Prepared Testimony

Of

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On

Proposed Amendments to the Sentencing Guidelines

Before the

United States Sentencing Commission

March 14, 2012

Good morning, Judge Saris, and members of the Commission. My name is Sara W. Stephens, MAI, CRE, and I am the president of the Appraisal Institute, the largest association of real estate appraisers in the United States. I am here today on behalf of the Appraisal Institute and the American Society of Farm Managers and Rural Appraisers. Collectively, AI and ASFMRA represent 25,000 real property appraisers, more than three-quarters of all professionally designated appraisers in the United States.

I am one of the principles of Richard A. Stephens and Associates, the oldest appraisal firm in Little Rock, Arkansas. My husband, Richard, and I maintain a practice offering a broad scope of appraisal services, specializing in eminent domain, litigation support and real estate tax appeal.

Thank you for the opportunity to appear before you today to share the appraiser's perspectives on proposed amendments to the Mortgage Fraud Sentencing Guidelines. Our organizations, along with others, have been working to combat mortgage fraud at the highest levels. It should be noted that our organizations were at the forefront of calling attention to and elevating awareness about mortgage fraud, predatory lending, and other nefarious activities in the lending industry. Our organizations have fought for legislative and regulatory changes in support of meaningful and diligent oversight and enforcement in the mortgage industry. We also offer education, training and publications to appraisers, lenders and others on spotting red flags in appraisal reports, helping to improve bank risk management, appraisal review, bank regulatory and law enforcement processes.

Background

The proposed amendment would make changes regarding the calculation of loss in mortgage fraud cases. For example, the first change would specify that in the case of a fraud involving a mortgage loan in which the collateral was disposed of at a foreclosure sale, use the amount recovered from the foreclosure sale. The Commission has asked whether it should provide an additional special rule for determining fair market value if the mortgaged property has not been disposed of by the time of sentencing. For example, should the Commission provide that, if the mortgaged property has not been disposed of by that time, the most recent tax assessment value of the mortgaged property shall constitute prima facie evidence of the fair market value, i.e., is evidence sufficient to establish the fair market value, if not rebutted?

> ***Response***
> ***Yes, we believe the Commission should adopt a special rule for determining the fair market value of real property, if the mortgaged property has not been disposed of by the time of the sentencing. However, this rule should require the use of real estate appraisals prepared by qualified appraisers, in accordance with the Uniform Standards of Professional Appraisal Practice, as opposed to tax assessments, to ensure fairness and consistency.***

Valuation of Real Property

Real estate appraisals have a wide range of application and purpose. They are commonly used in mortgage financing in loan origination, asset management, loan securitization, financial reporting, eminent domain proceedings and property disposition. Appraisers are unlike real estate brokers, attorneys or accountants in that we hold ourselves out to be completely independent and objective. This is a significant reason as to why courts often turn to our members when seeking to resolve critical real estate valuation issues.

The amendments propose to utilize tax assessments to determine fair market value when the property in question has not been sold. We do not support the amendment, as proposed, for several reasons, as described below.

1. Condition and Quality Inspections

Fairness to all parties demands a credible and thorough valuation of the property in question. It should take into consideration the property condition and quality. Property condition and quality is a significant factor in many distressed properties, as property maintenance quickly can become a concern. In fact, many foreclosures are damaged when they become vacant, whether intentionally or not.

Real estate appraisals are different from real estate assessments in many ways, but one of the key distinctions relates to inspections of the property. Typically, no property inspection is done in conjunction with a tax assessment; certainly not as of a point in time, as envisioned by the amendment. Alternatively, appraisals nearly always involve property inspections, especially the interior of the property and frequently the exterior of properties used as comparable sales. This strongly enhances the reliability of the valuation.

2. Reliability of Public Records Data

Real estate tax assessments utilize “mass appraisal” techniques, which typically are statistical algorithms. These algorithms rely generally on public data, but may be supplemented with real time information. However, this varies from jurisdiction to jurisdiction. Some authorities have staff in place to manage the assessment process, whereas others may have limited staff or contract out such work entirely. Further, public records data often is inaccurate and unreliable. Information about square footage, number of bedrooms and bathrooms, and the existence of a built-out basement are just some of the features that often are inaccurate in public records data. Such inaccuracies reduce the reliability of the valuation.

3. <u>Reassessment Periods Vary Widely by Jurisdiction</u>

While some jurisdictions reassess property on an annual basis, many do not. There is no commonly accepted reassessment period throughout the United States – some jurisdictions may reassess annually, or every other year or every six years. Some have not reassessed property in the past decade. In these situations, the jurisdiction simply may have adjusted the tax rate to pay for public services. In these cases, if a tax assessment is used in the calculation of a mortgage fraud sentence, it is likely to overstate the loss to the bank, and potentially inflate the sentence of someone convicted of mortgage fraud. For fairness reasons, obtaining an appraisal as of a specific date is far preferable and easily achievable.

4. <u>Assessed Value May Not Conform to Market Value</u>

Assessed value applies in ad valorem taxation and refers to the value of a property according to the tax rolls. Assessed value may not conform to market value, but it usually is calculated in relation to a market value base. Many jurisdictions estimate tax assessments as “worth” rather than “value”. For instance, a farmer with a hundred acres of farm land situated next to an expanding industrial park might have a market value of $50,000 per acre based on the highest and best use. But the farmer doesn’t plan to sell so the state tax assessment is based on current use ($5,000 per acre) rather than highest and best use.

In some states, the actual taxable value for rural land is typically by its agricultural use or productive value and not based on market value. The market value may be assessed as a practice, and then followed by the productivity or agricultural use value.

In many cases, tax assessments have little to do with market value. The ratio of assessed value to market value is called the common level ratio or assessment ratio. If, for example, the tax rate is $60 per $1,000 of assessed value and the assessment ratio is 50 percent, then the annual real estate tax (or effective tax) equals 3 percent of market value. If assessed value is not based on market value, the formula is modified to reflect the difference. Effective tax rates may be used to compare the tax burden on properties. In jurisdictions where tax assessments have an established or implied relationship to market value, appraisal services may be required to resolve tax appeals.

Appraiser Qualifications

We strongly recommend that the Commission establish a special rule relating to the qualifications of real estate appraisers. We suggest that those who perform these appraisals have earned a designation from a nationally recognized professional appraisal association, which awards the designation based on demonstrated competency that requires approved classroom training in appraisal practice, experience requirements, and preparation of a demonstration appraisal report or appraisal review report or a comprehensive qualifying examination.

Use of Sales Price

We offer one final comment, and that relates to the use of the actual sales price of foreclosed properties to be used in the sentencing criteria. One thing to consider with actual sales of REOs is that banks frequently do not obtain market value for the property. In fact, they often obtain something akin to “liquidation value” rather than market value. This is backed up by surveys of our members, which indicate that appraisers have witnessed properties being dumped on the market. In these situations, it would appear to us to be unfair to use the actual sales amount of a fire-sale property in the sentencing guidelines. To do so would be to unfairly penalize someone who has been convicted with an inflated sentence. Here, an appraisal of the property, even when the property has sold, may further enhance fairness to all parties involved.

Conclusion

For the reasons stated above, real estate appraisals prepared by qualified real estate appraisers, in accordance with the Uniform Standards of Professional Appraisal Practice, are clearly preferable to tax assessments for the circumstances described in the amendments. We urge the Commission to finalize Guidelines and to establish a special rule in the Credit Against Loss section that requires a real estate appraisal prepared in accordance with the Uniform Standards of Professional Appraisal Practice by a qualified, professionally designated appraiser.

Thank you for the opportunity to testify before the Commission. I would be pleased to answer any questions.