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Appraiser, Gary Crabtree Written Testimony Before the FCIC

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Affiliated Appraisers

REAL ESTATE APPRAISAL AND CONSULTING

**STATEMENT OF GARY T. CRABTREE, SRA
to the FINANCIAL CRISIS INQUIRY COMMISSION
September 7, 2010**

Good morning Mr. Chairman, Vice Chairman, and members of the Commission. Thank you for the opportunity to testify before you today regarding my personal views and opinions of the effects of the financial crisis upon the Greater Bakersfield community and its single family real estate market.

I have been requested to address four specific questions:

1. What was the impact upon the residential housing market?

The impact was and is the most dramatic I have even witnessed as a 48 year veteran independent real estate appraiser in Bakersfield. For your convenience and understanding I have included several charts and graphs the visually depict the impact of the crisis upon our community. The charts give a 10 year history of the Bakersfield market starting in 2000. From 1993 through 1998, the Bakersfield market underwent another housing recession that was caused by unemployment due to the downsizing of the military-industrial complex and had started its recovery . At that time, FHA financing was the "gold standard" for our community, with conventional loans that did not exceed a 90% LTV ratio and always was covered by PMI. On June 10, 1999 in a press release, then Secretary of HUD, Andrew Cuomo announced a "new initiative" to protect homeowners that were buying HUD homes from appraisals that failed to uncover needed repairs that would place the homeowners at risk. This initiative resulted in the most dramatic and cumbersome appraisal inspection and report in FHA history. The advent of HUD Handbook 4150.2 turned the process from one of appraising to also becoming a home inspector. I mention this as a possible mitigating factor to the advent of the so called "sub-prime" loan as homebuyers turned to an easier and faster way of financing their purchases, not to mention the ease of qualification. In September, 1999 I remember reading an article in the New York Times by Steven A. Holmes that indicated that the Clinton Administration was pressuring the GSE's to expand their portfolios to more low and moderate income people. Today, its hard to forget the prophetic quote of Peter Wallison, a resident fellow of the American Enterprise Institute, when he said "From the perspective of many people, including me, this is another thrift industry growing up around us. If they fail, the government will have to step up and bail them out the way it stepped up and bailed out the thrift industry."

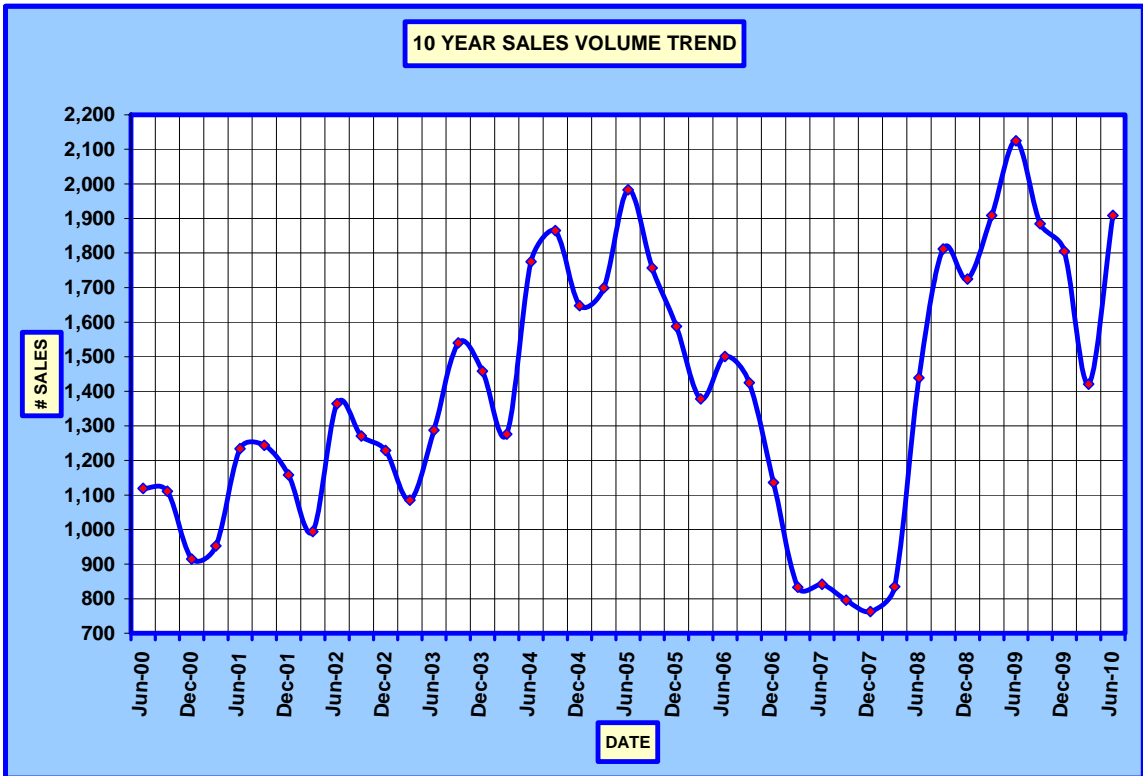
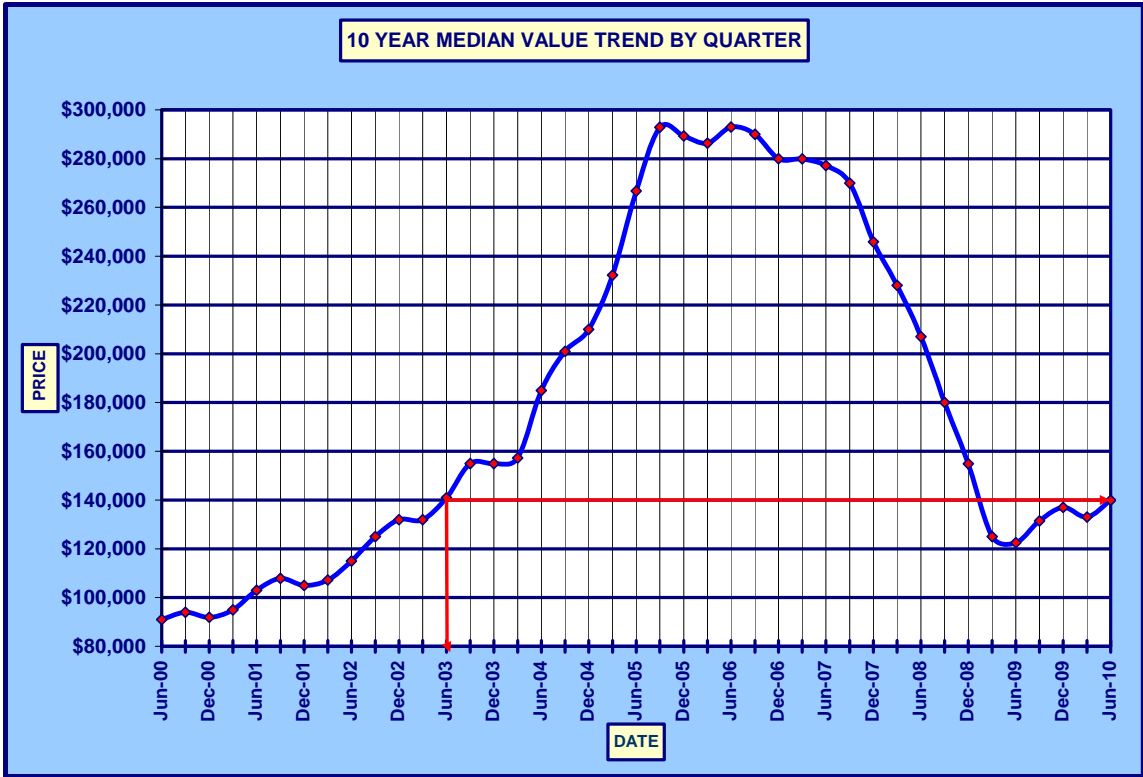
In 2000 the market was still in recovery from the recession with stable market conditions. In 2001, the market experienced a modest 10% increase in prices with unsold inventory at 3.1 months. In 2002, prices increased 26% to \$135,000

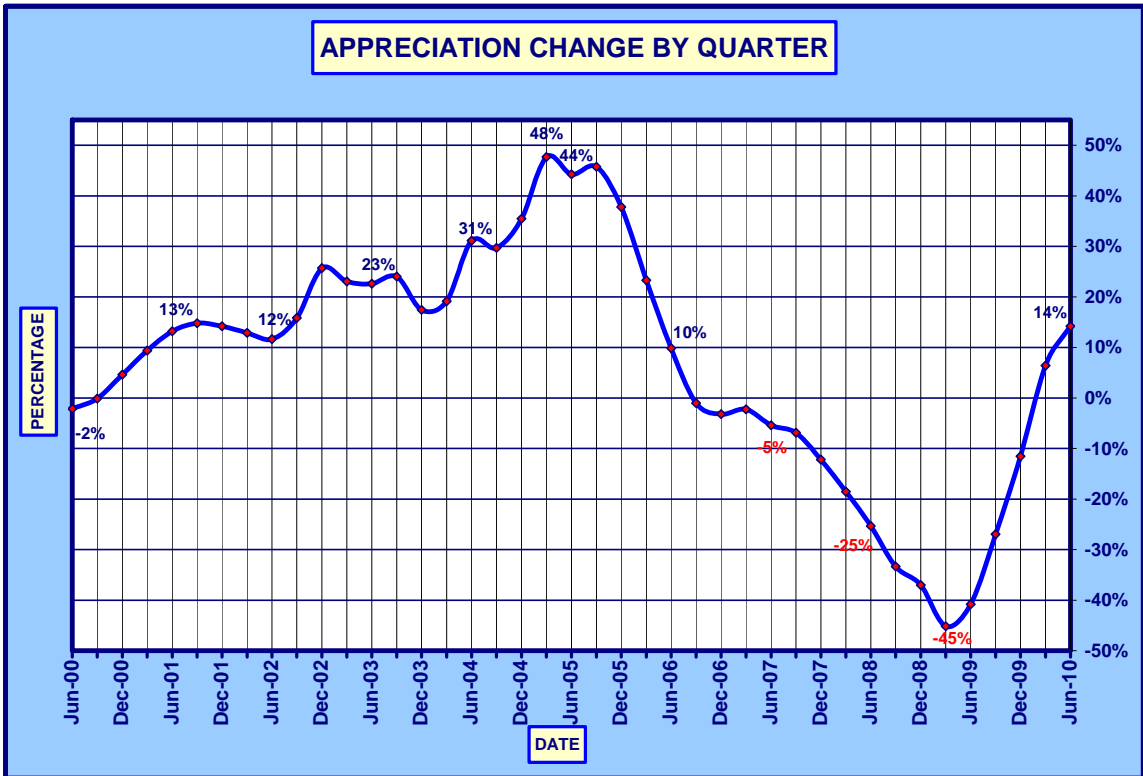
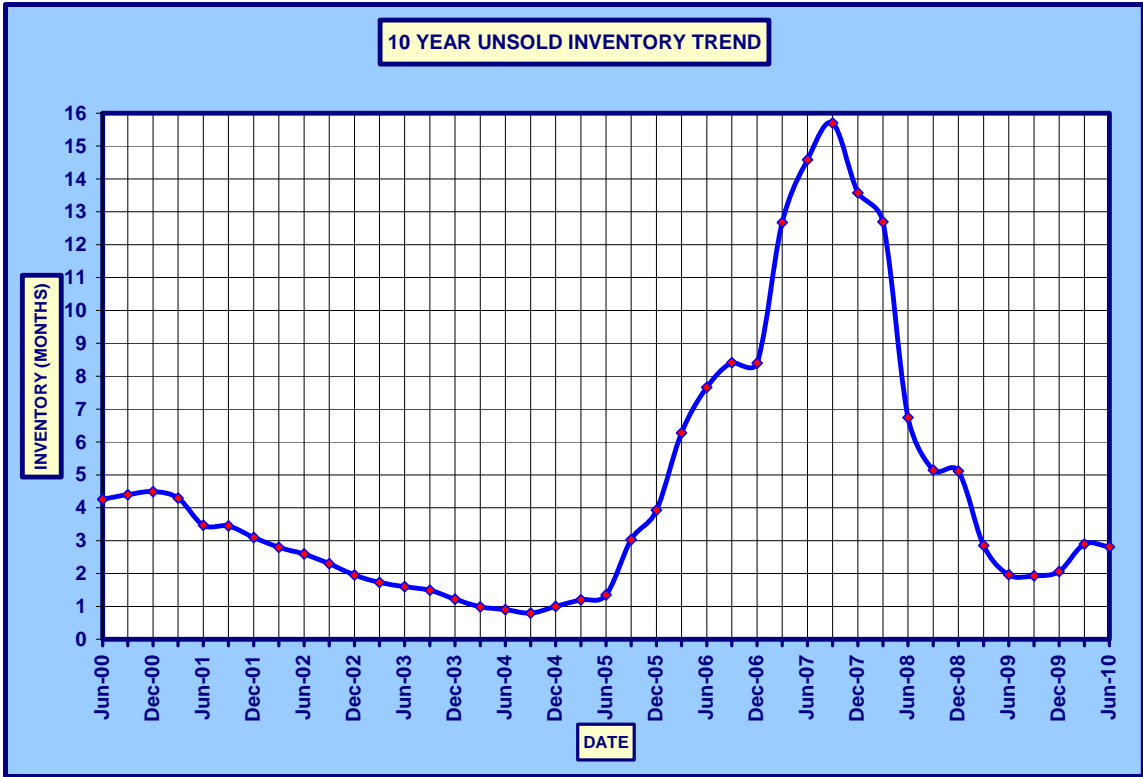
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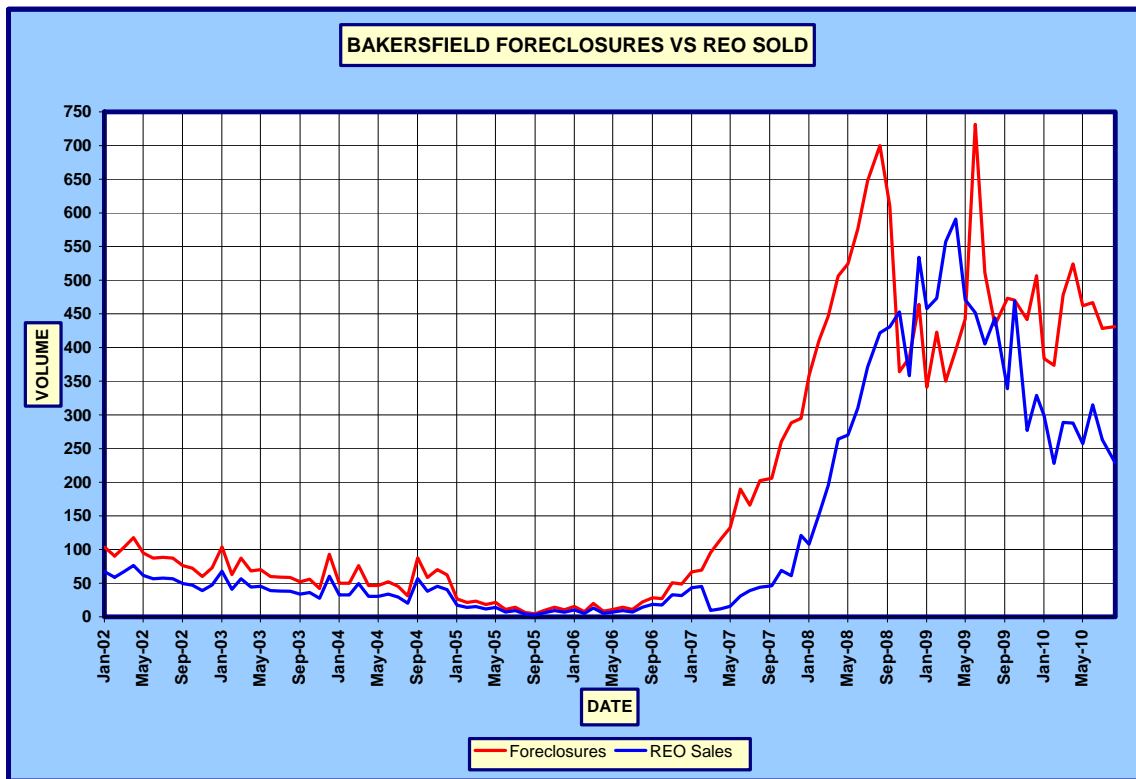
with a significant increase in sales volume depleting the unsold inventory to 1.7 months. 2003 saw a price increase of 17% to \$155,000 with increasing sales volume and reducing the unsold inventory to 1.2 months. 2004 was the start of a true buying frenzy with prices increasing 35% to \$210,000 with a record 6,564 closings and a 1 month unsold inventory and in September, 2004 there were only 496 homes in the entire city on the market, but 2005 turned out to be the peak year in which prices increased 38% to \$289,341 but inventory was mounting ending the year with 3.9 months unsold inventory. Pricing peaked in June, 2006 at \$292,990 on a total sales volume of 5,440 sales and by the end of 2006 unsold inventory had increased to 8.4 months. In 2007, it began its price decline in earnest falling 12% to \$280,000 with sales volume declining 41% to 3,234 and unsold inventory peaked at 15.7 months. 2008 saw a price decrease of 37% to \$154,900 with an 80% increase in volume to 5,811 sales as the foreclosures began to be absorbed into the market with unsold inventory declining to 5.1 months. Prices continued to decline in 2009 by 12%, however the market "bottomed" in April, 2009 at \$115,000 and subsequently has started a very long and slow recovery by "bouncing along the bottom" for the past year. The end result was a market that experienced the "highest of highs" being rated as the fastest appreciating market in the U.S. in 2006 and the "lowest of lows" being rated as the fastest depreciating market in the US in 2008.

In my opinion, the impact upon the Bakersfield market was:

- An unprecedented and unsustainable housing growth without any meaningful accompanying job growth, except for the construction and service related sectors.
- Valuable farm lands that were taken out of production in favor of "leap-frog" developments with an excess of 34,000 permitted lots that remain partially developed or undeveloped.
- A community that lacked the infrastructure to handle the growth thus turning the road structure into one of "gridlock" and the advent of special assessments via permitting fees that increased building costs to a point where construction was no longer economically feasible.
- Record price increases that drove a "buyers panic" that they were about to miss out on home ownership, thus reverted to "sub-prime" mortgages including the falsification of earnings, employment and financial statements.
- With the escalating home prices in the rest of the state and the Bakersfield market with a mean price of approximately 50% of the state median many homebuyers "immigrated" to Bakersfield due to its housing affordability. In a buyer motivation survey I conducted in the first half of 2006, I found that 3 of every 4 homebuyers were local residents that were "moving up" in price thus vacating the "entry level" market for first time homebuyers. 1 in 5 buyers "immigrated" from other parts of the state with the vast majority coming from Southern California to occupy the "entry level" existing and new home market. That increase also brought increased crime levels especially related to gangs. According to my survey, the average buyer lived in Bakersfield, was a two income family that purchased an averaged priced home of \$368,371 with a P/E ratio of 4.18 times their annual income. The average entry level buyer was a two income family, that purchased an average priced home of \$239,999 with a P/E ratio of 6.22 times their annual income.







2. When did you begin to observe changes in the local real estate market and what changes did you observe?

It was in 2003 - 2004 I first began to notice unusual changes in the market. Farm land acquisitions began to take place by builders for single family development. At the time, I recall single family entitled land was selling for \$5,000 to \$6,000 per acre in outlying areas to \$16,000 to \$18,000 per acre in areas in the "growth path". At the peak, the same type of land with "paper lots" was selling for \$160,000 to \$180,000 per acre.

The home builders, for the most part, were local builders with only a couple of "national" homebuilders on the scene. Next thing you know, the "national home builders" started acquiring the local builders or the local home builders exited the market as they could not effectively compete. I also noticed a decline in the quality of construction with changes in style and cheaper finish materials, yet prices continued to increase.

Individual small mortgage companies catering to individual ethnic groups increased dramatically. Large real estate brokerages began opening their own mortgage companies to capitalize on the additional income available in the conventional and "sub-prime" markets. I also noted that these mortgage companies all seemed to have their own "special group" of "favorite" appraisers.

In May 2006, as I was performing my due diligence in the confirmation of the comparable sales I was using in my appraisal reports, I began to notice transactions that did not make logical sense. As an example while searching for and confirming comparable sales data, I noted a property that was listed for

\$565,000 yet sold for \$605,000 with 100% financing from Sun Trust Mortgage. 28 days later the property was placed back on the market for \$580,000. After several calls to the selling agent, he finally admitted to me that the actual sales price was \$535,000. I then researched the MLS and public records and found that the buyer and the buyers agent worked for the same real estate brokerage and the loan was funded through the brokerage's mortgage company that used their "favorite" appraiser to obtain the "needed" value. Further research revealed that the buyer executed a deed of trust that required him to occupy the property as his principle residence within 60 days. I subsequently visited the property every time I was in the area, and never found the home occupied. In June 2007, a notice of default was filed and a notice of trustee's sale was filed in December, 2007 with Sun Trust acquiring the property in January 2008 for \$533,769. The property was finally resold in July 2008 for \$322,000 resulting in a loss \$283,000 plus foreclosure costs and commissions to the lender.

For fear of using these type of transactions as comparable sales in my appraisal reports, I began performing "additional" due diligence by researching, in detail, all of the sales I used in my appraisals. To this end, I developed data on a total of 214 fraudulent transactions through the end of 2006 and into early 2007.

One of my life's "cornerstone" verses comes from Leviticus 19:11 - "Do not steal, deal falsely, nor lie to one another". With this in mind, I selected three cases of mortgage fraud and, to the best of my ability, fully documented them and reported them to the Kern County District Attorney, the Federal Bureau of Investigation, the California Department of Real Estate and the California Office of Real Estate Appraisers in late October, 2006. To date, the end result of this filing is that one real estate broker and one real estate agent has had their license revoked and one real estate appraiser had his license suspended for 60 days and is on probation for 5 years and the case has been under investigation by the FBI for 3 years and 9 months with 4 "minor parties" pleading guilty to different elements of mortgage fraud and the case remains on going.

I also began to report the incidences of mortgage fraud to the lenders that were being defrauded, only to be met with indifference by quality assurance departments. I would call, some would call be back and thank me for reporting the fraud to them. Option One Mortgage was one that was especially grateful. Others would thank me but never seek any other additional information, and others would not even call me back. I recall one very specific phone conversation with a quality assurance officer at Fremont Investment and Loan. After I had related my evidence of mortgage fraud on one of their transactions to him, he replied "don't put your nose where it doesn't belong" and hung up on me.

As the crisis deepened, I observed builders with speculative or standing inventory starting to offer deep discounts and/or incentives up to as much as \$60,000 on homes priced in the \$350,000 to \$400,000 range. Other typical builder discounts included incentive packages of \$10,000 to \$15,000 for "upgrades", loan buy downs or closing costs.

Other builders with unsold homes, began selling their inventory to "investors" and "property flippers" that used "straw buyers" and sub-prime lenders to procure 100% financing. Some properties were rented for a short time but eventually all ended up in foreclosure.

Between the months of September 2007 and August 2008, I researched a total of 1,944 properties that were sold and then went through the foreclosure process. The results of that research are cited in the table below:

#of Properties	Gross ReSale Price	Gross Loans	Loss	Loan Loss Per Home
1,944	\$390,419,173	\$626,322,789	\$235,903,616	(\$121,350)
Mean Sale Price	Mean Sale Date	Previous Sale Price	Previous Sale Date	Price Decline per Home
\$222,784	2/29/2008	\$362,510	3/18/2006	(\$139,726)
Purchase Loan	Refinance	Hispanic	Asian	Other
63.2%	36.8%	55.1%	3.9%	41.0%

I continued to track the foreclosure re-sales through December, 2008. By the end of that period, a total of 3,914 properties were sold at an estimated loss to the lenders of \$438.2 million not including foreclosure costs and re-sale commissions.

3. What was the financial impact upon your business?

In April 2007, I "blew the whistle" on the fraud that was taking place in our market via an article published in the *Bakersfield Californian*. Almost immediately I experienced a dramatic decline in appraisal assignments from lenders. In 2005-06, 72% of my appraisal assignments were from lenders. In 2007 that market share declined to 36%. That also resulted in a 34% decrease in my adjusted gross income generated from my appraisal business.

Since I had developed extensive files on fraudulent transactions, I was naive enough to believe that end lenders would be interested in "forensic appraisal reviews". That was not even close to the case.

I then changed my business model to performing appraisals for estate and litigation (family law) purposes and was able to retain my relocation company and a few long term relationships with major banking clients.

As an aside, I wish to address the appraisal component in the financial crisis.

The appraiser and the appraisal process was placed in the transaction to provide an "independent" third party opinion of market value thereby insuring all parties to the transaction that the "public trust" is protected.

The top level issues and problems with the appraisal profession are highlighted below:

- Greed
- Total breakdown in oversight and enforcement

- Title XI gutted by de minimis and other exemptions (including complete exemption for Fannie/Freddie) - absolutely the wrong signal to send to the market
- Loan Production became the dominant force within institutions
- "Shadow" mortgage lenders who had virtually no oversight
- Mortgage brokers running in the Wild West
- Appraisal and Risk management marginalized
- Federal regulators writing rules but not enforcing them
- For appraisal, this meant a marginalization of the appraisal function within institutions (independence) and a commoditization ("race to the bottom") of a professional service
- Within appraisal profession:
 - Licensing provided a false sense of security - marginally qualified appraisers
 - Appraisal regulators feeble attempts to conduct meaningful enforcement as I have related in the one fraud case cited above
 - The issues surrounding the HVCC, AMCs, mortgage brokers are smokescreen for the real problem of a marginalized collateral valuation process (emphasis on price/turnaround times over competency, hitting the "number", "papering the file," AVMs/BPOs considered equivalents to appraisals, etc.)
- Timeline:
 - 1989 - FIRREA
 - 1994 - Final federal regulations adopted with 12 exemptions, and a de minimis allowance exempting any federally related transaction under \$250,000 which comprise a substantial portion mortgage loans
 - 1994-2003 - bank regulators washed their hands of appraisal oversight, and turned it over to state regulatory appraiser boards who were and are ill-equipped to provide oversight and enforcement. .
 - 2003 - Bank regulators release "Independent Appraisal and Evaluation Functions" - "The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) (the agencies) are jointly issuing this statement to address concerns identified during examinations about the independence of the collateral valuation process."
 - 2005 - Bank regulators release Frequently Asked Questions on the Appraisal Regulations and the Interagency Statement on Independent Appraisal and Evaluation Functions - "The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the National Credit Union Administration (the agencies) prepared this document in response to questions from federally regulated institutions (regulated institutions) on existing standards for selecting appraisers, ordering appraisals, accepting transferred appraisals, and other related topics."
 - 2007 - Cuomo investigation
 - 2008 - HVCC released and finalized between Cuomo and the GSE's.

- 2008 - HERA Act (FHA to use certified appraisers but ignored the law requiring verifiable FHA appraisal education, reducing appraisal quality.)
- 2009 - HVCC in effect which resulted in the following:

On May 1, 2009, my long term relationship with banks ceased as the Home Valuation Code of Conduct (HVCC) took effect. One major bank removed me from their panel on April 30, 2009 without notice. Although the HVCC looks good on the surface, it turned out to be a "nightmare" for the appraiser. The agreement, in essence, created a new unregulated industry called Appraisal Management Companies (most of which are controlled by the major banks, title and closing services companies.

As a point of reference, my "customary and reasonable" fee for a lender appraisal from 1997 to 2001 was \$325 and today it is \$400 or an increase of 23% over the past 13 years. With the Appraisal Management Companies now in control of 85% of the lender work, the fees offered to appraisers now range from \$175 to \$275 with a predominant fee offer of \$250. The resultant "cram down" fees has created an extreme financial hardship for experienced and ethical appraisers. The vast majority of the AMC appraisal work is being performed by lesser experienced appraisers whose work product is sub-standard and many times not creditable. A significant amount of local appraisal work is being performed by (out of area) geographically incompetent appraisers.

The "cram down" fees have caused a dramatic decline in licensed appraisers as evidenced by the hemorrhaging in California. At its peak California had over 21,000 licensed appraisers. Between the advent of HVCC and the "cram down" fees of the AMC's, California has lost over 3,000 licensed appraisers and are losing an average of 40 licensees per week. What is even more alarming is 23 of the losses are trainees, thus creating a future crisis as the "graying" of this profession continues. I would argue that the crisis has already begun. As an example, in May there were a total of 552,800 home sales in California with only 9,527 qualified appraisers available. If every sale were in need of an appraisal, each appraiser would have to average 2.9 appraisals per day, a physical impossibility. If some action is not taken, I suspect that lenders, including the GSE's will turn to AVM's and BPO's, both inferior valuation products, to fill the void left by the professional appraiser.

Further, It is my opinion, that the use of these AMC appraisers has resulted in a repression of a price recovery as these appraisers consistently value the property below the sales price thus causing either the transaction to fail or the lowering of the price that becomes a new comparable sale in the neighborhood thus further repressing the values. One only need to inquire of almost any Realtor that has lost a transaction to this phenomenon.

4. What is your perspective of the extent of mortgage fraud in the Bakersfield area?

It is my opinion, that mortgage fraud did play a major role in this crisis. Although I have been biased by the number of cases that I personally discovered and after the release of the April, 2007 article in the *Bakersfield Californian*, I became a "lighting rod" for the reporting of fraud cases by Realtors and individuals "that did not want to become involved."

Cases that covered the full spectrum of the different frauds taking place. Here are some examples:

- A young Hispanic "fry cook" making \$22,000 per year was paid \$5,000 to act as a "straw buyer" for a lender-loan officer team that reported him as a self-employed food cater earning \$65,000 per year to perpetrate a property flip for a \$70,000 profit and using two out of area appraisers to "value" the property.
- A Realtor that artificially inflated 7 properties by \$50,000 to obtain "cash back" from the sale transaction using "one favorite appraiser". Loss to lenders - over \$800,000.
- A mortgage loan officer team that purchased over 40 properties using relatives as "straw buyers" and then renting them until default and foreclosure.
- A Realtor using to relative to purchase homes with sellers in distressed conditions, then artificially inflating price using a "favorite" appraiser and then demanding \$70,000 to \$100,000 of the seller proceeds upon close of escrow.
- Loan officers and Realtors knowing fully well the buyer would not qualify, and preparing false loan applications and documents to "make the deal".
- Loan officers that had qualified buyers for FHA or conventional financing, but instead, placed them in Alt-A or Sub Prime loans to make an additional \$3,000 to \$5,000 bonus commissions depending upon the yield-spread premium at the time.

According to one mortgage fraud attorney, if all of the loans made during this period were audited, 7 of every 10 would reveal, at least, one false document.