

# The Current Residential Real Estate Foreclosure Situation

by Thomas May

in cooperation with the Minnesota Association of Assessing Officers (MAAO) Sales Ratio Committee and the Minnesota Department of Revenue

*The statements made or opinions expressed by authors in Fair & Equitable do not necessarily represent a policy position of the International Association of Assessing Officers.*

*Editor's Note:* This Foreclosure Advisory Document was prepared through a joint effort of the Minnesota Association of Assessing Officers Sales Ratio Committee and the Minnesota Department of Revenue. Its purpose is to provide assessors with a better understanding of foreclosure terminology and processes that most jurisdictions are currently encountering. The document describes different types of transactions occurring in today's market and provides guidance on the use of these transactions in sales ratio analyses.

This document can be shared with staff, boards of appeal and equalization, county boards and city councils, and the general public to further the understanding of the foreclosure process and its effect on the assessment process. It has been approved by both the MAAO Sales Ratio Committee and the Minnesota Department of Revenue for distribution. The committee also will be presenting a four-hour sales ratio workshop at the 2008 MAAO Summer Seminars.

## Overview of the Real Estate Foreclosure Process

Foreclosure is a legal process that allows a lender/bank to take possession of and sell a property due to non-payment of a loan that is secured by that property. After the completion of the foreclosure process, the lender/bank has title to the property.

The real estate foreclosure process begins when a borrower/owner defaults on loan payments, in this case, mortgage payments and the lender files a Notice of Default, which in Minnesota would be referred to as *Lis Pendens*. *Lis Pendens* is a publicly recorded notice of a pending lawsuit against a property owner that may affect the ownership of a property.

The Foreclosure Sale, or Sheriff's Sale as it is called in Minnesota, is the event at which the property is sold to the highest bidder. The notice of the pending Sheriff's Sale is published for six weeks prior to the sale, and the sheriff or designee will serve notice to the occupant one month prior to the sale. Typically, at the Sheriff's Sale the lender/bank will open bidding with the exact amount due at the time of sale. Following this opening bid, other bidders are given an opportunity to bid at higher amounts. The successful bidder will receive a Sheriff's Certificate of Sale. A Certificate of Real Estate Value (CRV) is

not typically filed and the assessor is not typically notified of this transaction. The time period from the *Lis Pendens* filing until the Sheriff's Sale is approximately four months.

After the Sheriff's Sale, the borrower has the right to redeem the property by paying the successful bidder at the Sheriff's Sale the amount of the successful final bid plus interest and applicable fees. This is referred to as the redemption period. For most properties this is six months in length. Under certain circumstances the redemption period may be shorter, and for agricultural property the redemption period may be up to 12 months. If a property is abandoned, the redemption period may be shortened to five weeks with a special court hearing.

During the redemption period, the original owner of the property may continue living in the property and the successful bidder at the Sheriff's Sale may not enter the property without permission of the original owner.

If, after six months, the property is not redeemed, the highest bidder at the Sheriff's Sale is the undisputed owner of the property. For Torrens property, there is a special hearing called a Proceeding Subsequent that must be held before the name of the new owner may be added to the Certificate of Title.

## Overview of the Sales Verification Process

The annual sales ratio analysis is guided by the Sales Ratio Guidelines published by the Minnesota Department of Revenue (DOR) utilizing the IAAO *Standard on Ratio Studies*, which was updated in 2007, for its guiding principles. This study is based on the analysis of sales that have been carefully screened and reviewed to ensure that they accurately represent true market activity. The purpose of sales verification is to determine if a sale meets the definition of an open market and arm's-length transaction and should be included in the annual Minnesota Department of Revenue sales ratio study. If the sale does not meet those definitions, the sale should be excluded from the department's sales ratio analysis. This is true for any property type, whether the verification is done via clerical screening or through an individual or manual verification process. The IAAO *Standard on Ratio Studies* (2007), in Section A.4 on page 48, Screening Sales, states that an objective of sales screening is "to ensure that sales are excluded from the ratio study only with good cause (e.g., when they compromise the validity of the study)."

Sales of commercial, industrial, and apartment properties are normally verified through an individual process that would include contacting the parties involved in the transaction, typically the buyer, and asking a set series of questions to determine if the sale meets the definition of an open market, arm's-length transaction.

Residential and seasonal residential recreational property sales, on the other hand, are normally verified through a process of clerical screening and computer edits. Clerical screening is the verification of sales on a mass basis, with limited staff time. Clerical screening involves reviewing the CRVs and noting the names of buyers and sellers and whether any of the boxes that identify the type of acquisition, are checked. The names are checked to determine if the parties involved in the sale are individuals, a bank/financial institution, or other entities, such as corporations.

Whether the sale is manually verified or clerically screened, all sales that are open market, arm's-length transactions should be accepted for the ratio study. An "open market sale" is one in which both the buyer and seller are acting prudently, and the price is not affected by undue stimulus. Neither the buyer nor the seller must be under great pressure to complete a transaction in a short time. An "arm's-length sale" is between two parties, both of whom are seeking to maximize their gain from the transfer.

Properties that sell/transfer during the foreclosure process usually do not meet the definitions of open market, arm's-length transactions. The IAAO *Standard on Ratio Studies* (2007), Section A.4.1 on page 49, identifies the types of sales generally invalid for ratio studies. Two of the types of transactions identified are typically related to foreclosures.

- 3. Sales involving financial institutions. A sale in which the lien holder is the buyer can be in lieu of a foreclosure or a judgment and the sale price can equal the loan balance only.
- 6. Forced sales. Such sales include those resulting from a judicial order. The seller in such cases is usually a sheriff, receiver, or other court officer.

Those sales/transfers during the foreclosure process that do not meet the definition of open market, arm's-length transactions need to be rejected from the DOR ratio analysis via the following rejection criteria Reject Codes (RC):

- RC 15 a. Sales to avoid foreclosure
- b. Sales involving legal actions such as foreclosures, divorces, bankruptcies. [Type of Transaction, Area #6 on the CRV: The box "Property condemned or foreclosed upon" must be checked.]
- RC 21 Bank sales (including HUD) and lending institution sales not exposed to the market. If the lending institution is only trying to recover their investment in the property, the sale should be rejected. Resales of repossessed property may be considered for use in the study. Thorough verification is essential before

using these sales. They should be used if the sale meets the "open market arm's-length test." Resales of repossessed property by lending institutions will not be adjusted for financing terms.

- RC 26 Sales of doubtful title or other non-arm's-length transactions that are atypical transactions. For example, sales that are not advertised, listed, or promoted to potential buyers. Please review the DOR's "Reject Code 26-3 Factor Test" for verification of sales in this category.

In some instances, foreclosure-type transactions become so prevalent in the market that these types of transactions actually become the market. In these cases, sales that reflect the typical market could be included in the sale ratio analysis. If these sales become the actual market, some consideration must be given to including them in the sales study to measure how well the assessor's values reflect the actual market. The only way to be certain whether to include these transactions is to do a more detailed individual verification.

If these types of foreclosure-related transactions are to be considered for inclusion in the ratio study, the physical condition of the property on the sale date as compared to the condition on the assessment date must be established. The IAAO *Standard on Ratio Studies* (2007) states, in Section 3.5 on page 24, "physical characteristics of the property on the date of assessment must be the same as those on the date of sale. Properties with significant differences in these factors should be excluded from the ratio study." This factor in sale verification is critical in foreclosure-type transactions because of the varying physical conditions of the structures at the time of sale. If evidence suggests that some of these sales should be included in the sales study, the analysis must be done in cooperation with, and approved by, the DOR Regional Representative.

## Types of Sales during the Foreclosure Process

Properties that sell/transfer during the foreclosure process fall into one of three categories based on the time period when they sold. The categories are Pre-foreclosure, at the Foreclosure or Sheriff's Sale, and Post-foreclosure.

### 1. Pre-foreclosure

#### *Normal Third-Party Sales*

These are very common sales where the loan(s) against the property are in some stage of default and the amount owed is less than the value of the property. These sales typically, but not necessarily, occur before the Sheriff's Sale. The parties are selling to avoid a formal foreclosure process and losing equity. These types of sales happen often and typically have been listed for sale and meet the definition of open market and arm's-length transactions. Verification via clerical screening of these sales would not indicate anything out of the norm and the sale would go through the process unnoticed. Therefore, these sales should be included in the sales ratio analysis provided that no conditions of undue duress are evident. See table 1 for the decision grid.

Table 1. Pre-foreclosure normal third-party sales decision grid

Good for study:	Yes, Acceptance Code 00
Good for study:	No, if evidence of undue duress or lack of market exposure with proper verification and regional representative approval.
Rejection code:	RC 26—Not typical of market (DOR “Reject Code 26–3 Factor Test”)

### Short Sales

A short sale, sometimes referred to as a discounted payoff, is the sale of real estate where the total purchase price is less than the total amount owed against the real estate. The lender/bank is thus accepting less than the total amount owed by the borrower. Please note that the IRS could consider the debt forgiveness as income and the bank/lender may pursue a deficiency judgment for any loss between the net sale price and the total amount owed.

The property is at some stage of the default process, possibly, but not necessarily, before the Sheriff’s Sale. The total purchase price is less than the mortgage amount, not necessarily less than the value that would likely be obtained in an open market, arm’s-length transaction. In a pre-foreclosure scenario, the parties are selling to avoid a formal foreclosure process. In the case of a post-foreclosure short sale, the seller is selling to reduce the potential loss.

The clerical screening of this type of sale probably would not result in anything out of the norm, as the seller named is the seller and the buyer named is the buyer and there is no indication of bank/lending institution involvement. Further individual verification using Multiple Listing Service (MLS) data could be the flag for potential issues, as the listing usually includes a comment, such as sale needs third-party approval or upon approval from lender, indicating that a bank/lending institution is also involved.

Even with this knowledge, the sale verifier should do a sales comparison market grid to compare the sales price to other open market, arm’s-length transactions to see if the sales price falls in the value range. See table 2 for the decision grid.

Table 2. Pre-foreclosure short sales decision grid

Good for study:	Yes, if deemed open market, arm’s-length with proper verification and regional representative approval. Acceptance Code 00
Good for study:	No, if not in value range, condition changes, etc.
Rejection code:	RC 15(a)—Sales to avoid foreclosure

### Deed in Lieu of Foreclosure

Sometimes referred to as a “soft sale,” this transaction occurs when the mortgagee and the mortgagor have agreed that “in lieu” of being foreclosed upon, the seller gives the deed to the lender. The property is typically transferred via warranty deed and the total purchase price is the amount of the loan in default, plus associated fees. The property then becomes the lender’s property, without the lender having to incur the costs and time associated with going through the foreclosure process. See table 3 for the decision grid.

Table 3. Pre-foreclosure deed in lieu of foreclosure decision grid

Good for study:	No
Rejection code:	RC 15 (a)—Sales to avoid foreclosure

### 2. Foreclosure Sale or Sheriff’s Sale

This is an auction, where the sheriff is selling the property to the highest bidder. In most cases the highest bidder is the bank/lender and the bid amount is the sum of the defaulted loan plus interest and associated fees.

The successful bidder will receive a Sheriff’s Certificate of Sale, but typically no CRV is filed. See table 4 for the decision grid.

Table 4. Foreclosure sale or sherrif’s sale decision grid

Good for study:	No
Rejection code:	RC 15(b)—Sales involving legal actions such as foreclosure, divorce, bankruptcy

### 3. Post-foreclosure

The redemption period on most properties is six months. It is very rare for a property that is post-foreclosure to sell and close before the end of the redemption period. An exception would be a lender (successful bidder)-approved short sale.

#### Bank Sales

A bank or other financial institution is listed as the seller. In these cases, the property is considered to be real estate owned (REO) by a bank and the bank acquired the property through foreclosure. The bank may sell these properties on an individual basis or as part of a group at auction (see below). Clerical screening would indicate that the seller is a bank or financial institution. See table 5 for the decision grid.

Table 5. Post-foreclosure bank sale decision grid

Good for study:	No
Rejection code:	RC 21—Bank sale

#### Auction Sales (*Not to be confused with the Sheriff’s Sale*)

This section specifically refers to those auctions where a bank or lending institution is selling off multiple properties. These are a subset of the bank sales above. These auctions may have from one to dozens of properties available. The terms could be an absolute auction or a reserved bid.

Typically, these sales are not considered to be an accurate reflection of market value. However, it is possible that when many properties in a submarket or neighborhood are auctioned, that auction sales then become the market. This has happened with condominiums.

The IAAO *Standard on Ratio Studies* (2007), Section A.4.2 Sales with Special Conditions, on page 50, item number 5 states,

*Auctions. In general, auction sales of real property tend to be at the lower end of the price spectrum. Auction sales that have been well-advertised and well-attended may be valid for consideration in ratio studies. The seller also must have the option to set a minimum bid on the property or the right of refusal on all bids (with reserve) in order for the sale to be considered valid.*

Minnesota Statutes, section 272.03, subdivision 8, state in part that:

*“Market Value” means the usual selling price at the place where the property to which the term is applied shall be at the time of assessment; being the price which could be obtained at a private sale or auction sale; if it is determined by the assessor that the price from the auction sale represents an arm’s length transaction. The price obtained at a forced sale shall not be considered.*

A distinction also needs to be made between typical farm or estate auction sales and bank auction sales. Farm and estate auction sales tend to be advertised, and knowledgeable buyers and sellers and possibly realtors are involved in the transaction. Quite often, farm auction sales will be considered good for the study, while estate auction sales are less likely to qualify as a good sale.

Bank auction sales tend to be similar to any other bank sale where the bank wants to “get the property off its books” and will consider all offers whether they reflect market value or not. Any auction sales that may be considered valid for the current sales *must* be verified by the appraiser to determine if the sale meets the criterion of an arm’s-length transaction. In many instances, auction sales will not meet the arm’s-length criterion since the seller may be forced to sell the property to close an estate or, in the case of bank property, close out the loan transaction. In many instances, the exposure time is very limited and the sale price does not reflect typical market value.

*As a general rule, all auction sales should be verified to determine whether the sale is an “arm’s-length transaction” and that the sale price is indicative/typical for that area.* For all auction sales, a verification form should be attached to explain how and why the determination was made that the auction sale was considered by the county as a good sale or why the sale should be rejected from the study. The regional representative will review the auction sale verification form/document and will make the final determination regarding each auction sale. See table 6 for the decision grid.

Table 6. Post-foreclosure auction sale decision grid

Good for study:	No
Rejection code:	RC 21—Bank sale

### Fraudulent Sales Prior to Foreclosure

Fraudulent sales should be excluded from the ratio study analysis as non-arm’s-length transactions. Properties that have sold in a study period and have entered the foreclosure process may still be in the ratio study unless the original sale is suspected to be fraudulent. This original sale should, if the timing will allow, be excluded from ratio analysis by rejection code 26, not typical of the market. In order to reject any sales suspected of being mortgage fraud, the appraiser verifying the sale must attach additional verification documentation to the CRV. The attachment may include a copy of the realtor’s MLS showing the original list price and the final sale price, when the final sale price is considerably higher than the original list price, and/or a list of three or more comparable sales that indicate what the typical market value is for the sale property compared to the actual sale price of the property.

The DOR Regional Representative may reserve the right to ask for additional documentation before the sale will be rejected, and the Regional Representative will make the final determination as to which sales are rejected from the study and which sales will be included in the study.

### Conclusion

In conclusion, it should be clear that assessors should consider all transactions and sales data that can assist them in determining current market conditions and trends. It is inherently the obligation of the assessor to determine and measure the extent to which foreclosure sales impact the overall market in their jurisdiction. It is essential that assessors work with the Department of Revenue through their regional representatives to ensure that the analysis of sales data is accurate and consistent with the published guidelines. These procedures will maintain the integrity of the sales ratio process and ensure proper assessment uniformity statewide.

### Resources

Minnesota Department of Revenue. 2008. *Sales Ratio Study Criteria*. [http://www.taxes.state.mn.us/taxes/property\\_tax\\_administrators/other\\_supporting\\_content/srstudy2008\\_criteriamain.shtml](http://www.taxes.state.mn.us/taxes/property_tax_administrators/other_supporting_content/srstudy2008_criteriamain.shtml)

*Questions regarding the criteria should be directed to Leonard Peterson at 651-556-6110 or [leonard.peterson@state.mn.us](mailto:leonard.peterson@state.mn.us); Tom Clark at 651-556-6101 or [tom.clark@state.mn.us](mailto:tom.clark@state.mn.us); Contact your DOR Regional Representative for clarification.*

International Association of Assessing Officers. 2007. *Standard on Ratio Studies*. Kansas City: International Association of Assessing Officers.

International Association of Assessing Officers. 2007. *Standard on Ratio Studies*. <http://www.iaao.org/documents/index.cfm?Category=23>. (requires IAAO member ID to access)

IAAO Toll Free Number: 800/616-IAAO (4226)  
Main Telephone: 816/701-8100, Facsimile: 816/701-8149

### Acknowledgement

This document is another example of an excellent tool developed for assessors through a joint effort of MAAO and the Minnesota Department of Revenue. Special thanks to Tom May, AAS, Hennepin County Assessor and Chairperson of the Sales Ratio Committee, for his leadership on this project. If you have any questions or comments, please contact Stephen C. Behrenbrinker, CAE, [Stephen.behrenbrinker@ci.stcloud.mn.us](mailto:Stephen.behrenbrinker@ci.stcloud.mn.us); or Tom May, AAS, [tom.may@co.hennepin.mn.us](mailto:tom.may@co.hennepin.mn.us).



**MINNESOTA • REVENUE**

**Tom May, AAS**, is the Hennepin County (MN) Assessor and Chairperson of the Sales Ratio Committee of the Minnesota Association of Assessing Officers