

Testimony of
Dennis J. Black, MRICS, ASA, IFAC

Submitted to the
Financial Crisis Inquiry Commission

Miami, Florida
September 21, 2010

Introduction

Appraisal fraud is a broad term that brings different images to different people and most of the images are probably correct. Appraisal fraud can be as seemingly innocent as falsely certifying that the appraisal report complies with the Uniform Standards of Professional Appraisal Practice, or it can be as blatant as the subject not having a kitchen or bathrooms and the appraiser not mentioning that fact. Both of these cases are fraud. The second is a full blown attempt to intently mislead the reader about the condition of the property, but the first can often be just as injurious to the holder of a mortgage note. If the professional standard which was violated has to do with properly analyzing a market and reporting the true market conditions the false certification is not just a technicality. The false statement in the certification should be the tool which is used against the appraiser. The problem is that the way the mortgage market functions appraisers who play fast and lose with the rules are the preferred appraisers for the lenders/developers who are just looking to push the deal forward. Appraisers who refuse to be “team players” do not receive more work.

This certainly is not new, but the powers that be cannot claim ignorance. Aside from other efforts, the “appraiser’s petition¹” was started in December 2000 and prior to its closing for signatures was signed by 11,000 appraisers. That petition was addressed to Ben Henson, Executive Director of the Appraisal Subcommittee, but for years was also forwarded to news organizations and many members of congress.

The concern of this petition has to do with our “independent judgment” in performing real estate appraisals. We, the undersigned, represent a large number of licensed and certified real estate appraisers in the United States, who seek your assistance in solving a problem facing us on a daily basis. Lenders (meaning any and all of the following: banks, savings and loans, mortgage brokers, credit unions and loan officers in general; not to mention real estate agents) have individuals within their ranks, who, as a normal course of business, apply pressure on appraisers to hit or exceed a predetermined value.

This pressure comes in many forms and includes the following:

- the withholding of business if we refuse to inflate values,
- the withholding of business if we refuse to guarantee a predetermined value,
- the withholding of business if we refuse to ignore deficiencies in the property,
- refusing to pay for an appraisal that does not give them what they want,
- black listing honest appraisers in order to use “rubber stamp” appraisers, etc.

Appraisal fraud is often hand in glove with mortgage fraud. People who are crossing the line in one area are often crossing the line in other areas.

¹ www.appraiserspetition.com

The Unholy Alliance

Developers have for decades been walking hand in hand with lenders so each can earn profits. In the 1980's this distinction became unrecognizable in many cases as developers bought small Saving and Loans across the country and through a series of corporations effectively lent money to themselves or friends to build project after project. As long as the appraisals indicated there was sufficient collateral and inflation remained strong all was right in the world.

The problem was that the appraisals of these projects often were based on the hypothetical condition that the buildings were up and ready for occupancy and that the change in the supply of that property type would be met by an equal increase in real demand. Unfortunately looking back we know that was not the case. New condominiums and office buildings were being built at a rapid pace, but no meaningful analysis was taking place of where the occupants would come from, or what would affect the shifting supply/demand ratio would have on prices. One type of grossly misleading analysis was appraisers just adding up the value of individual units and using the total as the appraised value. In short, appraising a single unit in a vacuum of a market where only current prices matter even though the commodity does not truly exist and the appraiser knows that when it does come into existence the number of competing properties will be far greater than at the present. The risk associated with the financing of these developments rested with the lender and, ultimately because they were insured by The Federal Savings and Loan Insurance Corporation, the tax payers of the United States.

Twenty-five years ago the secondary mortgage market was a small fraction of the size it is today. Solomon Brothers and the other major Wall Street firms were just starting to develop the concept of Collateralized Debt Obligations (CDO) and Mortgage Backed Securities (MBS) which would address the prepayment uncertainties of mortgages. This shift in the financing of residential property is at the very heart of today's real estate crisis. The Financial Institution Reform Recovery and Enforcement Act (FIRREA) of 1989 was drafted to address the lending paradigm of the 1980's, and it was inadequate to address the lending world of the twenty first century. In hundreds of communities builders and mortgage brokers enticed speculators to buy a piece of land and build a house on it and the way the transactions were structured they moved through the secondary mortgage market with ease. Why did they move through with ease, because each subsequent party was given just enough information to do the deal. In particular, the appraisals only addressed the value as if the house was standing there today and ready to be sold. The scope of work and due diligence employed by the appraiser was often truncated so that the enormous number of other speculator's projects were ignored. The assignment was completed as if the subject was up and standing, but did not extend the hypothetical condition out to competing properties which were also being built.

In effect the market was doing the same thing as in the early 1980's, but because there were scores of borrowers going through the secondary mortgage market these were all treated as separate and distinct appraisal assignments and the individual unit value was deemed to be the value of the collateral. This meant that the buyers of these debt bombs had no way of knowing the true state of the collateral's market because the valuation of that collateral was performed in a vacuum.

The Uniform Standards of Professional Appraisal Practice Scope of Work Rule is

For each appraisal, appraisal review, and appraisal consulting assignment, an appraiser must:

1. identify the problem to be solved;
2. determine and perform the scope of work necessary to develop credible assignment results; and
3. disclose the scope of work in the report.

An appraiser must properly identify the problem to be solved in order to determine the appropriate scope of work. The appraiser must be prepared to demonstrate that the scope of work is sufficient to produce credible assignment results.

Contained within the comments directly below the above Standards is

Appraisers have broad flexibility and significant responsibility in determining the appropriate scope of work for an appraisal....

Credible assignment results require support by relevant evidence and logic. The credibility of assignment results is always measured in the context of the intended use.

Having constructive knowledge that the intended use is to underwrite a loan and that the loan would with a high degree of certainty be sold into the secondary market employing a Scope of Work which fails to address competing supply at the time of completion does not appear to be prudent. Failing to provide sufficient information in a report and then hiding behind the concept that as of date of value it was worth x, knowing full well that the intended use of that report was for loan collateral and other factors were swirling around the market is ignoring the overall market. However that is what happened all across the country.

Applying such a scope of work to the problem is failing to provide the intended users of the report with an adequate picture. What pushed this concept is what I call “credit hot potato”. The client ordering the appraisal only wanted a value as of today and thus ordered an appraisal with the hypothetical condition that the structure was standing today and no effort was made to consider the future at all. The appraiser permitted their Scope of Work to be affected by the immediate goal of the lender, which was to make a loan. The secondary mortgage market was effectively doing exactly what banking regulations had forbidden twenty years earlier, but because each was a separate borrower the appraiser was encouraged to view these loan appraisals in a vacuum completely ignoring the reality that supply was being increased at a rate that would only lead to a price collapse and the person holding the hot potato would be financially harmed.

Some appraisers will argue that because the holders of those loan packages were not named intended users the appraiser owes no duty to them. This seems to contradict the opening two lines of the Uniform Standards of Professional Appraisal Practice Preamble which states

“The purpose of the USPAP is to promote and maintain a high level of public trust in appraisal practice by establishing requirements for appraisers. It is essential that appraisers develop and communicate their analysis and conclusions to intended users of their services in a manner that is meaningful and not misleading.”

Furthermore, it is a well established concept within the USPAP that “do the right thing” is a goal of the USPAP. The USPAP requires that an appraiser owes an ethical obligation to a homeowner who attempts to order an appraisal for a loan application that involves a federally related transaction. They are obligated to inform the homeowner that such an appraisal would not be acceptable to the lender because the client is the borrower and not the lender. How can it then be logical that you owe no duty of care to someone who you know will be the holder of that mortgage note? The homeowner is looking at a few hundred dollars where as the buyer of the loan package is on the hook for hundreds of thousands of dollars.

Another problem within the appraisal profession is the concept that appraisers are held to a standard of what their peers would do in a similar situation. This is a typical test within the arena of standard of care, but has never been meant to be a way for professionals to move en masse to a lesser performance level in an effort to lessen their professional duty. It is understood that at times professionals don't have the latest and greatest professional tools at their disposal, but to have them at your disposal and choose to not employ them is reckless. The extreme number of new housing units in these exploding markets was clearly evident. Just a simple drive around the area or reading the local papers was all that was needed to begin the thought process.

The defenses of “the value was as of that date”, “they're not an intended user”, or “everyone was doing it” just indicate the sometimes apathetic stance of the very professionals who the USPAP charges with “maintain a high level of public trust”.

Manifestation

The willingness to turn a blind eye to the true conditions of the market created a rippling effect in many markets. Yesterday's fraudulent deals become tomorrow's bad comparables. Lenders and developers came to rely upon appraisers who are either unethical or incompetent. In some cases they get lucky and the appraiser was both.

Example # 1

In 2009, I reviewed appraisals in a condominium conversion project in Orlando, Florida. The appraisals were of units that had been apartments in 2005 and the developer filed papers creating a condominium complex and was selling the units off individually. The appraisals were as of early 2006. The comparables cited in the report were all recent sales of similar units. However, a quick look on the internet uncovered that the developer would promise two years of rental income, pay all closing costs, and even waive the Condominium Fee for two years. I was able to find out that information three years after the fact in a matter of minutes. I then called the owners of the comparables and each stated they had participated in that plan. This was a case of failing to conduct reasonable diligence. Nowhere in the reports being reviewed did the appraiser divulge any of that information. Failing to report seller concessions such as those given by that developer is a violation of the Uniform Standard of Professional Appraisal Practice. It greatly affected the credibility of the report.

Those condominium units had been selling for over \$300,000 to people who sometimes never saw the units. In 2009 they were down to \$50,000 because the market was just full of other projects which also had blown up. Why did they blow up? Because when the owners tried to rent the units they realized that the rental amount being paid to them by the developer was not obtainable in the free market.

Example # 2

In another case in which I was hired by the Florida Division of Real Estate the appraiser used commercial comparables for a planned residential subdivision. Unfortunately for the bank, First Priority of Bradenton they lost millions and it contributed to their failure in August of 2008. Any objective reading of that report would cause a reader to question the validity of the analysis. The administrative case against the appraiser is drawing to a close.

Example # 3

Then there is the case of Coast Bank of Florida scandal. Coast Bank of Florida failed in 2007 and was the first of many to follow in the area. In that case Philip Coon, an executive for Coast Bank, plead guilty to fraud. I testified on behalf of borrowers who were victims of the fraud scheme. The borrowers had been induced into speculating on new residential construction in Sarasota and Charlotte Counties, Florida. At a restitution hearing in Middle District Federal Court in Tampa, Florida I testified that of the 15 appraisals I reviewed in my professional opinion that all 15 violated the USPAP. I also testified that of the 62 sales cited in those 15 appraisals, 33 were inaccurately portrayed.

Some examples of egregious errors were using comparables that were on golf course when the subject was not. Using comparables that over looked multi acre lakes and when the subject was a proposed typical residential dwelling looking directly into the rear of another typical residential dwelling.

In another appraisal performed for the failed Coast Bank of Florida, the appraiser utilized comparables from a golf course gated community when the subject was not on a golf course, nor in a gated community.

In the Coast Bank case borrowers were told that they would only have to pay 90% of the appraised value and would have instant equity. The reality was that the appraisals were inflated and fraudulent. I testified that of the 15 appraisals 9 had a sale price to appraised value ratio of exactly 90%. In the other 6 appraisals the ratio ranged from 87.5% to 89.8%. In no instance did the LTV exceed 90%. The appraisals were not the product of independent, impartial or object analysis. These appraisals were made to order.

Example # 4

In another instance I reviewed an appraisal of a proposed large custom home that was in a subdivision many miles up the Bradenton River. It had water access via a community boat ramp and only a few homes had sold at the time of the appraisal. Several of comparables were waterfront homes in well manicured established subdivisions that were minutes to the Gulf of Mexico. Any objective reading of the report, and a little prudence, would have shown the appraisal to be faulty at the time of underwriting.

Example #5

I reviewed an appraisal of a property in Cape Coral, Florida in which a single family dwelling that is on a canal which does not provide access to the Gulf of Mexico was valued by using comparables sales which have access to the Gulf of Mexico. In that assignment the appraiser ignored sales which had the same type of location and instead inflated the appraisal.

Example #6

Earlier this year I reviewed an appraisal of a property in a high end gated golf course community in Naples, Florida. The original appraisal was performed in late 2006. The value in the original appraisal was estimated at \$4,500,000. A larger house, across the street, had been listed for three months, at a price of \$3,200,000, on the date of value. The subject had sold for \$2,160,000 thirteen months earlier. My retrospective appraisal placed the value at \$2,500,000.

Example #7

I have a pending case in which the appraiser valued a single family dwelling that was across the street from the main entrance to two restaurants. The appraiser stated the property was zoned residential when in fact it was zoned commercial. All of the comparables were situated on nice

normal residential streets. He also utilized sales from many months earlier to supported an inflated value. That appraisal was performed in late 2007.

Example #8

In 2009 I was retained to review a report for Florida's Division of Real Estate. The case is still pending. In that appraisal a new condominium unit which overlooked a wooded area was compared with minimal adjustment to waterfront units with the complexes pool on the edge of Naples Bay.

Example #9

In early 2010, I reviewed an appraisal performed in March of 2008. In that report the appraiser stated the site size for comparable # 3 was 17,000 square feet. Actually the site size for that comparable sale was 52,707 square feet, or 1.21 acres. Any first week trainee would know when they are standing in front of that house taking their comparable photograph that the site was not 17,000 square feet. The appraiser reported he used MLS as his data source which stated the site size was between 1 and 2.5 acres. Aerial images and plat maps also made it clear the site was greater than 17,000 square feet. By understating the site size for the comparable sale the appraiser was able to support a higher value for the subject. The appraiser's license is currently stated as being on probation.

Example #10

There is a well know case in Miami-Dade County in which the appraiser's license was revoked in part because he used false photographs of the comparables. While not charged specifically with fraud he was found guilty of violating the USPAP.

Example # 11

Earlier this year I testified in a Florida Division of Administrative Hearings case in which the judge recommended to the Florida Real Estate Appraisal Board that appraiser be suspended for six months. In that case the judge found

The Department established that the use of Comparable Sale 1 was inappropriate. The unit was over 700 square feet larger than the Subject Property. There were other properties, which were closer in similarity to the Subject Property than Comparable Sale 1. Based on Mr. Coleman's testimony, the use of Comparable Sale 1 was to get a higher value for the Subject Property.

The case will probably be finalized at the October 2010 meeting of the Florida Real Estate Appraisal Board as the judges Recommended Order must be adopted by the FREAB.

I have had students tell me in continuing education classes that they have been ordered to ignore physical deficiencies such as missing kitchens, damaged walls, and inoperable mechanical systems. Many of those students then stated that by failing to violate the Uniform Standards and Florida Law they lost clients.

The story I have heard most often is the client saying he could not use the appraisal because the value was what they needed. This is twisted logic as the appraisal is intended to help the client make logic well supported decisions, not to accomplish a preordained goal.

The fallout

I have provided eleven examples of which I have first hand knowledge. I could provide dozens more, but I would only be conveying the same basic facts. Rather than remaining independent, impartial and objective as directed by the Uniform Standards of Professional Appraisal Practice. Too many become “rubber stamps” to help clients accomplish goals.

The belief of many was “So what, who does it hurt”. The reality is that many people who never even participated in the real estate boom have been injured. Those people had higher assessments on their properties because of inflated sales prices. They invested in the stocks of companies whose shares have plummeted because of the financial fallout. They have had the value of their property collapse as some areas have become foreclosure ghost towns.

Also it cannot be forgotten that many borrowers went to lenders and did not ask how much they could afford, instead they asked how much they could get. Then the lender used their preferred appraiser to push the deal. And for the past two years we have been seeing many of those borrowers default on those loans. This has caused emotional pain to families far beyond what ever could be counted.

The rising values hid many sins.

The risk to you effects your decisions

Before the mortgage securitization existed lenders were very prudent in how they acted. They were cautious because the loans sat on their books and defaults caused immediate pain to them. The more steps between the borrower and the holder of the risk the greater the chance for people to take short cuts. People who were compensated based on production ruled the day. All the way from the salespeople at the local real estate broker, to the mortgage broker, to the account executive at Option One, to the executives at Fannie Mae and Freddie Mac. In order to accomplish as much production as possible the unethical, and incompetent, appraisers were pushed to the front of the line and the ones who stayed true to their professional standards were shoved aside in favor of the number hitters.

The people who bought the CDOs and MBS have seen them plummet in value. The old prudent underwriting standards, including true appraisals, were abandoned. Even today too many lenders pick their appraisers based upon fee and turn around time, as opposed to qualifications.

Honest, competent, appraisers can quickly spot the shenanigans. The problem is that law enforcement has not recruited forensic appraisers in the same way they have recruited forensic accountants. That state appraisal boards are under funded. And lastly civil courts have not been apt to punish bad appraisers, or the people who use them in their schemes.

Only when it is painful to be an appraiser caught breaking the rules, or someone using a bad appraiser to move your agenda forward, will the situation reverse itself.

Addendum

Qualifications of Dennis J. Black, MRICS, ASA, IFAC

Exhibits provided to the court in the Coast Bank Scandal
(Comments have been added to convey my oral testimony)

These relate to Example #3

DENNIS J. BLACK, MRICS, IFAC, ASA

Mr. Black has twenty-nine years of experience in the real estate profession. He began his career as a salesperson and after five years I became a branch office manager for an eight office real estate brokerage firm. He then began performing residential appraisals for mortgage lending purposes. Over the next fifteen years, he completed thousands of residential valuations as well as hundreds of non-residential appraisals. These properties have included apartment and office buildings, marinas, private extraction sites, lumberyards, and recreational venues, such as health & pool clubs, bowling alleys, and miniature golf courses. In 1997, he moved from New Jersey to Florida and from July of that year to May 1998 the Charlotte County Property Appraiser's Office, employed him. He was part of the Commercial Property Section, and assigned to income producing properties. Since then, he has been active as an appraiser, broker and consultant, servicing the southwest Florida market. He has also provided over one thousand hours of instruction in real estate valuation standards and methodologies. He is recognized as an expert witness regarding appraisal standards.

AWARDS

NAIFA 2008 National Instructor of the Year
NAIFA 2009 National Appraiser of the Year

LICENSES – PROFESSIONAL DESIGNATIONS:

Appraisal Qualifications Board – Certified U.S.P.A.P Instructor (2002)
National Association of Independent Fee Appraisers – Councilor Member – IFAC (2008)
National Association of Independent Fee Appraisers – Senior Member – IFAS (1997)
National Association of Independent Fee Appraisers – Senior Certified Instructor (1998)
Accredited Member American Society of Appraisers – ASA (2007)
American Society of Appraisers – Real Property Faculty Member (2008)
State of Florida – Certified General Real Estate Appraiser #RZ 0002377 (1998)
State of Florida – Licensed Real Estate Broker # 0681814 (2002)
Member Florida Association of REALTORS (1999)
Marshall & Swift – Certified Instructor of Commercial Building Costs (1995)
Marshall & Swift – Certified Instructor of Residential Building Costs (1995)

PROFESSIONAL OFFICES HELD:

NAIFA National Board of Directors 2001, 2002, 2003
NAIFA National Education Committee Chair 2002, 2009
NAIFA National Education Committee Member 2000, 2001, 2003
NAIFA National Professional Standards Committee Member 2008, 2009
NAIFA Education Liaison to American Society of Appraisers 2008 & 2009
NAIFA Regional Governor 1999
NAIFA Florida State Director 1999 & 2008
NAIFA Mid Gulf Coast Chapter President 1998

DENNIS J. BLACK, MRICS, IFAC, ASA (cont)

CONTINUING EDUCATION COURSES AUTHORED

Comprehensive Continuing Education for Appraisers (2000)	23 hours
Valuing Real Estate in a Changing Market (2007)	8 hours
NAIFA Marshall & Swift Residential Handbook (2000)	8 hours
NAIFA Marshall & Swift Commercial Handbook(2000)	8 hours
Solving Tough Residential Appraisal Problems (2009)	7 hours
The New Fannie Mae Forms (2004)	7 hours
Construction Terms and Methods (2002)	5 hours
The Real Fannie Mae Guidelines (2002)	5 hours
ANSI Standard Z 765 (2000)	5 hours
NAIFA Valuing Undivided Fractional Interests (2000)	4 hours
Florida Law Update (2006, 2008, 2009)	3 hours
The Role of the Supervisor (2007, 2010)	3 hours

OTHER PUBLICATIONS

North Port Revealed – Released in March of 2007 it is a self published comprehensive analysis of the City of North Port, Florida. It laid out the case that the city’s rampant “spec” building was collapsing and that values would plummet. It led to the Sarasota Herald Tribune writing a story about Mr. Black and the study. Because of this publication he was featured in Florida Trend magazine, which is Florida’s most circulated business magazine. This study was an outgrowth of the course *Valuing Real Estate in a Changing Market*. It should be noted single family real estate values have fallen by as much as 75% in some parts of the city and thus the thesis was shown to be correct.

Analyzing Marinas and Boat Storage in Today’s Market – Valuation Strategies, published by Thomson Reuters. This is a 2,800 word article published November 2009 issue. It is an outgrowth of his NAIFA –IFAC counseling designation thesis.

DENNIS J. BLACK, MRICS, IFAC, ASA (cont)

FEATURED REAL PROPERTY EDUCATOR

- NAIFA National Conference – St. Louis 1999
 Undivided Fractional Interests
- IAAO State of Florida Conference - Orlando 2000
 Commercial Marshall and Swift
- ASA International Conference - Orlando 2009
 Valuing Real Estate in a Changing Market
- NAIFA National Conference –Atlantic City 2009
 Valuing Real Estate in a Changing Market

APPRASIAL TEACHING EXPERIENCE

He has have taught over 1000 hours of real estate appraisal education since 1992. He has taught continuing educations seminars which have been sponsored by the National Association of Independent Fee Appraisers, the American Society of Appraisers, the Appraisal Institute and the International Association of Assessing Officers. He also has taught for four different propriety schools, two being in New Jersey and two being in Florida.

He has taught in the following states

Continuing Education

Arizona
Arkansas
Florida
Georgia
Illinois
Louisiana
Maryland
Massachusetts
Minnesota
Mississippi
Missouri
New Jersey
New York
North Carolina
South Carolina
Tennessee
Texas

Qualify Education

Florida
New Jersey

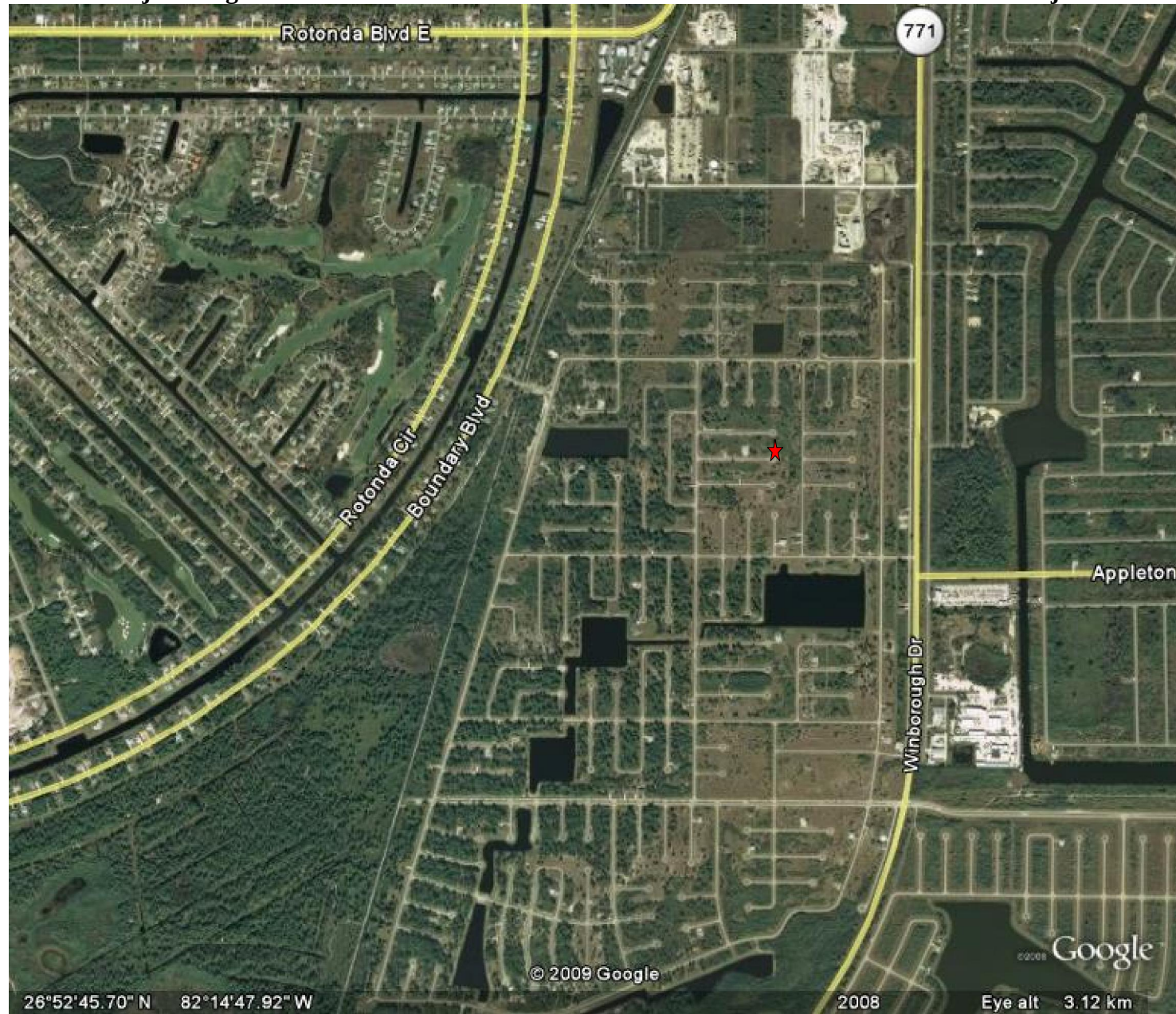
Coast Bank testimony exhibits

Lot 113 Transon Rotonda West, Florida



Subject Neighborhood

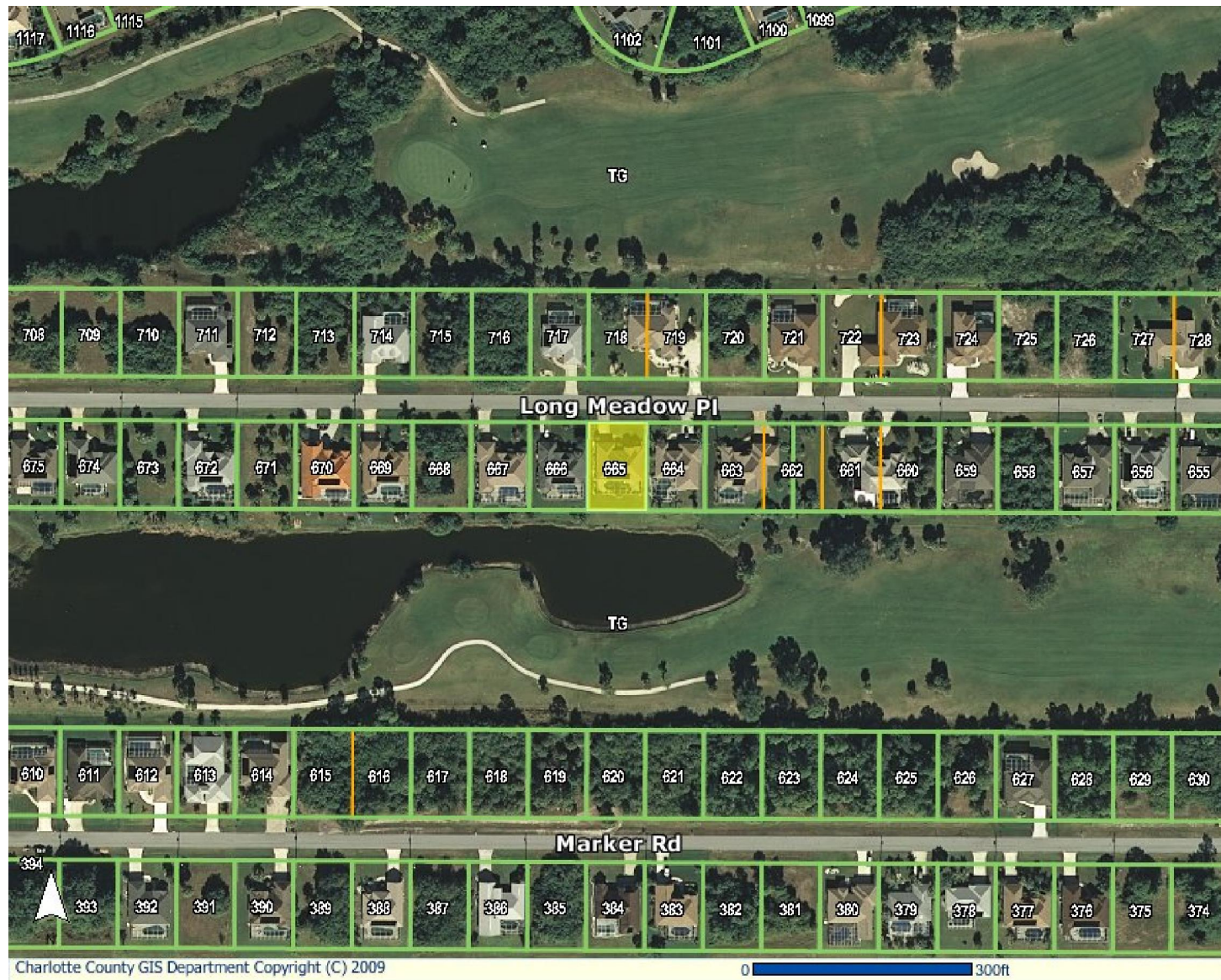
Red Star Indicates Location of Subject



Comparable # 1 is misrepresented. It had a pool at the time of the sale which is not mentioned by the appraiser. According to county records the pool was built in 2001. If the pool had been considered it would have indicated a lower value for the subject.



Comparable # 2 is misrepresented. It is located overlooking a pond and part of a golfcourse. If this had been mentioned and considered by the appraiser it would have indicated a lower value. The below image is from Charlotte County GIS.



Dennis J. Black, MRICS, ASA, IFAC

This photograph was taken by Dennis J. Black, IFAC, ASA on December 4, 2009. This is the view from the backyard of comparable # 2.



Comparable # 3 is misrepresented. It had a pool at the time of the sale which is not mentioned by the appraiser. According to county records the pool was built in 2001. If the pool had been considered it would have indicated a lower value for the subject.



Comparable # 3 is misrepresented. It had a waterview at the time of the sale which is not mentioned by the appraiser. If the waterview had been considered it would have indicated a lower value for the subject.



Comparable # 4 is misrepresented. It had a pool at the time of the sale which is not mentioned by the appraiser. According to county records the pool was built in 1996. If the pool had been considered it would have indicated a lower value for the subject. This photo was taken by Dennis J. Black, IFAC, ASA on December 4, 2009.



Comparable # 4 is misrepresented. It had a waterview at the time of the sale which is not mentioned by the appraiser. If the waterview had been considered it would have indicated a lower value for the subject. This photo was taken by Dennis J. Black, IFAC, ASA on December 4, 2009.



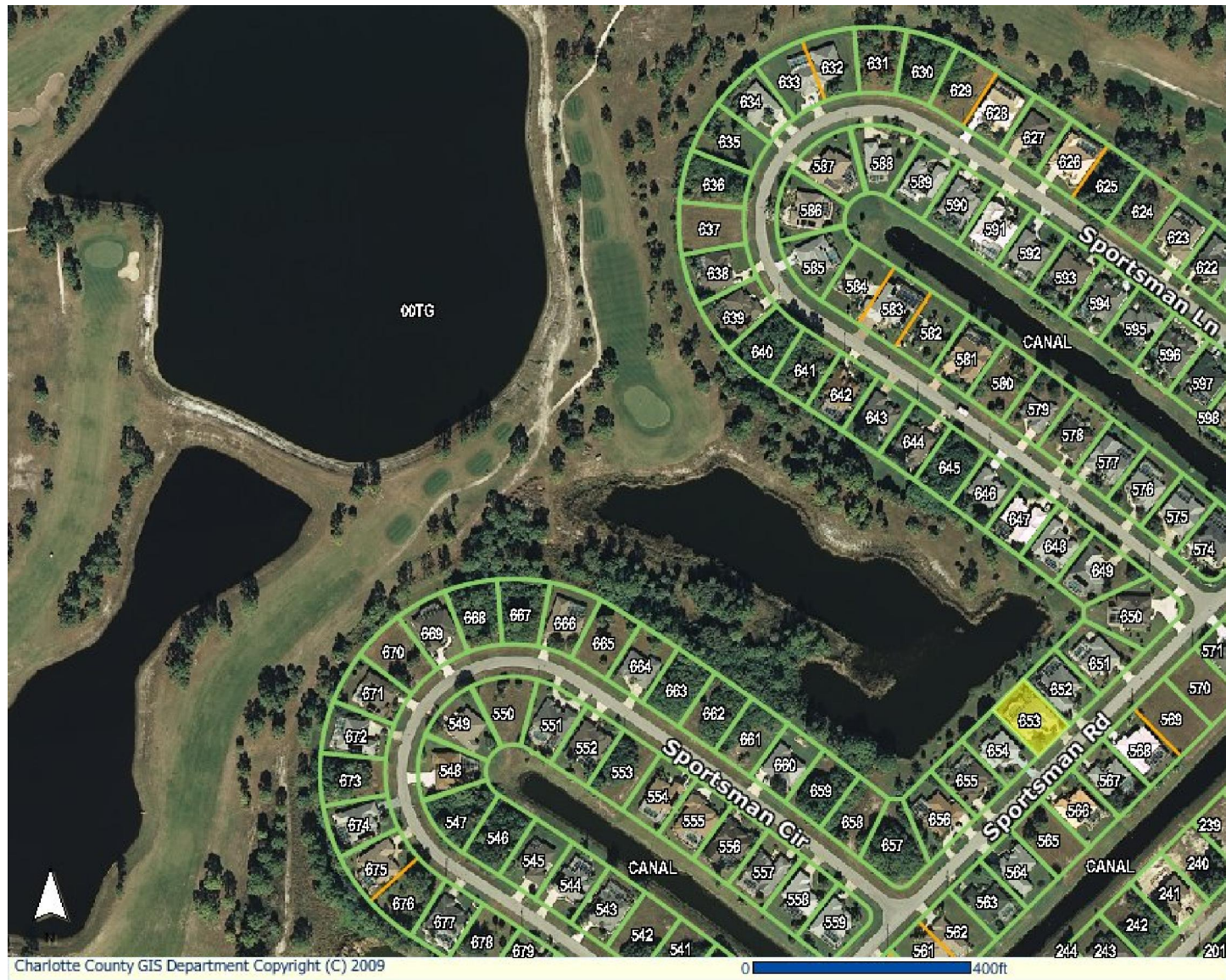
Comparable # 5 is misrepresented. It had a pool at the time of the sale which is not mentioned by the appraiser. According to county records the pool was built in 1996. It has a 20,000 square foot lot not a 10,000 square foot lot as portrayed by the appraiser.



Comparable # 5 is misrepresented. It not only had a two car garage at the time of sale but a detached 308 square foot detached garage. Also it is located on a greenbelt. This photo was taken by Dennis J. Black, IFAC, ASA on December 4, 2009. If the pool, the double lot and greenbelt had been considered it would have indicated a lower value for the subject.



Comparable # 6 is misrepresented. It is located on a large pond which gives it vastly superior privacy than the subject. In fact the view is so long and nice that the owner has a telescope set up in the pool area looking out over the lake and golfcourse in the distance.



View from the rear of Comparable #6

