Foreclosing on the American Dream

by Danielle Simpson

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Every American who has picked up a newspaper, watched a news program, listened to the radio, or simply stepped outside their door is aware of the foreclosure problem in the United States. The pursuit of the American Dream has turned into the pursuit of the American Nightmare. This problem affects almost everyone in the country, and the world of assessment is not exempt.

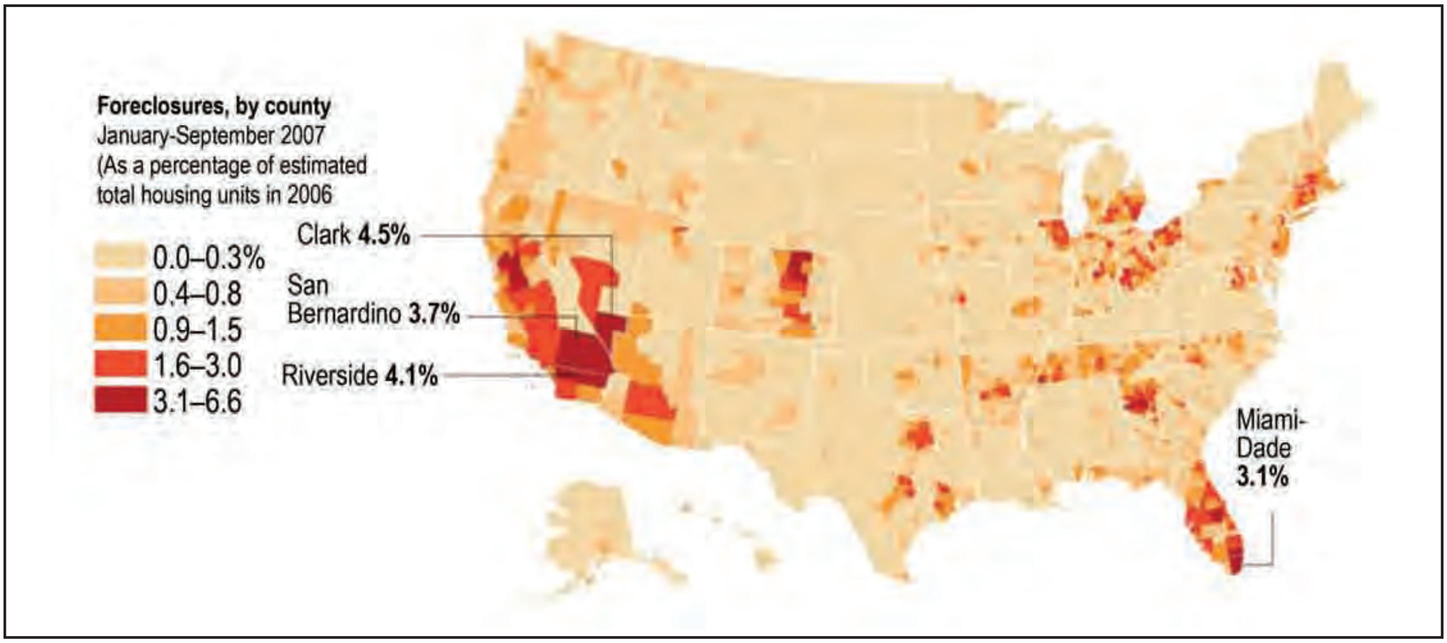
A National Crisis

Sacramento, Stockton, and Bakersfield, California, experienced an increase in foreclosure filings in 2007 of more than 200 percent over filings in 2006, according to RealtyTrac. Las Vegas foreclosures increased over 169 percent during the same time period. Cleveland and Miami suffered increases of more than 100 percent over their 2006 foreclosure filings. Figure 1 shows foreclosures by county nationally for January–September 2007 as a percentage of estimated total housing units in 2006. Unfortunately, an immediate remedy is not in sight. A December 2007 article on http://calculatedrisk.blogspot.com discussed the number of homeowners in America with no or negative equity: "At the end of 2006, there were approximately 3.5 million U.S. homeowners with no or negative equity (or approximately 7 percent of the 51 million households with mortgages). By the end of 2007, the number will have risen to about 5.6 million. If prices decline an additional 10 percent in 2008, the number of homeowners with no equity will rise to 10.7 million."

According to an article in the *Los Angeles Times* on January 23, 2008, the decrease in home equity has resulted in areas of the country experiencing "Intentional Foreclosures." The article defines this type of foreclosure as "... people that have otherwise had the capacity to pay, but have basically just decided not to because they feel like they've lost equity ... A homeowner who can't sell his house tells the *L A. Times*, 'Foreclose me. I'll live in the house for free for 12 months, and I'll save my money and I'll move on.'" In some cases foreclosure, once considered taboo, is becoming increasingly socially acceptable.

Who is to blame? The list of possibilities is almost endless. In the January 2008 issue of *Fair & Equitable*, John Lifflander identified four primary causes: "…unrealistic speculation, loose lending practices, fraudulent appraisals, and cheap money." This encapsulates causes such as adjustable rate mortgages, undereducated borrowers, greed, and property flipping, just to name a few. Not to mention the underlying principle of

Figure 1. Foreclosures by county nationally



Source: httpp://www.theatlantic.com/doc/200801/home-foreclosure (accessed May 12, 2008) "see no evil, hear no evil, speak no evil." Even when many real estate professionals and borrowers saw something suspicious, they seldom reported it.

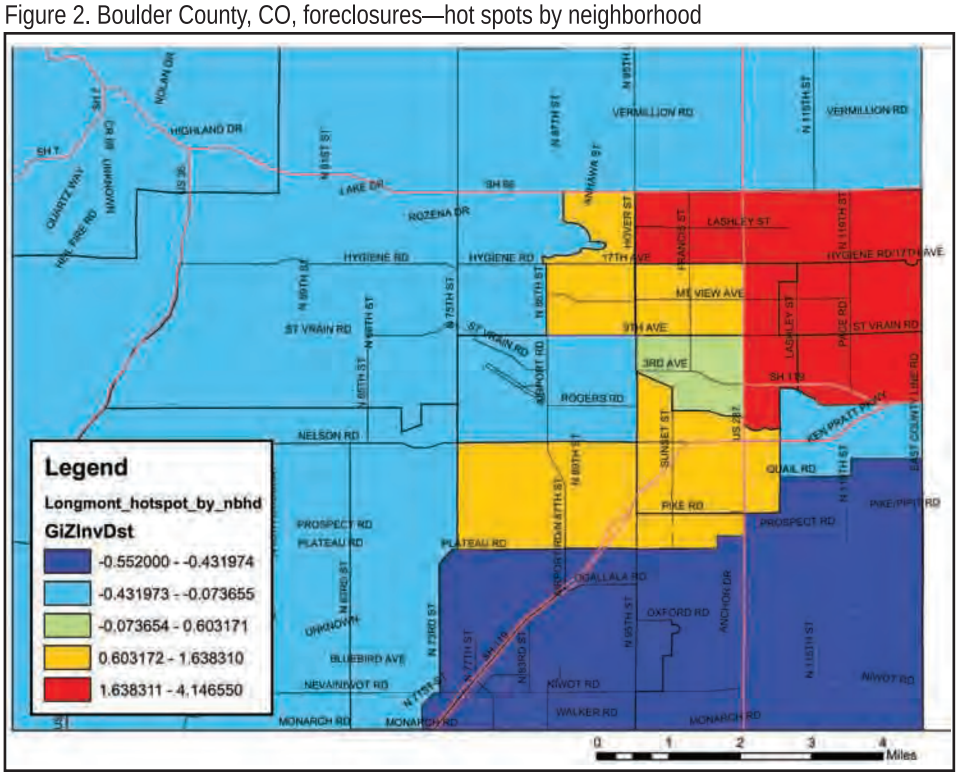
The challenge for assessors and their staff is to identify foreclosures, their influences, and their impacts. In addition, assessment staff must demonstrate to taxpayers that they have accomplished this task adequately in order to ensure equity and public confidence. Property owners want to know that they are not being overvalued, while financially strained taxing entities want to be assured that properties are not being undervalued.

Foreclosure in Colorado

The Boulder County Assessor's office is located in the heart of Boulder, Colorado, approximately 30 miles northwest of Denver. The staff of 47 employees includes fourteen residential appraisers. We acknowledged that we needed a better understanding of the foreclosure process locally. To begin our journey, we invited four real estate professionals to the assessor's office to explain the laws in our state as well as the influences at each stage of the foreclosure process. We invited a supervisor from Countrywide Home Loans, a realtor with over 20 years of local experience, a housing counselor from one of our county programs, and the appointed county official whose responsibilities include being the foreclosure administrator. These four experts described their professional responsibilities, how foreclosures affect their offices, as well as what they were seeing in the marketplace from their perspective. These explanations helped lay a solid foundation for analyzing foreclosures in the county and increasing our understanding of them. Any jurisdiction in any state would benefit from a similar roundtable discussion. The professionals we invited learned as much as we did.

The foreclosure process in Colorado takes approximately 9 months from the first missed payment to the final sale. Understanding each stage of the process helped us to identify the duress that the bank and borrower faced at each step. Many sales that needed to be identified and diligently reviewed occurred before the foreclosure was concluded. These sales fall under the definition of a *short sale*; that is, a lender accepts less than the total loan amount of the mortgage to avoid a possible foreclosure or bankruptcy. These sales are subject to approval by the sellers as well as their lending financial institution, and their closing can take 2–8 weeks longer than a typical property transaction.

Figure 2. Boulder County, CO, foreclosures—hot spots by neighborhood



Source: Boulder County Assessor's Office

City of Longmont Case Study

We discovered that Boulder County was retaining its value as a whole, but one city had a significantly higher foreclosure rate than the rest of the county, as well as a declining market (see figure 2). The City of Longmont's border extends into an adjacent county, Weld County. Weld County had three times the number of foreclosure filings in 2007 as Boulder County.

Longmont had a 39 percent increase in completed foreclosures from July 2006 through June 2007 compared to the same period the prior year. A study of realtor listings revealed that listings of lender-owned properties had doubled for the same time frame. Preliminary analysis included Z-score analysis, value versus foreclosure rate studies, bell curve analysis, and further sales studies. Appraisers used these studies to identify many geographic patterns, resulting in a starting point for refining geographic boundaries. Longmont's historic Old Town residential district experienced multiple foreclosures east of Main Street, but had only a few foreclosures west of Main Street (see figure 3). In the past, these two areas were combined for modeling purposes, but now will likely need to be separated.

Sources of Information

To identify potential foreclosures, the assessor's office uses a variety of sources. We rely primarily on information from the local realtor multiple listing service, auction information, deeds, and sales ratio studies. We are searching for indications that the property may be in the process of foreclosure or currently lender-owned and are also trying to identify the property condition.

Multiple listing services provide information on the ownership, property description, and even property condition. In reviewing realtor listings, assessors look for descriptions with the words *see seller addendum*, *bank addendum*, *short sale*, *subject to approval*, *bank-owned*, *sold as-is*, *download disclosures*, and any other atypical or suspect remarks. Listings bearing a glorious absence of information are particularly suspect. Frequently, in foreclosure listings, entire sections are left blank including public records, room counts, and room dimensions.

Multiple local and national auction Web sites, including www.williamsauction.com, show active listings and even sold properties for 12 months or more after the sale. Auction listings include the property address, auction date and time, opening bid, and final bid. Some listings even include detailed descriptions typically found in realtor-marketed properties.

Deeds in lieu of foreclosure are also becoming more common. A deed in lieu of foreclosure is a deed instrument in which a mortgagor conveys ownership of the property to the lender to satisfy a loan that is in default and avoid foreclosure proceedings. The property is voluntarily surrendered, and the lender can begin marketing the property immediately. This may lessen the negative impact on a borrower's credit and save the lender court costs, attorney's fees, and holding time. Deeds in lieu of foreclosure can also be recorded as warranty deeds or special warranty deeds with the lender named as the grantee.

Property Condition Woes

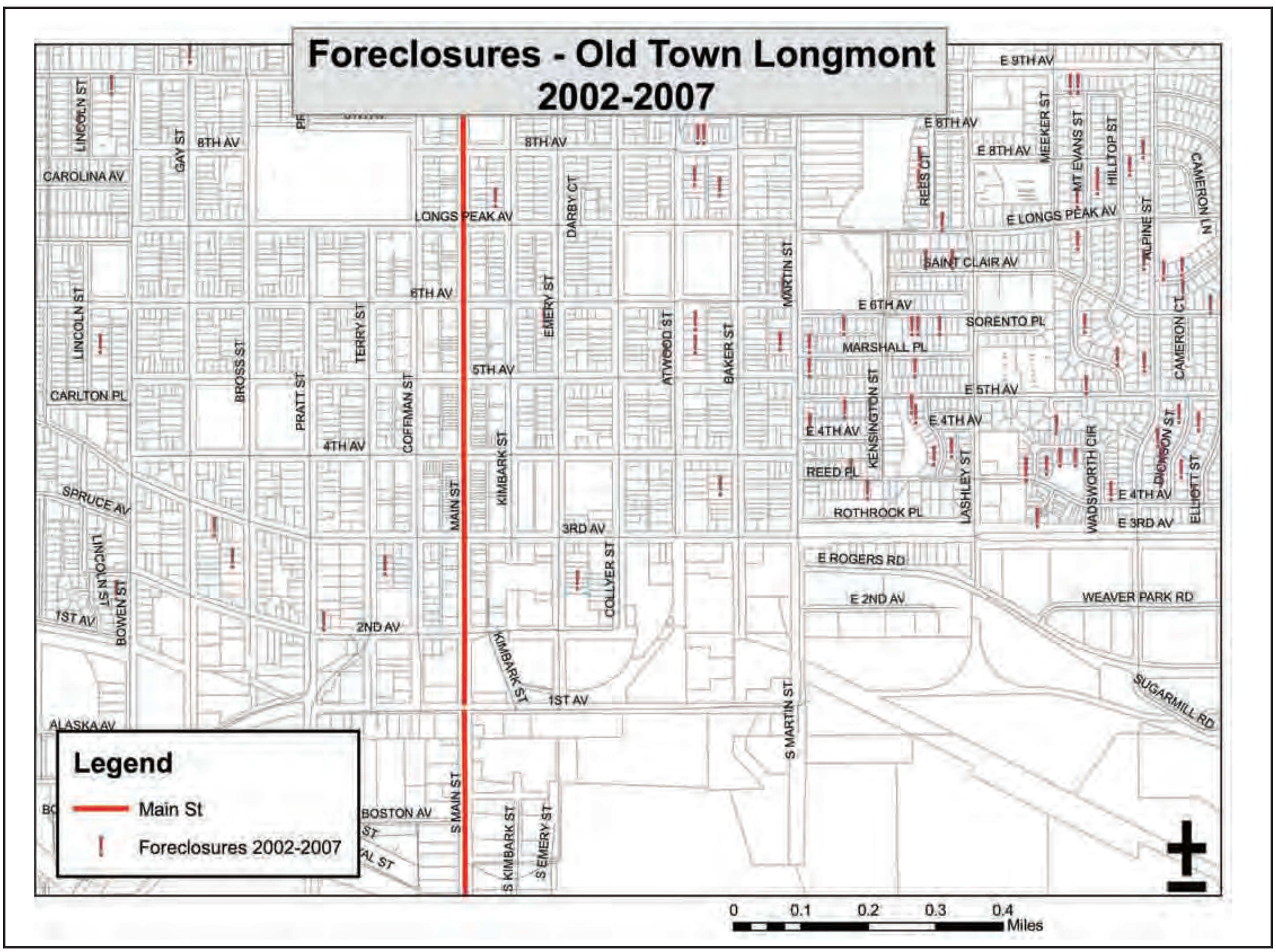
Disgruntled homeowners may leave a property in ruin after it has been foreclosed. Common foreclosed property conditions are ripped-out wiring, walls with holes and graffiti, rooms with pet feces, and the home being stripped of everything including the kitchen sink. A June 6, 2007, article by Maya Roney in *Business Week*, titled "Foreclosure's Filthy Aftermath," described instances in which homeowners have abandoned their pets inside the foreclosed home.

Determining the true property condition is a challenge. Some state laws limit an assessor's ability to investigate, and realtors or homeowners can be evasive about access to the property or the true property condition. Interior photos of foreclosures provided in a realtor listing can be an assessor's pot of gold. Sending out letters requesting property information may reveal some property conditions with varying levels of accuracy. Property inspections can be helpful, and nosy neighbors can be even more helpful. Every reasonable approach should be explored and utilized.

The Devil Is in the Details

Realtor listings can be useful if the assessor knows what to look for. In the oldest neighborhood in Longmont, two foreclosure listings were identified. One realtor's remarks gave clues to the prop-

Figure 3. Foreclosures in Old Town Longmont, 2003–2007



erty description, while the second listing gave a detailed description. The first listing described the property as “true fixer upper, but priced accordingly” and “sold as is with any/all imperfections.”

The second listing disclosed more detail. “Bank owned property sold AS IS—NO WARRANTIES…Water tap is active. House was owned by hoarder—filled with trash and animals feces and the smell is unbelievable. We have cleaned it out and removed carpets, but it STINKS. Please consider wearing a mask when entering property. Basement stairs are NOT stable and considered unsafe.” The property did not sell under this description, was withdrawn from the market, and then relisted with a different realtor.

Two extraordinarily different descriptions were used to describe these properties, but they actually described the very same property. This is an example of how deplorable a property condition can be and still be described as a fixer-upper. Realtors are hired to market a property. The second listing may have been honest but did not effectively market the home. The first description successfully enticed prospective buyers. Hints or suggestions that a property may be in inferior condition should be investigated.

Comparing Apples to Apples

Foreclosed properties may compete with other typical marketed properties and need to be scrutinized on an individual basis. If a property sold for significantly less than other competing properties, then it may need to be disqualified from the sales pool. However, if a property sold for a price similar to that of other competing properties, it is up to the appraiser (and state law) to determine whether it should be considered qualified for assessment purposes.

Property A is a 1910 ranch in a mature neighborhood. It had an assessed actual value of $114,900 but sold in September for only $69,000. The adjusted value range for three other similar properties of average condition in the same area was $122,000–$133,000. A review of the property revealed that the home had been neglected and was in need of significant repair. The property did not qualify for typical lending options and needed to be purchased as a cash-only transaction, thereby limiting the appeal of the property to predominately investors. The appraiser was not confident that description changes in their appraisal system could adequately compensate for all the influences affecting the property. Therefore, the sale was disqualified.

Property B is a 1970s split-level in a mature neighborhood on a busy street. It had an assessed actual value of $193,800 but sold in July for only $185,000. The adjusted value range for three other similar properties of typical condition in the same area was $189,000–$201,000. A physical inspection of the property revealed that the property was in average condition overall and in need of only minor cosmetic repairs. A typical buyer would probably consider purchasing this foreclosure when shopping other similar homes in the area. Therefore, the sale was considered qualified.

Examples such as these provide references that can be given to taxpayers to demonstrate why a sale was deemed qualified or unqualified.

For properties that are foreclosed and then sold multiple times, their sales should be reviewed in succession; this likely indicates a flip or remodel. A high number of foreclosures can create a playground for willing real estate investors who can afford to hold, flip, or rent a property until the market turns around. Having an intimate knowledge of the area as well as the realtors in the area can be advantageous in discerning whether a purchase is arm’s length, even for an investor.

Homes purchased by a realtor as a result of foreclosure and then relisted and sold require additional attention. For example, Laura purchased her home in October 2003 for $229,000. The home was foreclosed in January 2006. Erik, a local realtor, purchased the home for $192,000 in June 2006. Erik put in new carpet and paint and then resold it five months later for $222,500. When Erik purchased the property, he knew that he would receive a commission as the buyer’s agent, that he would receive the investor’s profit for fixing it up and selling it and that he would then receive a commission as the listing agent when it was resold. One reason Erik was willing to pay $192,000 was because he knew that the property was potential financially advantageous to him as an investor and as a realtor. What Erik did was absolutely legal; however, he was not a typical buyer in the foreclosure purchase.

What’s the Impact?

A preliminary time trend analysis revealed an estimated decline in residential property values in Longmont of 6–8 percent between July 1, 2006 and June 30, 2008. At this time, the projected decline will result in an estimated loss of $2,400,000 in tax revenue. The effect on individual taxing entities includes estimated losses of $360,000 to Boulder County, $480,000 to the City of Longmont, $72,000 to the water district, $48,000 to the fire district, and $1,450,000 to the school district. This type of information is critical for planning the budget of these entities. Negligent sales confirmation can inappropriately alter these figures.

All team members on an assessor’s staff wear multiple hats. A major obligation is public education. The public relies on the assessor’s information and its accuracy and looks to the assessor to confirm or refute what the media is telling them. It is reckless for the assessor’s office to feed false media hype or to deny the problem that lies at the front door. Taxpayers do not want to evaluate the sales ratio study, review state-mandated statistical compliance, or hear about the requirements for mass appraisal under governing standards. They want to know that the assessor’s office is acknowledging foreclosures in their area, honoring their place in the market, and adequately reflecting the influence of these foreclosures on their valuations, fairly and equitably. ■

Danielle Simpson has been a Residential Appraiser in Colorado for seven years. She joined the Boulder County Assessor’s Office four years ago. This article is based on a presentation of the same title at the 2008 Integrating GIS &/CAMA Conference in February in New Orleans. Additional contributors were Lisa Bryan, Lori Krager, Rachel Parrinello, Brooke Cholvin, and Ben Woodruff, of the Boulder County Assessor’s Office.