Prepared Testimony of

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on

Mortgage Fraud and Financial Institution Fraud
Proposed Provisions for Determining Fair Market Value

Before the

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Good morning. I am David Howell, a real estate broker licensed in Virginia, Maryland and the District of Columbia, and I am the Executive Vice President and Chief Information Officer of McEnearney Associates, Inc, REALTORS®. I also currently serve as Chairman of the Board of Metropolitan Regional Information Systems (MRIS), the nation's largest multiple listing system. Thank you for this opportunity to testify today on proposed provisions regarding the calculation of loss in mortgage fraud cases.

Introduction

The Commission is seeking comments on the possible provision of an "additional special rule for determining fair market" if the property has not been disposed of at the time of sentencing, and specifically asks if the "most recent tax assessment value of the mortgaged property shall constitute *prima facie* evidence" to establish fair market value. The simple and direct answer is "no."

Background

The IRS defines fair market value as "the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts."[1] In the complex and rapidly changing real estate markets nationwide, the single most difficult task for a real estate practitioner is determining the market value of a property. This is equally true whether we are representing a seller and our job is to maximize the value of their home or investment property, or representing a purchaser and our job is to obtain the property on terms most advantageous to our client. In short, every transaction is a journey to determine "fair

[1] IRS Publication 561 – Determining the Value of Donated Property, April 2007, Page 2

market value." We wish there was an easy, reliable yardstick to measure fair market value; the reality is that in the real world of negotiating agreed-upon terms between that "willing buyer and willing seller," the tax assessment of the property is an unreliable and inconsistent indicator of value.

Why Are Assessments An Unreliable Indicator of Fair Market Value?

There are three basic reasons: time, scope and purpose.

- **Time**. Assessments are not made at the time of sale and therefore cannot take into account the significant changes that can and do take place in markets in short periods of time. In Maryland, for example, assessments are made once every three years, and while careful efforts are made to project property values between assessments periods, no one can predict what a home will be worth three years from now – and if you find that person, we'd like to hire them! In Virginia, Washington, DC and most other jurisdictions nationally, assessments are done annually – but bear in mind that underwriters for new mortgage loans do not allow appraisers to use comparable sales that are older than six months. There's a reason for that. The more time that elapses between the evaluation of a property and its actual sale, the less accurate that evaluation will be, regardless of who does it or how well they perform their task. And there is a considerable disconnect between the time an assessment is done on a property and its sale in almost every instance.

- **Scope**. By necessity, assessors cannot and do not visit individual homes; rather, they base assessments on overall market trends and economic information. They therefore cannot take into account the differences in homes that go far beyond the numbers in their assessment database: bedrooms, baths, square footage and lot size, type of construction, year built, etc. Improvements to a home that do not require permits – or improvements that were done without permits – do not show up in the tax records database but can have significant impact on value, and an assessor can't see whether a home is well maintained or is falling apart inside. In addition, there is simply no way for an assessor to account for or anticipate changes in mortgage interest rates, the number of homes on the market in a given neighborhood, the condition of neighboring homes and a host of other "hyper-local" factors that effect a property. And most certainly, even the best assessor cannot predict or account for the human factors in a transaction that have nothing to do with the physical property - the motivations and needs of the parties to a transaction.

- **Purpose**. Most, if not all, jurisdictions have a mandate to assess properties at 100% of their "fair market value," and given the limitations described above, assessors do a remarkably good job. However, bear in mind that the assessment process is, at least in part, political. In some jurisdictions, for example, it isn't just the property that matters; who owns it matters as well. There are public policy reasons to vary assessments based on age or disability – and to be sure, this is not a criticism. The fundamental purpose of tax assessments is to establish an equitable basis for collecting taxes, and again, that is a wholly appropriate public policy. I think you would be hard-pressed to find an assessor who would state that the assessed value of a specific property is, in fact, its "actual fair market value."

Some Specifics

We have studied the relationship between assessed values and sold properties for years, if for no other reason that sellers and buyers may believe that there is close relationship between the two. (Unless of course a seller thinks their home is worth a lot more than the assessed value or a buyer thinks it is worth a lot less!) In preparation for this testimony, we compared the most recent assessed value to the actual sold price of over 2,000 homes that sold in Northern Virginia in the last 90 days, and this is what we found:

- Overall, the assessments averaged 90.93% of the average sales price. Taken in isolation that's a pretty impressive number, and truly speaks well for the diligence of assessors.
- However, the devil is always in the details:
    - Only 26.8% of the properties had assessments within 5% of the actual sales price.
    - 47.2% had assessments that were 5% - 15% below the actual sales price.
    - 13% had assessments that were 5% - 15% above the actual sales price.

We also looked at 320 homes that were "short sales" in that same 90-day time period:

- Overall, these assessments were very close to mark, averaging an astounding 102.9% of the average sales price.
- One again though, that doesn't apply to all properties:
    - 34.7% of the properties were assessed within 5% of the actual sales price.
    - 21% were assessed between 5% - 15% below the actual sales price.
    - 30% were assessed between 5% - 15% above the actual sales price.

And the results from 282 homes that were foreclosure sales were similar:

- The average assessment was 103.3% of the average sales price.
- 33% of the homes were assessed within 5% of the actual sales price.
- 28% were assessed between 5% - 15% below the actual sales price and 23% were assessed between 5% - 15% above the actual sales price.

This leads me back to my original statement that the most recent tax assessment on an individual property is not an appropriate or reliable indicator of fair market value. The averages are good to great – but that doesn't translate to the individual property.

Conclusion

We have great admiration for the quality of tax assessors' work, but it is simply impossible for that work to produce the reliable fair market value for an individual property. There are a host of Internet sites that offer automated valuation models (AVMs) that purport to predict the value of specific properties, using tax record information and a host of other factors in sophisticated mathematical models – and they generally don't get much that closer to the mark that the tax assessors do. If one looks at their fine print, they don't actually claim to predict values. Zillow.com, the most popular of those sites, says this about their "Zestimate" of value: "(It) is pulled from data; your real estate agent or appraiser physically inspects the home and takes special features, location, and market conditions into account. Variations in price also occur because of negotiating factors, closing costs, and timing of closing." They go on to encourage buyers and sellers to "supplement" their research by getting a CMA from a real estate agent or by getting a professional appraisal. I agree, and I also recognize that as a real estate practitioner that may seem like a self-serving statement. But if the objective is to determine the fair market value of a property, then that property has to be physically seen and evaluated by a disinterested professional - one not involved in the transaction. Ideally, that would be a licensed and experienced appraiser.

Thank you for the opportunity to testify today, and I will be happy to answer any questions I can.