*An INSITE investigation spotlights a major cause of the crisis in America's financial system which could seriously undermine the Federal government's scope for action if the economy dives into a recession.*

# Rotten to the core

LAND speculators have used crooked appraisers to help them get rich. The corruption has undermined the viability of hundreds of savings and loans associations (S&Ls) – the equivalent of Britain's building societies.

This makes the prospects of an economic crisis far more serious than commentators generally suggest when they emphasise the huge Federal deficit and the Third World debt.

Attention usually focuses on the speculative boom in Texas real estate, which has led to the closure of many Sunbelt banks. About 1,500 banks are now in the care of the Federal Deposit Insurance Corporation (FDIC). Another 200 casualties are expected, which includes the 87 that failed in the first six months of this year.

In fact, the speculation has been nationwide, and has as its chief feature the systematic bilking of billions of dollars from defenceless investors. Yet commentators limit their analysis to a criticism of "America's flawed credit system", in which blame is assigned to "the incompetent and the imprudent [who] have been able to bid for deposits based on subsidised credit in the form of the federal government's pledge to bail out insured depositors" (*The Economist*, July 18). No mention here of fraud.

The US government may not now be able to cope with a serious recession, for the Federal insurance which takes the risk out of placing money with S&Ls and banks has created an enormous financial problem.

So far, the cost to the Federal agencies of troubled S&Ls – between 500 and 1,000 are either bust or almost insolvent – has been placed at upwards of $80 billion. A bail-out would cost "more money than the Marshall Plan" to rebuild war-torn Europe, to quote Donald Shackleford, chairman of State Savings Bank of Columbus, Ohio.

The net result is that the most powerful Western economy is now built on a rotten financial foundation.

**FACT: The Federal Government currently guarantees mortgage loans totalling $482 bn.**

### THE U.S. BANK CRISIS

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|---|
| Banks[1] | 10 | 10 | 42 | 48 | 79 | 120 | 145 |
| Problem Banks[2] | 217 | 223 | 369 | 642 | 848 | 1140 | 1484 |
| Savings & Loans[3] | 4613 | 4292 | 3825 | 3502 | 3393 | 3197 | 3078 |

*1. Total banks closed or assisted*
*2. FDIC-insured commercial and savings banks officially considered problems.*
*3. Number of savings and loans associations*

**"Faulty and fraudulent real estate appraisals are an increasingly serious national problem. Their harmful effects are widespread, pervasive, and costly. They have seriously damaged and contributed directly to the insolvency of hundreds of the Nation's financial institutions and have helped cause billions of dollars in losses to lenders, private mortgage insurers, investors, and Federal insurance funds.**

**Responsibility for this problem rests with those who perform appraisals or base lending and related mortgage insurance/investment decisions on appraisals they know or should have known were improper or inaccurate. Equally culpable are the Federal agencies that regulate or oversee lending and mortgage insurance/investment activities and programs."**

*— Verdict of the Congressional Committee on Government Operations in its 48th report, p.4 (Sept. 25, 1986).*

A CONGRESSIONAL investigation has identified the scope of the corruption. Leading the campaign for reform is Rep. Doug Barnard, Jr., chairman of the subcommittee on Commerce, Consumer and Monetary Affairs Committee on Government Operations, who wants to impose tighter controls over appraisers who are supposed to estimate the market value of property. Earlier this year, at hearings into the Real Estate Appraisal Reform Act, he declared:

"What the subcommittee found in the real estate loan portfolios of virtually every failed S&L and in many problem commercial banks, was that faulty or abusive appraisals

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were systematically used to deceive bank examiners and to make speculative or even fraudulent real estate loans look secure." He cited examples:

• Investigations into the insolvencies of 33 California S&Ls revealed that appraiser misconduct was directly involved in thousands of defaulted real estate loans and investments that will cost the Federal Savings and Loan Insurance Corporation (FSLIC) $3.5 bn.

• The General Accounting Office has confirmed that appraisal problems have "plagued" the Federal Government's extensive mortgage loan guarantee programs. In just one year (1986), the Department of Housing and Urban Development (HUD) sustained a $629m loss, thanks in part to crooked appraisers.

• At hearings into insider bank fraud, Mr Barnard's sub-committee was told that all the cases that were prosecuted in one district of Illinois involved fraudulent appraisals. A U.S. Attorney declared: "At seven recently failed S&Ls, senior officers, working with corrupt appraisers, have falsely inflated the value of securities for loans to finance projects in which the officers had an interest, or could receive kickbacks or commissions. This is a pattern of fraud seen throughout the country in failed institutions."

## British banks at risk

**FOREIGN BANKS**, including some of the British multinationals, may be exposed to the crooked dealings in US real estate.

The stockholders of those banks won't know it, however, because a great deal of the fraudulently valued property is disguised in what is called securitisation – mortgage-backed securities which are commercially tradeable instruments.

Samuel Zell, a shrewd Chicago-based dealer who is actively buying properties in the depressed Houston market – he prides himself on his "gravedancer" nickname – has defined securitisation thus:

"Securitisation converts mortgages into a commodity that blurs the risk to the investor. Wheras government bonds and government agency bonds trade at a risk differential, the risk is clearly delineated and an efficient market follows.

"In real estate mortgages, the amount and quality of information either precludes investigation or requires effort that is unlikely to be undertaken.

"The proliferation of securitisation transactions represent a further move toward the replacement of real estate expertise with the common denominator, a Masters of Business Administration."*

The Office of the Comptroller of the Currency (OCC) has confirmed that "Several multinational banks [are] engaged in the mortgage-backed securities business, [but] we do not maintain aggregate statistics on this activity and cannot provide an exact number."

The Congressional Committee on Government Operations has criticised the OCC for not looking closer at dealings in these securities. As a result, "loan participations and mortgage-backed securities based on fraudulent appraisals have adversely affected many financial institutions around the country."

Financial institutions willingly bought these securities because they were associated with famous names like Bank of America or Wells Fargo, which acted as trustee/escrow agents for them.

The value of many of the securities, however, were inflated above their market worth by the simple expedient of fraudulent appraisals. In one case, 21 S&Ls nearly lost $95m by investing in securities which were backed by expensive single family homes, apartments and townhouse condos in Southern California and Texas. The appraisal values of the properties were found to be 2½ times the purchase price.

The S&Ls were saved by Bank of America, which assumed liability. If the Bank had not done so, six of the thrifts would have suffered losses in excess of their net worth.

* Samuel Zell, "Modern Sardine Management", *Real Estate Issues*, Spring 1986, p.3.

INDUSTRY experts have provided extensive evidence of corruption. Cecil Rhodes is President of NIA, an organisation that specialises in lender and mortgage insurer risk management issues which has completed indepth field audits of 20,000 mortgage defaults.

He says: "We found ourselves working in an industry with an amazingly large element of organised criminality."

In one case, "a group in Southern California used a simple equity financing scheme involving over 300 properties to bilk various lenders and investors out of a mind boggling $41m in just four years. This scam was driven by deliberately inflated appraisals.

"Similar scams have been perpetrated on HUD, the Veterans Association, S&Ls, banks – everyone in the business. Stories like these, where large sums are taken by small, well organised groups, continue to unfold without relief in sight.

"Observers conclude that mortgage fraud is here to stay, because in all cases it is recognised by its beneficiaries –

**FACT: In 40 States, real estate appraisers – unlike barbers and beauticians – are not examined, licensed or supervised.**

its perpetrators – as a low risk, extremely lucrative activity."

In another Southern Californian scam, 21 banks and S&Ls lent $14m on property that a few months before had been bought for $1m! The appraisal was supplied by a man who had been convicted of fraud in previous appraisal work, according to a report by an investigator for the Orange County DA's office.

APPRAISERS are well rewarded for holding up their end of the real estate racket. Typically, they are paid fees that are twice or treble the usual payment.

It can be money for old rope. In one case, involving the bankrupted Landbank Equity Corporation of Norfolk, Virginia –50% of the investor loans it marketed resulted in foreclosure – appraisers signed large numbers of blank appraisal forms and allowed Landbank employees to insert the value of properties.

For some deals, Landbank advised the appraiser of the amount needed to cover the loans they wished to advance – which again relieved the appraiser of having to do any work. The casualness with which some appraisers discharged their responsibilities is illustrated by cases in which they submitted their reports – on which the loans were supposed to be based – to Landbank after the loan deals had been closed!

Crooked appraisers have also affected credit unions, which at the end of last year held federally-insured assets totalling $162 bn., 27% of which was tied up in real estate. Michael Riley, Director (Examination and Insurance) of the National Credit Union Administration, cites two cases:

CASE 1 A credit union advanced loans on property which was later found to be over-valued by 40%. Loss: over $1m, which contributed to its liquidation.

**FACT: the number of appraisers operating in the U.S. is not a known fact. The number is thought to be around 225,000 to 250,000.**

CASE 2 A New Jersey credit union had within its loan portfolio about $43m in commercial real estate loans out of a total loan portfolio of $50m. The market value of the property was $8m less than the money that had been advanced. The union was liquidated.

Cases such as these have led to a dramatic run on the National Credit Union Share Insurance Fund.

The appraisers have not suffered. In the words of Dr Richard Hewitt, President of a financial consulting and appraisal firm from Fort Lauderdale, Florida, who formerly served as a chief district appraiser for the Federal Home Loan Bank Board:

"Not one appraisal professional organisation has had at risk or lost one cent during the past seven years, a period which the FSLIC has for practical purposes been bankrupted, FDIC greatly weakend and literally thousands of depositors and shareholders financially impaired."

The tab has been picked up by everyone from the banks and S&Ls down to HUD, State governments and – ultimately – the taxpayer.

BUT little attention is given to another category of losers: the families who seek roofs over their heads.

Corrupt appraisals of property values has affected the policies of lending institutions. One of these, Fannie Mae – the largest private investor in mortgages and a major issuer of mortgage-backed securities – has been forced to consider the need for higher down payments. "When this happens," notes Dale Riordan, Executive Vice President of Administration and Corporate Relations at Fannie Mae, "first-time home buyers find it more difficult to purchase a home because it takes longer to save for a down payment. In the meantime, as we have seen over the last decade, sales prices have increased faster than incomes."

This makes it increasingly dif-

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## TRAIL OF CORRUPTION

THE nationwide racketeering in US real estate has its origins in the 1970s with the advent of the money-market fund. This was a device invented to cope with high inflation and high interest rates.

Investment firms sold shares in a pool of assets – usually loans to large banks. Small investors could own pieces of certificates of deposit that would earn more than their own deposits in banks.

Result: money started flowing out of banks and savings & loans associations and into higher-yielding investments. Some institutions faced a severe cash crisis.

Reason: Regulation Q, a long-standing Federal Reserve directive which limited the interest that banks and S&Ls could pay their depositors.

Solution: in 1980, Congress passed the Depository Institutions Deregulation Act, which phased out interest ceilings over a six-year period. The intention was to ensure that all depositors, and especially those with modest savings, would receive a market rate of return.

The Act transformed the financial system, shifting power from the lender to the borrower. The banks were forced to pay more for deposits. So they had to make up those higher costs with higher revenues. This provided the drive to make more aggressive loans.

One outcome was the explosion in junk bonds. Another was the pressure on S&Ls to lend to speculators, which provided an incentive to fraudulently appraise the value of property on which loans were to be made: the larger the value, the more an S&L could lend.

## Philadelphia's two-rate tax battle takes an equestrian turn

# SADDLE-WISE

• *COMMITTED: George Collins, left, James Tayoun, Dan Sullivan, Jacob Himmelstein, Steve Cord*

By PETER POOLE

*SEND me back my Four Horsemen,* was the appeal from campaigning councilman James Tayoun when he launched a new bid to reform the property tax in Philadelphia.

The Pennsylvania city turned down a two-rate tax earlier this year, which would have reduced the tax burden on many owners of developed properties (see *Land & Liberty,* Sept-Oct, 1988, p.68).

Mr. Tayoun, a restaurant owner who is determined to keep the initiative, now wants to educate his fellow councilmen on the virtues of placing a higher tax rate on land values.

Addressing the Council of Georgist Organisations at Atlanta, Georgia, on July 29, he declared: "We are in economic chaos. We have a shortfall in the budget, which must finally be balanced. We will have to go back next year with another tax increase, and the year after that.

"Over the last seven years, property tax assessments were increased to the point that people who were paying $400 for a small house in a dingy street are now paying $800-1,200. These were hidden taxes paid each year."

Mr Tayoun informed the Mayor, W. Wilson Goode, that he was going to the Atlanta conference to lay his plans for a new campaign on the two-rate tax, and told him: "I am going to tell them that you are definitely committed to this, and he said 'I am'." Said Mr Tayoun: "I honestly think we can do the job. We have got the information to sell the policy."

When the policy was debated earlier this year, Mr Tayoun received the support of four tax reformers: George Collins, Director of the city's Henry George School, accountant Jacob Himmelstein, Steve Cord, Director of the Center for the Study of Economics, and Dan Sullivan.

"Give me my Four Horsemen," appealed Mr Tayoun. "Give them the money to work with, and our first battle will be to get the school district squarely behind the two-rate tax. That would pick up four councilmen.

"We can take this city. You would not only be taking the city of the first class, you would be taking the entire state of Pennsylvania, because once Philadelphia goes the state goes.

"But I need my Four Horsemen. I don't want to go on radio and television shows, so I need their help. And we have got to stop the broad-brush smears against the land value tax.

"I want the Bill passed by the council before we get into serious discussions about the budget in January. I have no fear we can make it go."

• *After the conference, Mr. Tayoun swung into action. The Bill to establish a two-rate tax which reduced the burden on buildings came before the council on October 15 as part of a 5-year financial plan for the city.*

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ficult for first-time buyers to get a toe-hold in the property market. "We have already experienced a decline in home ownership among American families," Mr Riordan points out, "particularly in the prime home buying group of 25 to 34 years old."

In the 1970s, fraudulent appraisals were disguised by the high rate of inflation.

If borrowers could not meet monthly payments, they could sell their homes at a profit and pay off the loan without suffering foreclosure. This was one reason why the climate of speculation in residential pro perties flourished: people "traded up" to higher-priced houses, all the time struggling to pay their mortgages which represented a growing proportion of their incomes. The struggle paid off: the investment return on their homes was enormous.

That stack of cards tumbled with the deflationary period heralded by Ronald Reagan. This gave rise to a phenomenon that has frightened the lending institutions: people literally walking away from their homes.

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# TAX HAVEN IN A SLUMP

*PAUL KNIGHT reports from Guernsey, the 24-square mile island (pop: 58,000) which until this year has been a haven for tax avoiders.*

PROPERTY sales on Britain's off-shore tax haven have slumped since the Thatcher government reduced the top income tax rate to 40%.

Guernsey is an island close to the French coast, which like neighbouring Jersey has relied heavily on tax exiles for its prosperity as a financial centre.

In the past, the demand for homes pushed up house prices. So to protect locally-born people a two-tier system was created, in which foreigners were excluded from occupying part of the housing stock.

Since Chancellor Nigel Lawson's last tax-cutting budget the sale of the Open Market homes – those available to non-islanders – has slumped. Estate agents report that houses in the mid-range of £300,000-450,000 are "very difficult to push".

In June 1987, 22 Open Market homes were sold – almost half the total for the first six months of this year. Between January and July this year sales amounted to £15.5m, compared with £20.6m over the same period in 1987.

This supports the claim by Norman Lamont, Financial Secretary to the British Treasury, that a tax rate of over 50% has the disincentive effect of encouraging people to "shelter their income".

In the past, the tax shelter has enriched Guernsey landowners who sold properties to mainlanders seeking a haven for their money. But the favourable tax regime under Premier Margaret Thatcher has persuaded some rich people to remain in their mainland homes!

*FACT: Guernsey's income tax rate is 20%. There is no Capital Gains Tax, Inheritance Tax, Corporation Tax or Value Added Tax.*

*FACT: Guernsey's property tax rates have not been increased since 1948. An average Open Market house worth £250,000 ($437,000) is liable for a property tax of £175 ($300) per annum.*

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Explained Mr H.L. Van Varick, Executive Vice President of American Savings Bank of New York:

"This often happened when a homeowner saw a neighbour's house selling for less than the outstanding principal balance on his own house, so the sacrifice of making monthly payments appeared to be too great."

A row is now on in Washington, DC, over who pays – and how. Danny Wall, chairman of the FHLB Board, asked the House of Representatives to pass a resolution which would give the FSLIC the power to raise money through the issue of loan notes.

The notes, which have been issued to raise money to bail out the foundering S&Ls, have not been well received by the financial institutions because of the lingering doubts about FSLIC's own long-term solvency. Some Federal Home Loan Banks – the lenders of last resort to the S&Ls – have refused to accept FSLIC notes as collateral for cash advances.

The politicians are split on what to do. The Reagan Administration regards the

## RISK-FREE JACKPOTS

**TROUBLED savings and loans associations have become the only gamble in town where the odds are stacked in favour of the punters.**

**Because of Federal insurance – depositors are covered for every cent up to $100,000 they invest in S&Ls and commercial banks – a crisis-torn institution is forced into a situation where shrewd insiders can spot a risk-free chance to make money. This is how it works.**

**A weakened S&L is forced to pay above market rates to attract the deposits it needs to keep going. Because it particularly needs long term money, it offers premium rates for deposits of a year or more.**

**Two Californian S&Ls recently offered 1.5% more than their rivals, which then drove up the rates throughout the local deposit market.**

**Money brokers spot these opportunities, and invest sums of around $90,000 a time for clients. But that is only the half of it.**

**The brokers buy long term deposits carrying the premium rate in the hope that the S&L will go bust before the deposit matures. Since the Federal taxpayer covers the principal and accrued interest – and the money is paid out – so the depositor enjoys the long-term rate of interest and receives his money back early.**

**It's a game in which money is paid to depositors to cover their risks – yet there are no risks!**

*• The two California S&L's depositors received $1.35 bn (£750m) after Federal regulations closed them down in June.*

## EDWARD DODSON PROBES CITIZENSHIP IN THE STATES

# Stolen hearts need repair

**IN THE United States a large number of people do not enjoy rights of citizenship, because the laws infringe true political liberty and eliminates the potential for widespread economic well being.**

Constitutional and legislative law suppresses the most fundamental birthright we have as human beings, that of equal access to nature.[1]

*This has been accomplished by force and fraud, in total disregard for moral constraints.*

Claims to exclusive ownership of nature cannot be justified when we as individuals are beneficiaries of a bounty we had no part in producing. Even the value-free analyses of the economist recognizes that nature has a zero production cost, its economic price having nothing to do with the expenditure of human labour. And yet, the law sustains claims to nature, in effect allowing title holders to extract wealth from others in return for access.[2]

Political power thus possessed translates into economic power, and through some convoluted logic, titles to nature are grouped with the fruits of productive labour as "private property". The end result is a society in which citizenship based on equality of opportunity is impossible and the creation of a large, impoverished class of people is inevitable.

France in the 18th century, Ireland in the 19th and Russia in the 20th provide the historical experiences of upheaval against landed aristocracies. Marx himself finally recognized that landed monopoly power was at the root of monopoly capital; and, as one should expect, it was the landless peasantry of Russia - and not the worker proletariat - who brought Marxist-Leninism to that society.

Only when denied access to nature did the landless resort to labouring, if they could, for money wages - a narrowing of options that increased their vulnerability to the peaks and troughs of the new plague, "business cycles," as well as the oppression of "robber baron" greed.

FRAMING this issue in terms modern Americans can appreciate has been made very difficult because the concentrated control of nature has been fused with a similar degree of control over industry and finance. Despite this fact, the majority of Americans continue to believe there is plenty of opportunity for almost anyone to rise to the top. Those who have benefited do not understand what is, at bottom, the cause of their advantage.

The wealthy, even those who have struggled from poverty to get there, quickly forget their past and join those who herald the status quo. In fighting off attempts at reform, they have used wealth to gain political power and, when their interests are threatened, rally the population to support anti-democratic and anti-republican policies in both the domestic and international arenas.

Alongside "nationalism" we have as a consequence

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## REFERENCE POINTS

1. *1. A May 1983 report by* TOWN & COUNTRY *(p.176) indicates: "About 3 percent of the population, or 7 to 8 million people, own 55 percent of the total land, and a full 95 percent of the 1.3 billion acres of privately owned land in this country." Our reaction to similar statistics in "third world" societies is to call for land reform, while most of us are unable to see any connection between the concentrated control over nature and the large numbers of unemployed in the industrially-advanced countries.*
2. *The cost of acquisition of territory has come with a tremendous cost in human lives and the destruction of produced property. History is a story of land grabbing through three primary means - force, fraud and theft. By what right did the monarchies of Spain, France or England issue grants of land occupied for thousands of years by another race of people? The aboriginal tribes, for their part, had no concept of selling titles in the earth; theirs was a collective (if exclusive) form of control at least with equal access provided to all tribal members.*
3. *The right of all people to share in the bounty of the earth is the basis for the so-called "Law of the Sea" developed to harvest the sea bottoms. The United States has thus far refused to sign the treaty because private interests are opposed to paying leasing fees to the United Nations (which would then be distributed internationally on the basis of population, according to one version of the treaty).*

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notes as "money-good". But senior Congressional politicians have strong reservations. One of them described support for the notes as issuing "the Federal Government's gold credit card".

Observers are beginning to note that, in the face of a major economic crisis, the crooked deals in real estate could limit the scope for remedial action. For the constraints on action now not only include the Third World debt's impact on US banks, and the budget deficit on the Federal government, but also the huge amount of lenders' money tied up in the 511 insolvent S&Ls which are still trading and notching up new losses at the rate of $1 billion a month.

Congress is reluctant to launch an industry-wide lifeboat operation, now, because of the costs involved. George Gould, the Treasury's Under-Secretary for Finance, says the Reagan Administration is "not in the mood for a budget-busting bail-out."

But the next president, Bush or Dukakis, will not be able to sidestep the financial timebomb.

**FACT: S&Ls, now down to 2,770, are the principal lenders in a home mortgage industry worth $1.3 trillion (million million).**