 23, 1998, on an assessment appeal involving an open market purchase of real property encumbered by improvement bonds? and (2) Are assessors required to correct prior valuations that were determined by setting fair market value at the total consideration *including* the assumption of debt for improvement bonds? As to the first issue, it is clear that the amendments made by SB 1997 did not alter the standard of fair market value. That is, both before and after the enactment of SB 1997, the basic definition of "full cash value" or "fair market value" remains the same. Specifically, under subdivision (a) of section 110, these terms are defined to mean

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 the 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.

While SB 1997 did not alter this definition, as a practical matter the legislation did 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 an open market transaction was *not* included in the balance of the consideration exchanged for the real property. Thus, as to assessment appeals concluded on or after September 23, 1998, the newly added presumption places an additional evidentiary burden on an assessor who asserts at an appeals hearing that fair market value is something other than the stated purchase price.

Note that either party in an appeal may rely on the longstanding “purchase price presumption,” and that in doing so the party attempting to rebut the presumption assumes the burden of proving both (1) that the sale was not an open market transaction and (2) that the price paid would have been different if the sale had actually occurred under open market conditions. By contrast, only the *taxpayer* may rely on the new “SB 1997 presumption” that the stated purchase price included the value of any improvements financed by improvement bonds. Thus, in rebutting the presumption added by SB 1997, the *assessor* has the added burden of proving, at a hearing concluded on or after September 23, 1998, that the value of such improvements was not reflected in the stated purchase price.

As to whether assessors are now required to revise prior valuations determined by setting fair market value at the total consideration *including* the purchaser’s assumption of debt used to finance public improvements, the answer is “no,” since the amendments made by SB 1997 did not establish that such valuations are erroneous as a matter of law. Instead, as indicated above, the amendments shift to the assessor the burden of rebutting the presumption in the event of an assessment appeal. In this regard, it is the view of the Board’s Legal Division that the amendments are procedural in nature and are therefore effective for appeals hearings concluded on or after September 23, 1998.

Summary

- Senate Bill 1997 amended section 110 to establish a rebuttable presumption that, where the terms of an “open market” purchase of real property included the purchaser’s assumption of debt to repay improvement bonds, the stated purchase price—which is rebuttably presumed to represent the property’s full cash value—is itself rebuttably presumed to reflect the value of the improvements financed by the bonds.
- The amendments shift to the assessor the burden of proving by a preponderance of evidence at an appeals hearing that the value of the improvements financed by the bonds is not already reflected in the stated purchase price.
- The amendments apply to all applications for reduction that were not heard and decided prior to September 23, 1998.

If you have any questions about the guidance provided by this letter, please contact our Real Property Technical Services Unit (916) 445-4982.

Sincerely,

/s/ Richard C. Johnson

Richard C. Johnson
Deputy Director
Property Taxes Department

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