THE FAILURE OF EMPIRE SAVINGS AND LOAN ASSOCIATION

OF MESQUITE, TEXAS

by

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PROFESSIONAL REPORT

Prepared for B.A. 398 Under the Supervision of

Dr. Joseph Ewers in Partial Fulfillment

of the Requirements

For the Degree of

MASTER OF BUSINESS ADMINISTRATION

THE UNIVERSITY OF TEXAS AT AUSTIN
Graduate School of Business
August, 1985

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Chapter One

INTRODUCTION

On Wednesday March 14, 1984, the Federal Home Loan Bank Board (FHLBB) announced the closing of Empire Savings and Loan Association of Mesquite Texas, placing it into receivership with the Federal Savings and Loan Insurance Corporation (FSLIC).[1] This action by the Bank Board ended a remarkable two year period of growth and development that saw a small one office thrift institution expand at an unprecedented rate, and almost single handedly finance the condominium boom along a once desolate stretch of Interstate 30, east of Dallas. Yet, due to the sheer magnitude and concentration of this construction, it appeared evident that the institution not only was destined to fail, and when it did, government agencies paid out over $250 million in insured deposits and became custodians of over 3000 condominiums Empire had funded plus raw land planned for development, making it the largest single thrift failure in the 50 year history of the FSLIC.[2]

Given the past history of Empire Savings and Loan Association, it seemed highly improbable that this institution could have grown as much as it did in so short a period of time. Yet under the aggressive leadership of Spencer Blain, a highly respected Texas banker, and the close support of several affluent real estate developers, the thrift coordinated its growth objectives through the rapid rise of loans for the development and sale of condominiums in the lucrative Dallas real estate market. However a closer examination into these investments revealed an overwhelmingly one-sided portfolio of loans concentrated in an exceptionally small geographic area which served to expose the thrift to excessive risks. Yet these high risks also produced high yields, and for a period of time Empire was regarded by outsiders as one of the most profitable and successful institutions in the state. Eventually, the overconstruction of condominiums created a tremendous surplus, which led to reduced sales and a sudden rise of loan losses. These loan losses quickly eroded the aura of strength Empire had created, and even though regulators attempted to control the deteriorating situation, there was no way to prevent the final outcome.

A second factor to Empire's profitability involved the means used to structure investments, including the way individuals were persuaded to participate in the ventures, and the ability to design loans loaded with excessive debt. A key feature of the investment packages the developers designed was the use of multiple land sales to inflate the final sales price artificially. In addition, the investors who purchased these packages were generally people with little real estate background, who were motivated by the promises of high profits for almost no money down. Furthermore, many received as a bonus immediate cash payments for just signing the Empire originated loans. These loans, however, not only contained high land values, but were loaded with above average interest rates and fees which served to push the final loan amounts even higher. All of these activities were done so that Empire could lend in an area that was already becoming a virtual sea of condominiums.

While the multiple land sales served to boost the perceived value of the land used for development, an outside independent appraisal of the property was needed to substantiate this. Although the appraisal process is a particularly demanding task, entailing high professional standards and ethics, the appraisers for the Empire projects appeared to have totally disregarded their ethical responsibilities and readily approved of the inflated prices in their reports. For this, the appraisers received large bonuses and investment opportunities in the condominiums, thereby generating alleged conflicts of interest.

To fund all this development, Empire required a large pool of highly liquid deposits. Because this was not available in the immediate area, the thrift turned to a relatively new source, money brokers, who in exchange for above average yields, funneled millions in brokered deposits, in the form of short term jumbo certificates of deposit (CDs), into Empire's deposit base. Although this was the most visible sign of the association's growth, it also represented a highly volitile resource that could easily be withdrawn and moved. This aspect was in fact the immediate cause of the failure, and the impetus for active federal regulatory involvement.

While the FHLBB and the Texas Savings and Loan Commission cited brokered deposit growth as the primary reason it became involved in the situation at Empire, there were many other opportunities for earlier involvement. From the moment Blain assumed control of the thrift, there was a continual trail of regulatory violations and suspicious activities that appeared in the periodic examination reports conducted on Empire. Yet due to a variety of reasons stemming from the bureaucratic rigidity of the agency, the FHLBB chose not to take early effective action that possibly could have saved both the institution, and the millions paid upon the collapse.

These unusual circumstances that hindered federal supervision were the focus of a congressional hearing exploring the causes leading to the collapse of Empire. From these inquiries, the congressmen recommended a number of legislative rule changes that hopefully would help prevent a similar failure of such magnitude.

While the failure of Empire had an immediate impact on all savings and loans, there has been a more prolonged effect on the communities that grew as a result of the intense construction. Vacant and unfinished condominiums litter the I-30 area, and there appears no immediate solution on what to do with them. Similarly, five other thrifts that became entangled in the constuction boom have been forced into insolvency.[3] For those people closely involved in the Empire fiasco, civil and criminal charges are being investigated. From this, though, there has been an increased awareness to the pitfalls of assuming that an institution's strength derived from rapid growth is genuine, when in fact it may only be paper thin. All of this has resulted from a failure one analyst appropriately characterized as the "Penn Square of Thrifts".[4]

Chapter Two
THE FAILURE

Empire Savings and Loan Association did not always have the reputation as a mover and shaker of the Dallas financial community. Formed in 1973 as Town East Savings and Loan, a state chartered federally insured institution, Empire maintained a modest $13.25 million in assets in its one office at 2920 Motley Drive in Mesquite.[5] As a strip shopping center bank, it primarily served the needs of its 2000 depositors in the surrounding communities of Mesquite, population 67,000 Garland, population 138,800 and Rowlett, population 7,500.[6] In March 1982, Spencer Blain moved to the association from his position as president at the much larger First Federal Savings and Loan in Austin. Blain succeeded S.A. Beiher as president and by August became the principle shareholder of Empire by acquiring 67% of its outstanding stock. At this point, he was elected Cheif Executive Officer and Chairman of the Board, allowing Carolyn Seabourne, a high school graduate who had joined Empire in 1974 as a secretary, to be named president and a director of the association.[7]

The arrival of Blain was a welcomed occasion, since he brought with him an impressive list of accomplishments from his other positions. As an officer of an Orange

Texas savings and loan and later as president at First Federal, he was instrumental in helping turn these thrifts into highly profitable institutions. In addition to these credentials, Blain served on numerous boards and committees, including as Director of the FHLBB Bank in Little Rock, Arkansas since 1979, and Vice Chairman of the executive committee of the Federal Home Mortgage Corporation Advisory Board. Just three months after the Freddie Mac appointment, he was elected president of the Texas Savings and Loan League, representing one of the highest acheivements for any industry executive.[8] Although Blain's acceptance of the Empire position was a sudden event, many reasoned that it occurred because it represented stock ownership possibilities which were not available at First Federal, because it was a mutual association.[9]

Once in control at Empire, Blain established a plan to help turn the association from a marginally profitable institution frought with inefficencies, into a highly successful thrift. His outline included aggressive lending in construction, followed by the sale of these loans, without recourse, in the secondary market for a fee. He intended to finance all this through the growth of jumbo CDs. To further suppliment the profits realized in making the loans, Blain intended to have Empire become a limited partner in the building of condominiums through its wholly owned subsidiary, Statewide Service Corporation. Not only would this build upon the thrift's operations, but would help limit its liability for the debt.[10]

As the units sold, Empire would either close the loans to the buyers, or secure commitments from mortgage companies, Freddie Mac and Fannie Mae, which would then be used to pay off the jumbo CDs. After this cycle was complete, Blain would then allow his association to become smaller, while having retained substantial profits. The timetable for this program was to cover two to four years.[11]

A key element of this scenario required seeking out suitable areas in which to lend. One promising possibility was to invest in the projects that had begun to spring up along Lake Ray Hubbard in east Dallas, which were spearheaded by Danny Faulkner and his associate, former Rowlett mayor Jim Toler. Eventually, these two individuals would become closely tied to the fate of Empire, based upon their personal abilities to insure the success of their condominium developments.

Danny Faulkner is, in many respects, the epitome of the Horatio Alger saga having raised himself from poverty into a position of power and affluence. Born in Mississippi, the son of a sharecropper, Faulkner dropped out of school in the sixth grade, unable to read or write.[12]

After a series of jobs as a painter in Alabama and south Texas, he migrated to Dallas, where he happened to meet millionaire insurance man, Kenneth Murchison. Murchison, impressed by Faulkner's down-home manner and business astuteness, persuaded him to become a paint contractor by lending his initial seed money. Within a few years, Faulkner built a thriving business, and by 1979 began to look for areas to invest his excess profits in. His first venture was in a real estate development along Lake Ray Hubbard. The condominiums he built, which relied partially on funds lent to him by Blain at First Federal, became the instantly successful Faulkner Point project. Faulkner netted millions from this endevour, which he used to purchase large tracts of surrounding raw land. Later in 1982, he lent Spencer Blain over $600,000 that was used to acquire Empire and to purchase stock for himself.[13]

While Faulkner realized quick success in real estate, his sudden wealth propelled him into the ranks of Dallas's High Society. He embarked on a prolonged period of conspicuous consumption that included extravagant jewelry, a million dollar box in the Dallas Cowboys Ring of Champions at Texas Stadium, in addition to cars, jets and helicopters.[14] For his son, Danny Jr., Danny senior hired the Oklahoma Symphony Orchestra to perform at the reception. His flamboyance has been further heightened by stories of his leaving $100 tips at burger joints, the purchase of several Rolex watches for his employees, and the erection of a billboard along I-30 proclaming "Danny Faulkner Welcomes you to Garland".[15] Yet despite all his wealth, Danny Faulkner has remained a deeply religious man who does not drink nor smoke, and is a faithful supporter of most charitable causes donating millions annually. As one friend describes him, Faulkner is simply "a good ole boy from Mississippi whom everyone likes."[16]

A second individual who became a pivotal figure in the condominium projects was Clifford Sinclair, who through his corporation Kitco Developers Inc., coordinated most of the construction in the I-30 area. Sinclair also was responsible for attracting many of the outside investors who bought participations in the developments he organized.

Sinclair, like Blain and Faulkner, had established himself as a successful businessman. In 1981, while sales manager at J. Stiles Custom Homes, he was named "Salesman of the Year" by the National Home Builders Association.[17] Later that year he joined the sales team at Faulkner Point as its sales manager. However, unlike Blain or Faulkner, Sinclair is haunted by a checkered past. In 1977, he was indicted in Alabama for theft under false pretenses, and later charged in Arkansas with fraud, failure to obtain securities credentials, and making false statements.[18] In the Alabama case, Sinclair was accused of defrauding two dozen residents of $5000, and in Arkansas, officials alleged that he defrauded a couple of $175 which was paid to him so that he could submit their loan application to various credit firms.[19] It was later revealed that some of the firms Sinclair was supposed to have contacted were nonexistant. Although the Arkansas case was eventually closed without any restitution paid by Sinclair, a business partner of his eventually reimbursed the disputed funds to the Alabama residents. Still both states tried to extradite Sinclair for proscecution, but were unsuccessful, since Texas authorities felt that with his current job in Dallas, he would experience an "undue hardship for his family and excessive loss of income."[20]

While Blain, Faulkner and Sinclair were the principle trioka behind the growth of Empire and the I-30 area, other individuals played important roles in the growth process. For all the title closings associated with the land deals, the developers chose to use the Rowlett office of the Dallas Title Company for these transactions. Its president, Robert C. Lea, was associated with Empire through a trust account in his name which was used to process funds gained in later land sales. Jane Nix, the senior broker, was also a member of Empire's Board of Directors.

A sixth person, Paul Jensen, became involved in the I-30 projects through his association with several area thrifts who were persuaded by him to lend in the area. Like Danny Faulkner, Jensen was a man of considerable means, with ties to the Osmond recording and television companies in Utah.[21] Jensen, who spent lavishly on himself and others, came to Dallas from California with the intention of brokering land deals to area thrifts. He, along with other developers, engaged in a majority of land sales Empire made loans on and maintained deep involvment in both Empire and other S&Ls. Despite these, connections in the Dallas area, Jensen left for Utah in 1983, having made millions for himself and the thrifts he worked with, just as mysteriously as he had come.

A final group of people in this complex operation were Earnie Hughes, Ken Caswell and Jim Toler. Hughes, like Sinclair, assembled investors and sold them development packages through his Peak Investments firm.[22] Later, he was responsible for all marketing operations. Ken Caswell, a former Rowlett High School football coach, also marketed the condominiums, and along with Hughes, became actively involved in the multiple land transactions. Jim

Toler, who was the mayor of Garland in the 1970's served as the principle associate of Faulkner in arranging their land and condominium deals that Empire loaned on.

The area selected for development was a concentrated section of Interstate 30 between Interstate 635 and Lake Ray Hubbard, located primarily in the communities of Garland and Rowlett. This 10 mile long stretch, known locally as the "I-30 corridor", was a relatively untouched area prior to the arrival of Danny Faulkner. Suprised by the speed with which the 232 unit Faulkner Point project sold out, his firm, Faulkner Investments, began to gradually purchase adjacent property, and consolidate its control of the corridor. Once this was done, plans for massive condominium developments encompassing hundreds of units took shape. While the smallest of these was only 40 to 50 units, the largest project, known as The Park, called for 3,127 units to be built on 187 acres.[23] Almost overnight the peaceful bedroom communities in the Dallas suburbs were teeming with construction crews all building condominiums. The flurry of activity not only changed the once barren landscape, but helped change the financial situation at Empire. In just one year, the association's loan portfolio skyrocketed from \$27.4 million to \$257.9 million by June 1983. At year's end, Empire had over \$390 million tied up in land and development loans in the I-30 corridor.[24] This sudden growth also helped turn net income from a June 1981 loss of $22,000 into a $3.4 million gain by December 1983. Similarly, total net worth increased from $765,530 to over $11.6 million over the same period.[25] This spectacular turn around led the National Thrift News to name Empire Savings and Loan the Top Rated Institution for 1983.[26]

All of this success did not escape the attention of other area thrifts. Within months of Empire's initial ventures into condominium lending, Bell Savings and Loan of Belton Texas, First Savings and Loan Association of Burkburnett, Investex Savings in Tyler, State Savings and Loan in Lubbock, and Lancaster First Federal Savings and Loan all contributed funds to the I-30 growth.[27] Some of these institutions were initially contacted by Paul Jensen, who would broker land deals for them. Two of the thrifts, Bell Savings and Lancaster First Federal, profited substantially from their involvement with Jensen. Bell grew from $22 million to over $77 million in just six months, while Lancaster First added over $85 million to its asset base of $16 million during the same period.[28] Relations became so close between Jensen and these associations, that he became a Director at Lancaster First, and attempted, though unsuccessfully, to purchase each. Overall, by the end of 1982 these six thrifts accounted for over $345 million of the $750 million invested in the I-30 corridor.[29]

During 1983, the objectives initially set by Blain were proving to be exceptionally successful. Not only was the association growing spectacularly, but was one of the few truly profitable institutions in the state. During the 1979-1982 recession, Texas savings and loans lost millions due to the unprecidented high level of interest rates. Strapped with low yield mortgages in their portfolios, these thrifts adopted drastic austerity measures in order to survive. Given these hardships, it was suprising to see Spencer Blain arrive at an annual meeting of Texas Savings and Loan League in a new Rolls Royce.[30] Furthermore it was stunning that Blain's one office thrift had, in 1983, booked more commercial real estate loans, totaling $329.6 million, than InterFirst Corporation ($309.4 million), RepublicBank Corporation ($253.9 million) and Mercantile Texas Corporation ($174.8 million).[31]

However, late in the year, the Dallas real estate market began to show signs of weakness. As the hundreds of finished units hit the market, the area quickly became saturated, resulting in a "condo glut". By December 1983, 2266 units were finished, 2268 under construction, and an additional 1500 were planned.[32] Unfortunately, a study by M/PF Research, a Dallas real estate consulting group, found that the maximum number of new condominiums the I-30 area could accomodate, or absorb, was only 75 units per month, and at the present rate of development, a 12.5 year oversupply would occur.[33] This was a staggering figure, especially because a nine month supply was considered adequate. From this study it was clear that the area was becoming seriously overbuilt, and as more units were dumped on the market, demand eventually dried up, resulting in entire projects totally vacant. By January, only 779 condominiums in the I-30 corridor were occupied.[34]

The immediate effect of this was that the rental income necessary for loan payments never materialized, and as these short term obligations came due, Empire was forced to record them as losses. As the situation at Empire worsened, the Texas Savings and Loan Board Commissioner L. Linton Bowman III entered into a supervisory agreement with Empire in June 1983, and asked that no further land loans in the corridor be made.[35] In November, the Dallas Morning News published the first in a series of articles on the I-30 condo glut. These stories, culminated a two month investigation into the dealings of Empire, Faulkner and Sinclair, and represented the first time significant media attention was brought to the area. The result of this coverage was increased public awareness as well as further declines in the sale of condominiums, which by this time had fallen to just four units a month. According to developers' records, a 200 unit per month sales rate was needed for the projected loan payments to work.[36]

On January 9, 1984, Empire had deteriorated to such an extent that Bowman directed his agency to assume control of the thrift.[37] Although the daily activities of the association were being conducted by the state, Blain still remained its CEO. On the same day, the FHLBB issued a cease and desist order prohibiting Empire from making any further loans and to stop accepting more jumbo CDs.[38] It also directed the FSLIC to arrange for a merger to prevent a possible default.

While the regulators were effectively in control of Empire, Blain still actively searched for buyers of the condominiums. In late January, he arranged for the sale of a limited number of projects to major investors, and by the end of February began negotiations with Lincoln Properties, the second largest real estate development company in the country, for the purchase of hundreds of condominiums.[39] He also contacted Freddie Mac and Fannie

Mae to have these federal mortgage corporations purchase some of the outstanding loan commitments. However, this request, like those made earlier, were denied due to the excessive risk of the loans. Finally, Danny Faulkner agreed to purchase $32 million of the obligations to keep Empire afloat until more sales of units could be arranged.[40]

However, by this time, Empire was experiencing an avalanche of loan defaults. Similarly, the short term CDs that financed the projects were coming due, and could not be paid off. Once the FSLIC determined that a merger would be unreasonable, given the high risk of the loan portfolio, the FHLBB began to file the necessary documents for insolvency, including an Order of Removal and Prohibition, which was signed by Blain on February 28.[41] Two weeks later Empire was declared insolvent.

Chapter Three

THE INVESTMENT PROCEEDURES

The dramatic rise and fall of Empire hinged on maintaining a high volume of acquisition and development loans within a small geographic area, funded by a highly liquid CD pool of brokered deposits. While the overdevelopment of condominiums and this heavy reliance on brokered deposits could have easily caused the failure, Empire also employed a number of unusual investment proceedures that helped hasten its demise. These factors involved not only the financial mismanagement of funds but included irregularities in the way land was transacted, the unusual method of selling development packages to outside investors, and an overall lack of attention to the activities of others investing in the I-30 corridor.

The basis of the Lake Ray Hubbard projects was the acquisition of the raw land on which to build. Because the I-30 corridor was essentially undeveloped, land prices in the area tended to remain stable over time. Yet when Faulkner, Toler, and later Sinclair and Hughes, began to purchase land in 1981-1982, they went to elaborate lengths to inflate the value of their acquisitions, using a process commonly refered to in real estate jargon as a "land flip". A land flip is essentially the the resale of a unit of land within a short span of time and is usually done between parties who know each other.[42] If used prudently, over a period of several months to years, it is a legal, though uncommon, practice. However when land flips were used in the I-30 corridor, they took place within a matter of days, sometimes hours. The process became so rapid that some flips essentially became paper shuffling exercises among the developers.

With each flip, the sales price of the land would climb significantly, and when completed the final price of the tract could be as much as 800% above the original aqcuisition cost.[43] After the flipping, the land was subdivided and sold to outside investors at the inflated prices, allowing the developers to realize millions in profits. The investors, in turn, would use loans from Empire to pay for the land.

In their initial expose of the condominium crisis, the Dallas Morning News diagrammed how a typical land deal occurred.

> One 45 acre tract along Oates Drive was consolidated and sold in October 1981 by Arlington attorney Eric Vogel to Gary Sibley, an Arlington real estate broker. Sibley sold the 45 acre tract on October 21, 1982 to Paul Jensen. On the same day, Jensen sold the land to his assistant, Bjorner Fredriksen. Still on the same day, Fredriksen sold the parcel to Sinclair's Kitco Developers Inc., and to a Faulkner trustee, Brenda Kennedy. Again on the same day, Ms. Kennedy deeded Faulkner's share

> back to Kitco, and Kitco deeded the entire 45 acres and an adjacent 15 acre plot purchased from Jensen, to east Dallas realator, Earnie Hughes. Hughes, acting for Sinclair, then subdivided the entire 60 acre tract into 60 parcels of just over two acres each. These individual parcels were then sold to 26 corporate investors for a total of $21,173,512. From the Sibley sale to the corporate purchases, the price of the land rose more than 600% from $1.10 per square foot to more than $8.00 per square foot. 44

The subdivision of the land into smaller tracts to be purchased by the corporate investors was crucial. Due to federal regulations limiting the size of loans, as set forth in the loans-to-one borrower statutes, it became necessary to divide the land into small sections in order to allow Empire to finance an entire development, and still include the highly inflated land prices in the loan amount.[45] Similarly, by "slicing the pie" into smaller pieces and selling them to several unrelated investors, it reduced the probability of any one individual discovering the land flips.

After the land was organized into managable units, Empire arranged loans that not only covered the flips, but were also heavily laden with excessive points and fees. Normally, all loans contain fees and points to cover the costs of originating, closing and servicing the loan. The average range for the fees is 2-4%, and can be recorded as immediate income. However Empire was charging 10-12% in points on each loan, which yielded enormous profits. In addition, it was also charging interest rates of up to 18% resulting in large sums of interest income.[46] While this excessive debt was immediately profitable to the association, it also allowed the developers to make draws on the funds even before the projects had begun, thereby increasing their profits.[47]

In approaching other savings and loans, the developers willingly offered the same incentives Empire received, to persuade them to make loans. Based on these unusual offers, in addition to recommendations from Blain and the brokering efforts of Jensen, the thrifts who did participate realized up to 8% points per loan and 15% interest rates. To further sweeten the deals, lenders often received bonuses and kickbacks once the loans were closed. Some of these incentive payments even exceeded the value of the loan.[48]

To close the loans, the developers needed outside investors willing to sign for them. The typical investor interested in participating in a condominium project would purchase a development package from either Kitco or Peak Investments, containing the necessary financing to purchase the land, build and then market the project. Since this type of package allows minimal involvement with a project, it has become quite popular with experienced real estate investors. Yet most of the I-30 investors contacted were not exceptionally knowledgable in real estate. Kitco made most of its investor sales to people with varied backgrounds, including young professionals, politicians and even football stars.[49] One common thread that did link each investor was a desire to make excessive profits with almost no money down. Over 150 people were enticed to sign loans, and when more were needed, Sinclair sold his packages to loan officers, appraisers, secretaries, and others closely associated with the projects.[50] Later, it was revealed that many of these people should have been unqualified to sign for the loans, because their net worth "was near zero".[51]

Since the size of these loans ranged from a hundred thousand to several million dollars, the developers compensated the investors with bonuses of up to $43,000 for closing a loan.[52] Similarly, to make the loan qualification process easier, investors only had to provide a minimum number of documents and little or no money down. However before a loan was closed, each investor had to form himself into a personal corporation, and enter into a joint venture agreement with the developers. This essentially allowed the developers to make draws on the loaned funds, but placed all the burden of repayment on the individual investor. Finally, each note would be written to come due within one year, which greatly increased the risk of default if a project did not sell.

While the investors may have been promised high returns on their investments, very few of them actually came out ahead. First, the bulk of any potential investor profits had already been extracted through the high fees, interest rates and the use of land flips. Furthermore, the sale of units was well below expectations, due to an oversupply, which was aggrevated by a marketing staff that didn't have the proper training or enough enthusiasm or knowledge of the market. In the end, the only hope the investors had of being able to pay off their huge notes was through the sales generated from national real estate groups and other "white knights" who would buy large blocks of condominiums, rent them as apartments, and later sell them after having exhausted their total tax shelter potential.[53] Although Blain was attempting to arrange such a transaction with Lincoln Properties, the thrift failed before a deal could be struck.

One of the investors, Jack McGrath, told of how at first it appeared that the Kitco packages were guaranteed money makers, and how easy Sinclair had made it for him to participate. After McGrath was convinced to invest in "a deal that looked great on paper", he qualified for his Empire loan simply by presenting a financial statement, a copy of his resume, and copies of his 1981 and 1982 tax returns.[54] He then formed a corporation through the law offices of state Senator Ted Lyon (D-Rowlett), which was handling a majority of all investor legal matters.[55] Two weeks after he filled out the forms he went to the Rowlett office of the Dallas Title Company to close the deal.

Normally in a title closing that involves millions of dollars, the buyer and seller will spend hours, sometimes days, negotiating over the contract before signing. However, the experience McGrath went through was radically different. Upon his arrival at the title company, he discovered that he was "one of about eight or nine people who were on the same piece of property. Each had his own slice of the tract and a separate loan from Empire."[56] The investors then sat down and signed stacks of documents, passing each copy on to the next participant until everything was complete. While the investor was usually told what was being signed, at no time did any of the closing documents leave the office. At the height of the land deals, the Rowlett office stayed open all hours of the day and night in an effort to keep up with the hundreds of closings. Said one investor later, "It was not unusual to drive by and see the lights on in the office past midnight, with people inside signing papers and eating pizza."[57]

Just as the backlog of documents created confusion within the title office, a similar situation was occurring with the records at Empire. Not only did the thrift have trouble keeping up with the filing of the hundreds of loan documents, but its wholly owned subsidiary, Statewide Service Corporation, had even had stopped even trying to post every transaction it was involved in. This slipshod bookkeeping became a tell-tale sign of a thrift that had outstripped its abilities to function as a business.

Under Federal and Texas state law, Empire was allowed to own a service subsidiary to assist in outside investment activities. However, the scope of Statewide's involvement in land deals and partnerships as an equity participant soon exceeded state limitations. In addition, soon after Blain joined Empire, the books of the subsidiary were no longer updated, and remained that way for over a year.[58] In fact at the time of the collapse, regulators were still unable to determine all the deals Statewide was a part of. Blain maintained that these transactions were few in number, and the reason why none of were ever posted was due to an oversight on his part.[59] Yet the disorganized condition of Statewide was effective example of the much larger chaos within Empire as a whole.

A final element relevant to the investments Empire engaged in is the belief that the Dallas real estate market was capable of sustaining such rapid growth over a prolonged period of time. Based on this feeling, Empire did not seek to diversify itself, and chose to ignore the involvement of other investors in the I-30 corridor.

According to Blain, part of the reason he decided to lend so heavily along I-30 was that he placed a great deal of faith in the strength of the Dallas condominium market, causing him and others to fall into a "boom psychology".[60] Based on the spectacular sales of Faulkner Point, it was felt that future projects would also essentially sell themselves, and with liberal zoning laws passed in 1981, officials hoped further economically feasable and well rounded development would be encouraged.

However, the codes passed, called "freeway zoning", virtually allowed any type of reasonable development, as long as it conformed to local building restrictions.[61] The result was, that instead of the intended mix of retail, office, and residential neighborhoods, the dominant development was in condominiums. According to one Garland city planner,

> They [condominiums] spread like wildfire. The developers simply did not take the time to look beyond their own projects to notice the tremendous glut emerging. Everyone was getting in at the same

time, and nobody knew what was happening in the rest of the market. 62

In March 1983, the Garland city council voted to restrict further construction of multifamily homes along the I-30 corridor, but by then over 30,000 condominium permits had been issued.[63] Blain however felt confident that his projects would not be seriously affected by this, even though a market study he commissioned by the Dallas firm of Crossen & Danis, in early 1983, detailed the low condominium absorbtion rates. Blain simply adjusted these findings with sales contracts he received since the market study cut-off date to generate higher, and more acceptable absorbtion figures.[64] By "massaging the data" in this way, Empire was able to produce the necessary justification for further construction.

Despite the intense growth of condominiums, and the flagrant use of land flips to inflate prices, Empire was still able to secure high appraisals that formed the basis of its loans. A pivotal reason for this was in the way developers were able to alter the appraisal process, which, like other parts of the investment system, was plagued by abuse and misconduct.

Chapter Four

THE ROLE OF APPRAISALS

While the use of land flips were crucial for establishing high land prices, an independent appraisal was required to certify these prices as true market values. Only then could the inflated prices be used as the basis of any loans Empire would make. Through the manipulation of the appraisal process, in addition to the neglect of legal obligations and professional ethics, appraisers in the I-30 corridor generated a steady stream of reports that consistantly determined high property values for most of Empire's loans. This apparent conflict of interest and fraud by a small group of independent appraisers allowed Empire to legally and justifiably lend on land that was clearly overvalued.

The appraisal of real property is a science that relies on both established techniques and the competence of the individual to arrive at a value. The American Institute of Real Estate Appraisers (AIREA) defines an appraisal as "an unbiased estimate of the nature, value, quality, or utility of an interest in, or aspect of, identified real estate."[65] While an appraisal has numerous applications as both an evaluation and as a valuation, its use as a valuation is critical in securing a mortgage loan. To arrive at a valuation, the appraiser has many available options depending on the characteristics of the property. The three major classifications are the cost approach, the income approach, and the sales comparision, or market value approach.

In the cost approach the appraiser must first estimate the value of the subject site by comparing it to recent sales at similar sites. The reproduction cost new of the improvments is then estimated, and depreciation from all sources is determined from the cost to arrive at a present worth. The present worth of all improvments is then added to the estimated site value with the result being the indicated value.[66]

The income approach, also known as the gross rent miltiplier approach, involves the processing of a net income stream into a present worth value. Like the cost approach, it requires extensive market research to determine gross income potential, expected expenses, and the duration and pattern of these income streams. The income streams are then put into a present value through the use of a capitalization process, and from this an indicated value is made.[67]

The direct sales approach uses the comparision of properties that have recently sold, or are offered for sale, with the subject property. The elements for comparision include location, conditions of sale, timing, financing and income and expense characteristics. The notable features are then adjusted from the subject to indicate a value range for the property being appraised. This value range is then corralated into a final indicated value for the subject.[68]

In the final reconciliation, the appraiser must weigh the significance, defensibility and applicability of each approach as it relates to the type of property being appraised. In the instance of single family homes, condominiums and raw land valuations, the sales comparision approach is recommended.[69]

Appraisers also rely on evaluation of market feasibility and the concept of highest and best use in determining value. To perform an evaluation of a paricular project, an appraiser must first consider the needs and goals of the client in relation to all resources and limitations.[70] If this one area is not met then the demands of the client are not being fully satisfied.

In a feasibility analysis, the appraiser must first determine cash inflows and outflows from the proposed project. The project must also be studied against existing and competative projects. From this, demand and supply projections can be formulated as well as anticipated rent or price schedules, in addition to an expected absorbtion rate for the development.

An essential element of the feasibility analysis is attention to development constraints. These constraints include zoning, terrain, and location in relation to the surrounding community. Also the scope of the project should be evaluated as it pertains to the market to insure reasonable fit with the concept of the highest and best use.[71] Together a valuation and evaluation provide information not only on questions related to market value, but also provides answers to real estate questions on the feasibility of the project.

Once an appraisal is completed, it is normally submitted in a report format in which all adjustments between the subject and the comparables are explained, justified and are defensible to outside individuals. The report also lists complete descriptions and any analysis and opinions by the appraiser.

The appraisal is an unquestionably detailed and thorough process and to perform one adequately requires special talent and training. Most appraisers gather their knowledge through courses offered by the numerous national appraisal societies. One of the most prestigious of these is the AIREA.[72]

The AIREA was founded in 1932 with the purpose of establishing a professional group of appraisers specialized in real estate. Like the legal and medical professions, the AIREA provides education, has an organized professional ethics code, and admits as full members only those appraisers who satisfy the detailed requirements set forth by the Institute. As the founder of the AIREA, Harry Atkinson commented

> we will create an educational institution which could develop and teach courses in appraising and will have the power to award an appropriate designation...that will mean as much in real estate appraising as CPA does in accounting and MD does in medicine. 73

This designation ultimatly became the MAI (Member Appraisal Institute). To earn an MAI certification has been compared to earning a college degree, since the candidate must not only attend classes and pass examinations in professional practice and ethics, but have specialized in a particular segment of real estate appraisal for at least three years.[74] Due to these stringent requirements, only a small percentage of real estate appraisers are MAI certified.

Despite these guidelines and proceedures an appraisal is still an estimate of value which can vary with different perspectives and sets of assumptions, and because of this has led to numerous criticisms that anyone can go out and "buy" an appraisal or that an MAI appraisal is in reality "Made As Instructed".[75] However the overall integrity of the appraisal profession is exceptionally high and many outside institutions have ultimate faith in the judgement of an MAI appraiser to provide accurate and unbiased valuations. As one savings and loan president commented, "If you cannot trust an MAI appraiser, who can you trust?"[76]

While appraisers must abide by the rules of the various appraisal societies, they must also follow many relevant federal regulations. One of these rules is Memorandum R-41b established by the FHLBB. This rule sets forth specific proceedures for preparing values of development properties and requires that appraisal reports contain market and economic feasibility studies.[77] These factors became exceptionally relevant in the valuation of properties that were used to develop the condominiums.

Since both Sinclair and Faulkner orchestrated nearly all of the land transactions on which Empire made loans for, they were able to control the number of different appraisers used to secure valuations. As a result almost 90% of all the appraisals were conducted by three individuals, Larry Hutson, Art Formann, and Paul Tannehill.[78] Furthermore, to aid in the appraisal process all land closings occurred at the one Rowlett title office which reduced the time that it took to prepare a report from weeks to a matter of days. Finally, to insure favorable reports, the developers paid exceptional bonuses and allowed the appraisers to participate in the properties they were evaluating.[79] Based on these incentives, the final reports often contained incorrect and unsubstantiated data in violation of both legal and ethical responsibilities.

Under the provisions of R-41b, each appraisal must contain a feasibility study and a valuation derived from the use of all three appraisal methods, or include an explanation why a particular method could not be used. Also, all adjustments made to arrive at a final valuation must be supported by a detailed justification in the narrative. However, for the I-30 appraisers, adhering to these legal parameters was more the exception than the rule. Almost none of the appraisals done by Formann and Tannehill contained feasibility studies, which was an important ommission. If a proper study was done, it would have indicated the prescence of a "condo glut" which would mean that the indended use of the site for condominiums was not in actuality the highest and best use. From this, the final value should have been adjusted downward.

Similarly, the sales comparision method was used almost exclusively for all the appraisals, and although it is a recommended approach, the appraisers could have also used the cost and income methods. One reason for using the market method was that the appraisers were free to choose the comparables from around the I-30 corridor. Sometimes, however, these comparables often did not reflect the true characteristics of the subject property.

For one tract of land, an appraised value of $11.00 per square foot was determined using comparables of $16.50 and $15.00 taken from lakefront property on Lake Ray Hubbard some five miles away. Later it was shown that the same tract was only worth $5.00 per square foot.[80] In addition, adjustments to land values seemed to occur randomly, with no supporting documentation given. Some appraisers also used sales contracts and not the actual closings as a basis for the comparables. Finally, in almost no cases were the values of flipped land adjusted downward based on their dubious sales histories.

Ethically, the appraisers engaged in conduct that did not follow the standards set forth by the AIREA. One of the most blatant areas of abuse was in the acceptance of thousands of dollars in fees and investment offers. Both Formann and Tannehill each made $221,000 on their appraisals, and Hutson, who did over 400 appraisals, recieved $1500 per land appraisal, and $2500 per condominium appraisal.[81]

Tannehill also invested $1.2 million in one I-30 project and later performed an appraisal on a nearby property. This apparent conflict of interest was not isolated. Formann had been a long time friend of Danny Faulkner, dating back to when Formann was president of Civic Savings in Irving, Texas and Faulkner was one of its stockholders. Civic Savings later failed, and Formann was removed by the state for various imprudent lending practices.[82] As an appraiser, Faulkner hired Formann often, even though he lacked the MAI designation which is an implicit requirement for loan appraisals. To solve this problem, Formann would write the appraisal, which sometimes contained figures predetermined by the developers, and then Tannehill, an MAI, would add his signature the finished product.[83]

Although both Tannehill, Formann and Hutson appeared to have participated in illegal and unethical practices, other appraisers did not. Some MAI's contend that their reports ended up inflated, not because of personal misconduct, but because of inaccurate and falsified documents from the title company. Although the one Rowlett office helped make the search for comparables easier, it also provided greater opportunities to alter documents at the title office resulting in more favorable reports. As one appraiser commented

> at one time we kept a guy down at Dallas Title because it was easier getting things from there than trying to go down and pitch it through the courthouse. We had no reason to doubt any information coming out of there. But that changed. There were some things that came up where there were some definate alterations of documents. 84

The reports the appraisers submitted became the basis of the loans made in the I-30 corridor. These included 16 appraisals for $15.25 per square foot as the basis for $8 million in loans from Lancaster First Federal, 31 appraisals of $13.00 used to justify $20.8 million in loans from Bell Savings, and 39 appraisals of $13.50 to warrant $32.8 million in loans from Empire.[85]

While the appraisals justified making such massive loans, they were still overvaluations. In some cases the appraised value was as much as 70% over the true market value, which cost Empire an estimated $35 million alone.[86] Not only did this further increase the risk of the loan, but when the loan was sold in the secondary market, it was highly probable that other independent appraisers would detect the miscalculations. However this was not a major concern of the developers, or Empire, since they had already realized their millions up front.

While appraisals provided the necessary justification to warrant Empire's multimillion dollar loans, it was still necessary for the thrift to raise the money to fund them. Due to the low availability of capital in the immediate area, Empire turned to a growing and highly liquid source, brokered deposits. This market, incorporaring brokers in a nationwide network, eventually was the primary reason the regulators took effective action against the institution.

Chapter Five

THE ROLE OF BROKERED DEPOSITS

It soon became obvious to those at Empire that to finance the operations at the level that was intended, it would be necessary to turn to sources outside their immediate area. The small communities of Mesquite, Rowlett, and Garland certainly did not have enough depositable assets to fund the millions in loans needed to develop the corridor, and even the larger Dallas metroplex would prove difficult to rely on due to the tremendous competition for funds already occurring. To solve this dilemma, Blain turned to, and became extremely reliant on a relatively new market, brokered deposits, which were not based on a local or regional sources, but encompassed a national network of independent money brokers able to electronically direct large sums into the deposit base of an institution instantaneously.

The rise of brokered deposits is a relatively new phenomenon that has grown tremendously in both size and activity in recent years. A brokered deposit is simply a negotiated certificate of deposit (CD) that is placed at an institution through a third party.[87] This intermediary then receives a fee, or commission, from the institution. The brokered funds market can be divided roughly into two areas. The first is the institutional market of uninsured CDs, those over $100,000, and a second is the institutional market in insured CDs, those at or under $100,000.[88] The primary difference between the two is that the second catagory of CDs are fully insured, whereas the second type of CDs are only insured up to the federal limit of $100,000.

Currently the brokered funds market is estimated at $120 billion nationwide.[89] Many different types of firms operate in brokered deposits, ranging from the major Wall Street investment houses, who deal in large uninsured CDs, to small local firms that deal exclusively in insured CDs. Since the larger investment services purchase and sell CDs well above the $100,000 insurance limit, they must utilize sophisicated credit and portfolio analysis to examine the institutions that accept their funds. However, the brokers of insured CDs often do not check for credit and lending risks, but rather seek to maximize the highest return on their investment. This limited perspective is dangerous, since it is often the case that the banks offering extremely high yields are in severe liquidity binds and possibly on the verge of collapse.[90] Not only does this put further pressure on the institution to make higher risk loans to compensate for larger interest payments, but also greatly increases the magnitude of a subsequent failure.

While the role of a broker can take many forms, there are three basic types of CD services available. The first, simple brokering, involves either the placement of funds directly by the investor into an institution selected by the broker, or the broker can place the investor's funds in a CD listed in the broker's name. The second service involves the use of computer networks that link brokers with banks. The banks list in the computer what quantities, rates and maturities it has to sell, and the broker uses this information to determine what are the best investment opportunities. The broker then electronically transfers funds to the bank in exchange for corresponding CDs. The final broker service involves the securities firm as a broker-dealer. The money broker purchases a quantity of CDs and then sells them to individual investors.[91] These CD participations involve the greatest activity by the broker, and are the most attractive to individuals with limited investment funds.

While the prescence of large sums of brokered funds in failed institutions has attracted considerable attention and criticism, supporters point out that brokered funds offer many positive features including an important source of liquidity, especially in areas that are limited in local capital.[92] Brokered deposits also help redistribute capital more equitably, and in the current period of deregulation, helps small bankers economically attract funds to grow and extend beyond local markets.

Brokered deposits, however, also pose several risks that can help precipitate a failure. Since brokers have the ability to funnel millions of dollars into an institution almost instantaneously, they can artificially prolong the life of a troubled bank. The eventual collapse often occurs when the bank cannot meet the high interest payments on the CDs, and the deposits are withdrawn. Similarly, the sudden inflow of capital may promote irresponsible and high risk lending by bank management, and small banks, unacustomed to large volumes of capital, may become unable to use the funds efficently.[93] In addition, critics feel that brokered deposits may allow institutions to become less reliant on local sources of funds, and result in their not serving their community adequately.

However, the biggest perceived problem of brokered deposits is that through careful purchases of CDs, bankers and brokers are able to place millions in a single institution with no risk of loss due to collapse. By buying $100,000 CDs, brokers can protect their funds with federal insurance, and earn excessively high rates of return. In the opinion of regulators, this is the equivalent of getting something for nothing, since the investor has transfered all risk to the government.[94] In a recent failure, one broker who placed over $117 million in high yield CDs, lost only $500,000.[95] All the other funds were paid out by the FSLIC. This situation led FDIC Chairman William Isaac to comment that these practices, in addition to the incomplete reporting of specific brokered funds activities by banks, have made it,

> hard to assess the individual condition of financial institutions when brokers can move large funds in and out quickly and...can turn small problem banks into larger problem banks...often with government insurance at risk. [96]

Despite its perceived risks, Blain actively pursued the brokered deposit market. By offering rates of 11.75% to 16.25%, some of the highest in the country, Empire's deposit base grew dramatically.[97] From June to December 1982, the level of withdrawable savings earning above average rates exploded from $17,340,528 to $48,437,385. A year later, this total exceeded $291.4 million. This represented a 1700% increase over the short 1.5 years.[98]

The majority of the deposits were in the form of $100,000 CDs, which qualified them for federal insurance. Although this placed the FSLIC insurance fund at great risk, Blain purposely sought this type of CD, explaining that if Empire had single deposits of $10 and $5 million regulators might assume that it was trying "to create all those exposures for the public."[99] By keeping the CDs small, he thought that it would be more of a public service.

Most of the brokers who placed their funds at Empire were independent small staffed firms who had little knowledge of Empire, other than it was offering exceptional rates. Of the 2289 brokered accounts in Empire, over 1400 were placed by one firm, First United Fund of Garden City, New York, and accounted for over $159 million of the total deposit base at the time of failure.[100] Fifteen other brokers, including FAIC Securities in Miami, High Yield Investments of Clifton N.J., First Empire Funding in Huntington N.Y., and Connie Tate Financial Services of Ventura California, supplied almost $100 million.[101] In all $252.8 million of the total January 1984 savings balance of $308.9 million, or 85%, came from brokered deposits. Of this, only $9.8 million was uninsured.[102]

While many brokers contributed millions to fuel Empire's growth, others did not choose to participate. The recent collapse of Penn Square Bank N.A., the largest bank failure in history, was found to contain large sums of brokered deposits, and to certain brokers, the growth at

Empire was reminiscent of Penn Square. According to one broker, Empire's surging deposit base, and consistently high rates "should have raised flags" to brokers.[103] Furthermore, news of the Dallas real estate problems alerted others to the potential hazards of investing in Empire. To increase this awareness, one Dallas thrift president even sent newspaper clippings to brokers wishing to make deposits in the area.[104]

However, despite these warnings, brokers still channeled money to Mesquite. A broker at FAIC Securities stated, "on paper they look very well. But we weren't actually given enough information to make a proper evaluation, so we didn't know all their problems."[105] Many of the brokers blamed the government for not keeping them properly apprised of what was happening, especially since the FHLBB had known of these problems well before the collapse. James Haggerty, a money broker with Pennesula Savings, summed up the feeling of other brokers who desired more active communication with regulators by saying, "I would welcome with open arms for the FHLBB to tell me to stay away from an institution that they feel is not credit worthy enough to accept brokered deposits."[106]

Although the FHLBB may not have communicated directly with the brokers, it should have been obvious to them that something was wrong with the institution. Often

Empire would not provide information to substantiate the profitability of their real estate loans. Furthermore, the regulator contends that some brokers did know of the situation, and still placed $100,000 deposits because they would be covered by federal insurance in case of a failure, yet still earn Empire's high rates.

Based on the steady stream of deposits from across the country, Empire was able to continue its lending program. However, as the condominium sales slackened, and after the Texas state authorities began supervising the association, brokers began to slowly withdraw portions of their funds. From January to March 1984 over $40 million was removed.[107] Yet due to its lack of loan revenue, Empire tried to attract other brokers not familiar with the institution to place more funds in order to pay off those CDs that had reached maturity. This practice continued, even after the FHLBB ordered the thrift to stop accepting brokered funds, in the hope of preventing a wholesale run on the institution.[108] When the collapse eventually came, regulators blamed it in part on the wreckless actions of money brokers, which it characterized as a "spreading cancer on the federal deposit insurance system."[109]

Based upon the mixture of unusual investment proceedures, irregular appraisals and the use of brokered deposits, federal regulators began to extensively examine the activities occurring in the east Dallas area, and the Mesquite thrift more closely. However, while the interest into how and why Empire was so profitable was intense, the action taken to correct the problems was, by comparision, slow and deliberate. Eventually, both the FHLBB and Texas Savings and Loan Board would become victimized by a form of bureaucratic rigidity that not only hampered their efforts to save Empire, but may have precipitated the collapse.

Chapter Six

THE ROLE OF THE REGULATORS

Federal and state regulatory concern over the operations at Empire began soon after Blain assumed control. Through an apparent oversight, he was allowed to remain the president of the association without ever filing the required documents with the regulators. Later the agencies became concerned over land transactions with developers that Blain was a part of, indicating possible conflicts of interest. In addition, the periodic examinations of Empire by state and federal examiners were showing that the supposed strength and profitability of Empire was in reality only paper thin. However, despite all these adverse signals, the FHLBB took no significant action to assist the institution. Hampered by manpower shortagaes, reorganization within the agency, as well as legislative and bureaucratic rigidity, the FHLBB waited until the last minute to assert itself. By this time, though, it had become obvious that Empire was destined to collapse. The problems that resulted in such chronic inaction highlight a regulatory system that found itself illequiped to handle a situation like the one which involved Empire.

When Spencer Blain became president of Empire in

March 1982, it was a welcomed event at not only the thrift but at the FHLBB, given Blain's record of past accomplishments. However, the agency was disturbed by the fact that Blain did not file a Notice of Change of Control in a Financial Institution, as required under the National Housing Act, prior to taking control.[110] This action was particularly suprising, since Blain, as president of the Texas Savings and Loan League, was well versed in the statutes governing thrifts. To correct this oversight, the FHLBB and Blain engaged in an eight month long exchange of letters, requesting the Notice be filed. During this time, Blain became CEO and Chairman of the Board through the acquisition of controling interest in the association. In September, he sent in the Notice, requesting retroactive approval. In January, while the FSLIC was reviewing this request, Blain consented to an order forcing him to transfer his stock in a blind trust, but also allowing him to remain in office.[111] Apparently, the FSLIC never took any action on this matter, and Blain was allowed to hold his positions at Empire, despite specific rules prohibiting this. Later in the year, federal authorities uncovered further improprieties involving the association's CEO, which should have brought a swift end to his tenure of office.

In June, the processing of the request for retroactive approval of the Change of Control Notice was interrupted when the FSLIC learned of several land sales by Blain to developers, who were also borrowers at his institution. Between August 23 and September 10, 1982, Blain, as chairman of Empire, purchased over 66 acres of land in Rowlett for .56 per square foot, or $1.6 million. In January 1983, Clifford Sinclair purchased 244 acres of unrelated land for $7 million, and subdivided 79.1 acres of this into 39 tracts which were sold to investors, using loans from Empire, for $32.8 million. Thirty days later, Sinclair purchased Blain's 66 acres for $5.57 per square foot, or $16 million. This money was drawn on a check from the Robert C. Lea trust account at Empire, which was used often by the developers, and paid into the "James H. Pyle trust account for Spencer H. Blain Jr."[112] To regulators, the excessive profit from the land deal represented a potential conflict of interest, to which Blain responded that the final purchase price was not excessive but a fair market value, and that he should have received more, since Sinclair was able to immediately turn around and sell the same land for more. However, the price Sinclair paid represented a 900% appreciation in value, which hardly seemed justified given the six month holding period. In addition, the land could not be used for multifamily housing, because the Rowlett City Council had denied a zoning change request by Blain just two months earlier.[113] As in the violation of the Notice statute, the FHLBB refused to take any action on the possibility of a conflict of interest until an investigation had been made.

In addition to the Blain land deals, the FHLBB later learned of investments activities made by other officer in the association. Carolyn Seabourn, President of Empire, netted $400,000 in 1982, and over $800,000 in 1983 on land deals that also involved Sinclair.[114] Furthermore, in mid-1982, Blain dissolved the loan committee, and chose rather to approve all loans solely by himself, leading to a state of mass confusion in the record keeping of approved notes.[115] In December, the FHLBB uncovered the agreement between Blain and Statewide Service Corporation involving a profit sharing arrangement. This plan was challenged by the agency and not approved. Under the challenged deal, though, Blain would have been entitled to $250,000 for the sale of land in 1982. Ironically, the Board of Directors later voted their chairman a Christmas bonus of $250,000 to suppliment his $30,000 annual salary.[116]

While these highly unusual circumstances did not directly lead to substantive FHLBB action, the examinations of the thrift eventually did. From the time of the first report in October 1982, examiners noted many of Empire's weaknesses and problem areas. Yet the manner in which the FHLBB reacted to these indicated that their motivation was more of a legislative obligation than a true concern for the association.

On October 3, 1982, the FHLBB began a periodic supervisory examination of Empire, which was completed in December and received in Washington one month later. The examination covered numerous aspects of the thrift, including financial performance and position, lending policies and practices, and management structure. While the report found Empire sound financially, with both high net income and net worth which both received "A" ratings, it was critical of the lending practices, the manner in which savings were solicited, and the overall management of the institution. Each of these areas received "C", or adverse ratings.[117] In particular, the report cited missing appraisal reports for several of the loans, and that many of these loans had little or no borrower equity. Also the high concentration of these loans within a limited area and in one type of development, indicating poor diversification and high risk, were highlighted.

The report detailed the dramatic growth of brokered deposits, and concluded that this highly volitile funds source could cause potential trouble for the institution, given its asset base. In addition, violations of the loans-to-one borrower statute had occurred, in which over 25 borrowers had over $24.22 million lent to them in excess of the regulatory limitation.[118] The thrift had also violated Regulation Z, covering the disclosure of APR, in five cases.[119]

The management of Empire by Blain was also criticized, not only because of his delay in submitting the Change of Control Notice, but for his profit sharing relationship with Statewide indicating a possible conflict of interest. Finally the report uncovered that Blain had overdrawn his NOW account on 40 different occasions for sums of up to $14,500, and had not paid any interest on the overdrafts.[120]

From this examination, the report concluded that Empire was exposing itself to excessive risks in the structuring of its loans, and in accepting such large sums of short term brokered deposits as savings. In addition, the report cited numerous rules violations which required immediate correction. The examiners finally noted, that due to the rapid growth Empire was experiencing, its books were in a severe state of disarray, which accounted for part of the delay in preparing the final exam.[121] Given this overall situation, the institution was assigned an adverse

CAMEL rating of "3". Normally, such a rating would result in a meeting with the directors, but in this case, it was decided by the FHLBB that these problems could be resolved through correspondence.

On January 9, 1983, the FHLBB sent a letter asking what actions had been taken to rectify the problems outlined in the examination. After no response was received from Empire, a second letter on February 25, followed by a third on March 16, were mailed. Finally, on April 6, Empire responded to the original inquiry, with a noninformative letter that was later characterized as a "kiss off".[122] Given the attitude of the directors of the association, and their apparent lack of concern to the situation there, it seemed reasonable that the regulators should have been spurred to take more constructive action. However, the FHLBB appeared content to follow its more deliberate process.

The next indicator of trouble in Mesquite came in the spring of 1983, as an outside audit of the association was being completed by Coopers & Lybrand. By this time, Empire was growing tremendously and the auditors were struggling to complete an audit that had begun in September. Because the records of the thrift were in such confusion, the auditors asked for numerous extensions on the filing deadline, which were approved by the FHLBB "in a stylized bureaucratic fashion".[123] Finally in June, the audit was completed, and a qualified opinion was given for both Empire and its subsidiary. In the final statement, the auditors noted the extreme disarray of Empire's books, and that the records for Statewide hadn't been updated in over a year. It also indicated that some of the accounting techniques Empire was using to record its loans, while legal, may not have been particularly appropriate given their structure. It was felt that if a more appropriate proceedure was used, the profitability of the association would be radically altered.

The Coopers & Lybrand audit showed that Empire had classified nearly all its real estate lending as loans, despite the fact that many of these had little or no borrower equity, which assigned all the risk to Empire. This treatment, however, also allowed the thrift to record points and fees up front as income, thereby boosting profitability. In the opinion of the auditors, a more correct means of recording this type of lending would be to classify them as real estate investments, which would have forced Empire to with hold reporting any income until the property had sold.[124]

While this distinction appeared simple, there was, at this time, a heated debate within the accounting profession on the proper accounting of investments versus loans. Peat Marwick and Mitchell initially took the position in support of defering income until the projects had sold, but backed off this position because the great difference in tax treatments required would essentially drive a number of institutions into insolvency.[125] Because of the inability to resolve this matter, Coopers & Lybrand chose not to make any recommendations to federal regulators when it met with them later in the month. Similarly, the FHLBB decided not to pursue this, mainly because Empire was essentially following the agency's accounting guidelines and until the accounting profession could reach a satisfactory conclusion on the issue, the regulators would not change their policies.[126]

At the state level, L. Linton Bowman III directed the Texas Savings and Loan Commission to conduct an examination on its own soon after he took office in January 1983, and after the federal examination was received. The Texas report not only confirmed the conclusions reached in the earlier report, but showed that the situation had worsened considerably.[127] As a result of these findings, Bowman, who had maintained close contact with his federal counterparts in the past, arranged a meeting with Blain and recently nominated FHLBB Chairman Edwin Gray to discuss the situation at Empire. From this May meeting, it was decided that the state would enter into a supervisory agreement with the thrift until September 1 to better monitor it and help eliminate the use of land flips as a basis for lending activities.[128] The FHLBB also acted, but not in a supervisory capacity. Instead it ordered a special limited examination.

The results of this August exam, received in October, showed that Empire was hopelessly entangled in a web of bad loans and mismanagement, which warranted a CAMEL rating of "4", meaning immediate forceful supervisory action recommended.[129] The report confirmed the suspicions of the Coopers & Lybrand audit, concluding that many of the loans were in fact misclassified and should be considered real estate investments. Also it noted the widespread use of flips to inflate land prices, as well as the hundreds of improperly prepared appraisals. From this the report concluded that, based on the fraudulent appraisals, along with the already saturated housing market, dozens of loans were in direct risk of default, and would put the institution in danger of collapse.

Based on this rating, the Board moved in November to conduct its own appraisals of the I-30 corridor to determine the true value of the thrift and to gather the necessary evidence for a temporary cease and desist order.

However, by late December, it appeared evident that Empire was headed for insolvency.[130] During December, federal regulators converged on Empire in such numbers that a shocked area thrift president to comment "it wasn't so much an examination as it was an invasion. We didn't have that many in Normandy on D-Day."[131]

On December 5, the FHLBB issued a temporary cease and desist order to prevent further unsafe and unsound banking pactices in condominium and land developments, and to halt violations of the loans-to-one borrower limitations. Later it made criminal referrals to the U.S. District Attorney's Office concerning the land transactions of Spencer Blain.[132] Finally it issued an order preventing the further acceptance of brokered deposits, but was unable to enforce it tightly so that the thrift could accept funds to stay afloat.

In January, Texas authorities assumed control of Empire and on February 28, Spencer Blain was finally removed from office. On March 14, the Bank Board appointed a receiver for Empire and declared it insolvent.

Shortly after the failure, the U.S. House of Representatives Commerce, Consumer and Monetary Affairs Subcommittee of the Committee on Government Operations opened hearings to investigate Empire. The purpose of the hearings was not only to better understand how the association did fail, but to try to ascertain the role of the federal agencies in this collapse. From this inquiry, the subcommittee hoped to formulate new rules and regulations to help prevent a similar failure in the future.

Chapter Seven

THE CONGRESSIONAL HEARINGS

On Wednesday April 23, 1984, the U.S. House of Representatives Commerce, Consumer and Monetary Affairs Subcommittee of the Committee on Government Operations convened in Washington D.C. to hold hearings on the adequacy of federal supervision in the failure of Empire. Chaired by Rep. Doug Barnard (D-Ga.), the subcommittee heard testimony from five witnesses, from which it hoped to form the basis of proposed legislative changes in thrift operations and regulatory supervision.[133]

The subcommittee traditionally had a strong role in overseeing the operations of federal banking agencies, and had conducted numerous investigations into the causes of several large bank failures. In 1982, it looked into the role of regulators in the failure of Penn Square, and in 1983 it examined the collapse of United American Bank of Knoxville, Tennessee. The subcommittee has also issued reports on real estate leasing practices, the Truth in Lending Act and most recently the propsed restictions on money brokers. Like these past inquiries, the hearings on Empire promised to provide constructive reform of regulatory ineffICENCIES and weaknesses.[134]

The first witness before the subcommittee was David

Cates, President of Cates Analysts, Inc., which provides a variety of computer generated analytical services to help determine the strength of all types of financial institutions. As an expert on bank failures, Cates stated the primary causes of insolvencies stem from continual mismanagement within the institution. This mismanagement is based not only on incompetence, but greed. The product of this greed is an unnusual hunger for assets to generate revenue, and include high yield and high risk loans, resulting in spectacular growth trends relative to other banks. In turn, this hunger for assets leads to a similar hunger for funding in the form of deposits. To attract these funds, the institution must offer above average interest rates.

Through his analysis of Empire, Cates outlined this chain of events. In 1981, Empire had total assets of \$16,937,783 which by the end of 1982, had grown to \$67,690,472 and later skyrocketed to \$332,512,459 just one year later, representing a 1960% increase in only two years.[135] The bulk of this growth came from increases in mortgage loans which exploded from \$13,012,973 to \$437,228,416 over the same period. In just the last six months of 1983, the portfolio mushroomed 198%. Cates noted that the average yield on these loans was 21.14%.[136] Since

Empire's loans were loaded with points and fees, it wasn't suprising that net income went from a 1981 year end loss of $22,468 to a remarkable $6,133,019 yielding 13.79 ROA, at a time when Empire's peer group was only recognizing .1 ROA.[137] This hunger for assets also meant that real estate investments would not increase, due to the delay in income recognition. Over the two year period these investments only rose from $100,000 to $457,633. Therefore, the predominant amount of lending was classified as loans rather than investments for accounting purposes.[138]

The funding hunger was easily recognized by the surge in brokered jumbo CDs. These above rate savings rose from $14,574,528 in December 1981, to over $291,409,080 in just two years. Since this deposit source accounted for 85% of the association's total deposit base, Cates did acknowledge that brokered deposits did play a role in the failure, but adamantly maintained they were not the primary cause.[139] In his testimony he went to great lengths praising brokered deposits, saying they were an excellent source of funds for institutions who use them prudently, but

> ...the emphasis on brokered deposits as some sort of major cause of bank failure is simply misleading. Mismanagement is the cause of bank failure. That leads to a hunger for assets. That leads to a hunger for funding. Brokered deposits is only one way to attract these funds. 140

The next witnesses before the congessmen were Texas Savings and Loan Board Commissioner L. Linton Bowman III and FHLBB Chairman Edwin Gray. Their testimonies centered on why their agencies had not acted more expediently in the Empire matter. The primary reasons offered for their delays were that the association was apparently so profitable and had such a high net worth. As Mr Bowman stated,

> The biggest problem that we were faced with was that at least on paper - and as a matter of fact according to the National Thrift News - [Empire Savings] was a leader in the industry. They had the fastest growth picture, they had the best return on assets of any association in the United States, and they were few even in second place.
>
> This of course is an alarming thing to us, because there is no Santa Claus. But by the same token, it makes it that much more difficult for us to walk in the front door and say "I'm sorry Number 1, but were going to close you down". So we felt we had to develop a fairly complex set of evidence to allow us to go into court and defend our position if we walked in the front door. 141

Though the examinations of Empire clearly showed that its image of profitability was in fact an accounting fascade, the inability of the accounting profession to resolve the loans versus investment issue prevented the regulators from making their own judgements, This heavy reliance on accountants to set the standards for the FHLBB was severely attacked by the subcommittee. It felt that the FHLBB should have asserted itself, independent of the accountants. In their report the subcommittee summarized the predicament the regulators found themselves in,

> The "failure of analysis" described is a classic example of circular reasoning or a "Catch-22" situation. So long as the association showed steady earnings and high net worth, the regulators would not bring a cease and desist proceeding or other supervisory or regulatory action. The association would continue to show high earnings and net worth if it took fees and points on real estate activities up front, simply because it characterized these activities as loans rather than investments. It remained for the regulators to interceed and break the cycle....It should not have taken the accounting profession's lead for the agencies to be able to distinguish between a loan and an investment. 142

The subcommittee also questioned why no action was taken against Empire based on the fraudulent appraisals. The congressmen were incredulous that Empire could make their large loans on land that was extremely overvalued through the use of land flips which the appraisals seemed to support. It was explained that both the state and federal authorities, as well as most financial officers, do not question appraisals performed by certified appraisers done on an independent basis. It was this faith in the work of MAI appraisers that was the subject a discussion between Mr. Bowman and Mr. Barnard,

> MR. BARNARD: As far as the banks and savings and loan associations are concerned [lending on land inflated in price through land flips] is not a prudent lending practice, is it?

MR. BOWMAN: No sir. The secret to making this particular scheme work is the appraisal

MR. BARNARD: What is the practice? Isn't the appraisal the lowest price that was made on a property?

MR. BOWMAN: No sir.

MR. BARNARD: Is it the highest?

MR. BOWMAN: Its the market value.

MR. BARNARD: The market value the same day?

MR. BOWMAN: Yes.

MR. SCHILLING: [OES Director] I might add that part of the appraisal process is to do comparables, that is other land sales in the same area that have comparable identity. If you're doing a wholesale number of land flips in a given area, part of the appraisal process is underwritten because the comparables are all in the same bag.

MR. BARNARD: Now, what are you all doing, both the state and the feds, to overcome that? that is certainly not a prudent lending practice.

MR. BOWMAN: No sir. You're absolutely right.

MR. BARNARD: Why wouldn't you impose a rule that it had to be an independent appraisal, rather than just the highest market value?

MR. BOWMAN: These were all independent appraisals.

MR. BARNARD: Oh come on.

MR. BOWMAN: They were all done by people who were lettered by the professional appraisal societies. The MAI was on each one of those appraisals.

MR. BARNARD: Who has oversight of apprisers now? [Laughter] That is a subject of great interest. 143

From this testimony, the subcommittee recommended that the FHLBB seek civil damage suits against the appraisers responsible for the faudulent valuations.

A third reason for the lack of regulatory attention to Empire was the disregard of the monthly call reports submitted by Empire. These reports clearly indicated the rapidity of the association's growth, highlighting not only the rise of brokered deposits but the concentration of mortgage loans. Similarly the subcommittee faulted the FHLBB for not closely analyzing the ratios that plotted Empire's activities relative to other comparable thrifts. This fact was brought out earlier by Cates, who placed particular emphasis on five critical ratios that he generated from FHLBB data to describe the growth of Empire in relation to other institutions or peer group. For 1982, Empire's ratios and those of its peer group were 144

Ratio	Peer Group 1982	Empire 1982	Empire 1981	Empire 1980
Mortgage loans/Total Loans	12%	48%	20%	10%
% Growth Loans	7	137	24	42
Loan Yield	11	21	14	12
Jumbo CDs/Earning Assets	6	64	37	31
% Growth Jumbo CDs	45	317	52	170

Asked if the FHLBB used similar computer generated ratios in its reports, Mr. Schilling, director of the Office of Examination and Supervision responded positively. However, according to Cates, it appeared that the FHLBB was the least sophisticated among the regulators and that their system was not currently programmed for such an early warning system.[145]

The use of such an efective early warning system could have provided sufficient justification for issuing a cease and desist order. However the regulators explained that even with guidance the issuance of such an order would have been still a difficult process.

The cease and desist order is the most potent tool available to a regulator to prevent an institution from engaging in an undesired area. There are two types of orders, either a permanant injunction or a temporary case and desist order. Since a permanant injunction often requires a trial, the temporary order is most often used to produce the quickest results. To issue a temporary cease and desist order requires an agency to find a violation of regulations of an unsafe or unsound to practice that is likely to cause insolvency or dissipation of assets, or seriously weaken its financial position.[146] This final point, that the practices would lead to insolvency was the main stumbling block that prevented regulators from issuing an order, since although Empire had violated numerous regulations, its financial position was not threatened, but was in fact growing. Also, because the FHLBB viewed the appraisals as inherently accurate and that the rise in brokered deposits in and of itself could not lead to a failure, the FHLBB could not justifiably issue a cease and desist order on those grounds.

The subcommittee found other problems within the bank board that hindered its actions. Because the FHLBB is composed of a central Washington office and several regional banks, very little action is taken at the regional level withough first consulting Washington. Furthermore, the communication between these offices are agonizingly slow due to a bureaucratic system that requires weeks to effectively process letters and documents. As an example, the October 1982 examination which was completed by December 17 was "transmitted" on January 18 and "received" on January 20.[147] Furthermore, the FHLBB rules have organized the examination tasks so that the examiner must report his findings to the supervisory level at which point any required regulatory act is instigated. This division of responsibilities proved to be another area of inefficiency the subcommittee recommended to be changed.[148]

Mr. Gray also suggested that staffing problems within the Bank was part of the reason action was not taken sooner. At the time of Empire's greatest difficulties, the Little Rock Bank was in the process of moving to Dallas. This move took seven months, tied up resources and resulted in the loss of 80% of all personnel who could not relocate. This came at a point when the FHLBB was already seriously under staffed.[149] Due to the inability to field enough examiners to oversee the large number of troubled thrifts in the widely dispersed Ninth FHLBB District a tremendous backlog of examinations developed. Empire was unfortunately part of that group.

At the conclusion of his testimony, Gray admitted to many of the shortcomings his agency had in trying to control Empire. He stated that,

> the manner in which this case was handled by the regulatory apparatis, this agency, was deficient in a number of ways....I think that [if the FHLBB had acted quicker] that [Empire] would not have failed and possibly it could have been saved. 150

This frank statement summarized a great deal of sentiment the subcomittee had towards the FHLBB in this matter.

The final witness was the chairman of Empire, Spencer Blain. Against the advice of friends and associates, Blain appeared before the committee to outline his role at Empire in detail. After addressing allegations leveled at him by Gray in earler testimony, Blain insisted that his objectives for the association had always been public knowledge and that they would have succeeded if it were not for the slump in the Dallas housing market.[151] In response to questions raised by the congressmen on his failure to file the change of control notice, in addition to the bookkeeping problems, and the NOW account overdrafts he contended that these were mere oversights on his part and had been blown out of proportion.[152] Similarly, he believed that his decisions to finance so many projects of one type in so small an area did not directly produce the condominium glut, but rather his initial sales attracted others to enter the market, leading to the total development of 30,000 units, of which Empire only controlled 6,000.[153]

Blain maintained throughout, that because of the clumsy manner in which the FHLBB handled the closing of Empire the magnitude of the failure actually increased. He believed that if allowed to pursue his original plan to fruition, not only would Empire not have failed, but would have posted a respectable profit. If he had done anything wrong at the institution he was unaware of it. As Blain put it "nobody hit us in the face."[154]

Throughout the hearings there was a noted sharpness and even hostility in the questions asked Bowman, Gray and Blain. At one point chairman Barnard lashed out at Gray for not notifying his subcomittee of the failure earlier than he did especially because Gray was a witness at the hearings on brokered deposits the day Empire closed. At the outset of the Empire hearings Barnard told Gray,

> now, I should state frankly that the subcommittee should have been informed on March 14, the morning before you closed it, that afternoon. I think that the bank board's failure to have done so was embarrasing *to me and disrespectful to the serious inquiry* that this subcommittee was under taking. 155

Later in questioning Blain on his NOW account overdrafts, Barnard revealed a sense of frustration in the following discussion.

MR. BARNARD: How do you respond to the Bank Board's examination report that you were frequently overdrawn on your NOW account by as much as $23,000 and that no interest was charged on these overdrafts?

MR. BLAIN: I had the association calculate interest on that and paid - I wrote a check for interest based on what the association charging other borrowers. That never happened again.

MR. BARNARD: In other words, you're saying that it was a one time happening?

MR. BLAIN: Oh, I was guilty of it, I was guilty of it over a period of two or three months. But--

MR. BARNARD: How many times?

MR. BLAIN: I don't know sir.

MR. BARNARD: Would 44 sound like a reasonable number?

MR. BLAIN: I don't know. [156]

It was clear from these sections of testimony and others that the sucommittee was angered not only by the way in which Empire failed, but by the comedy of errors that had tried to prevent it. To avoid such an event from ever repeating itself, the congressmen made a number of recommendations which it reported to the Committee on Government Operations in July.[157]

In its findings, the subcommittee suggested several areas of reform in regulatory rules and proceedures to help hasten the supervisory process. First, it recommended that the reach of a cease and desist order be broadened to include "institution related parties" and affiliate groups including second tier service corporations. This change would have allowed the FHLBB to act against Empire based only on the activities of Statewide. It was also recommended that the meaning of unsafe and unsound practices be expanded to include books and records in disarray, and that the word "substantial" be stricken, since the Bank Board complained of the difficulty in trying to prove that the continuation of a practice would likely result in an insolvency.[158] Finally the subcommittee proposed certain amendments to the Change in Control Act to provide better definition of the meanings and stiffer enforcement and penalties for noncompliance.

One of the more suprising conclusions reached by the subcommittee concerned the role of brokered deposits. Although the Bank Board had long held that this was the substantial factor contributing to the decision to close the association, the final report disagreed, noting that,

> brokered deposits was not the proximate cause of Empire's failure. Brokered deposits did indeed provide additional fuel, but the fire had been raging, and was not originally ignited by the brokered funds. Moreover, the Bank Board was aware of the potential problems resulting from brokered deposits as early as the 1982 examination, but did not act on limiting Empire's access to these funds until too late, in early 1984. 159

Based on these findings, there appeared to be no further need to seek any further legislative action against money brokers, other than to maintain a closer watch over the growth of institutions using them improperly as a signal for other problems

The adjournment of the subcommittee did in no way put to rest the Empire story. Months after the failure, the effects are still being felt in the communities Empire invested in and by the other thrifts that participated in these projects. State and federal criminal investigations into the I-30 area have turned up stacks of falsified financial statements, suspicious land deals involving public officials, and other evidence that is being used to warrant civil and criminal proceedings. However not all the effects of the collapse have been negative. Because of Empire, the state has taken greater steps to protect thrifts, and the appraisal profession has stiffened penalties for professional abuse. Based on these actions, a greater awareness to the pitfalls of overreliance on a particular market for growth has occurred from a failure that has been dubbed "the Penn Square of Thrifts".

Chapter Eight

THE AFTERMATH AND CONCLUSION

The effects of the Empire collapse have been both immediate and long term, affecting all levels of Dallas society. The most immediate impact was on the FSLIC insurance fund, since over $275 million of Empire's deposits were in accounts of $100,000 or less.[160] Similarly, other savings and loans that contributed to the I-30 corridor began to feel the shock waves of Empire soon after March 14, and for months afterwards. The long term effects have been felt most in the east Dallas communities that saw their small cities grow almost overnight, and are now filled with vacant and unfinished condominiums. The appraisal profession has also suffered, resulting in tighter enforcement of ethical rules. Also the money brokers have incurred a sudden flurry of regulatory action against them that has yet to be resolved. Continuing media and federal investigations have turned up reams of documents suggesting that the true scope of the Empire dealings may never be fully known. Many of these documents and other evidence are now being used as the basis of the on-going FBI pursuit of civil and criminal indictments against the individuals connected with the condominium development schemes. Finally, regulatory changes at the state and local levels have provided some hope that the events that produced the insolvency may not repeat themselves.

The morning after Empire was closed, the small one office thrift was bustling with activities of a different type. Inside, federal and state regulators were beginning to sift through stacks of records and statements, trying to grasp the magnitude and scope of the failure. The most immediate task was to pay off the millions in insured accounts held at the association. Within 24 hours, regulators received sacks of overnight letters from the hundreds of depositors with brokered funds at Empire. By March 18, over $8.5 million was paid out to these brokers.[161] In addition to brokered accounts, people from the Mesquite area trickled into the office at 2920 Motley Drive to collect on their accounts. While many of these depositors held their lifesavings at Empire, there was almost no panic about not receiving their money. As one elderly lady put it, "I think we could all laugh about what happened because we knew we'd get our money back."[162] However not all the depositors were as lucky. Over since $9.5 million at Empire was uninsured, and while the majority of these accounts were with money brokers, some, including a trust account for an order of retired nuns, were from ordinary people who simply did not maintain insurable balances.[163]

The Empire failure also had a hard impact on the entire Dallas real estate market as well as on many area thrifts. While outsiders had not been aware of the developments Empire was financing, those within the local real estate community considered the unusual I-30 land deals to be one of the worst kept secrets in the metroplex. After the failure, the Dallas market, once considered a prime real estate lending area became tagged as a "high roller" region.[164] In the opinion of on North Dallas thrift executive, "Faulkner Point ruined it for all of us."[165]

For those savings and loans who invested in the corridor, the collapse signalled the beginning of a new wave of trouble for them. Investex in Tyler, which lent $110 million, began to feel the effects even before the failure, when it entered into a supervisory agreement with the state in January.[166] It later became insolvent and was merged with another institution. First Federal of Burkburnett and Lancaster First also became insolvent and are now operating under a conservator. They will likely be merged. Bell Savings in Belton faced a similar fate months later and despite concerted efforts by management to save the institution, it too will be merged.[167] The demise of Bell hopefully has stemmed the tide of the major lending problems associated with the I-30 corridor, although the actual number of thrift involved well exceeds the major seven.[168]

As the regulators try to contain the fallout of Empire within the financial community, the cities of Mesquite, Rowlett and Garland must come to grips with the acres of condominiums within their municipalities that are still unoccupied. A majority of these are now under the control of the FSLIC, which will determine how to dispose of them. Others are being taken over by major real estate management firms for long term investment purposes. Despite this improving situtation, the I-30 cities will continue to suffer as a result of the overbuilding.

In the months immediately before and after the failure, hundreds of units stood vacant and in various states of competion. They soon became inviting targets for vandalism and arson, resulting in the destruction of dozens of units. While most of these vandals were disgruntled construction workers, others were believed to be desparate developers who were unable to sell their projects.[169] Yet after March 14, the FSLIC took control of the projects through foreclosures and loan assumptions and took measures to protect their new found holdings.

From an investigation into these properties, the agency uncovered many of the effects the inflated appraisals had on these loans relative to actual market values. FSLIC Associate Director Scott Taylor noted that the real net worth of the properties was anywhere from 80% to 2% of what Empire loaned, leading him to remark "we're going to loose alot of money" when it is time to sell the units.[170] This prediciton was borne out in the two foreclosure sales the FSLIC held in May and June which attracted a diverse group of people ranging from serious investors to curiosity seekers. These sales produced bids averaging 20-30% of loaned value, and in one case an investor bought property with a loaned value of $20 million for .90 a square foot, or 3% of the value recorded on Empire's books.[171] Afterwards, the FSLIC was severely criticized for not spending any money for improvements to increase their marketabiltiy and attract higher bids. Eventually the agency reversed this position and decided to spend money to finish out many of the projects as well as to commission studies to find the best way to market the properties. One of these proposals, from the real estate division of the CPA firm Kenneth Levanthal and Co., is to convert the developments into a planned retirement community.[172]

While the FSLIC controls 2442 of the I-30 condominiums, other major real estate groups have stepped in and made purchases in the area. These firms include Trammel Crow and Lincoln Properties who manage the units as apartments.[173] Two Trammel Crow companies, Crow Western and Brentwood, are also under contract with the FSLIC to finish and lease 945 units controlled by the agency.[174] Yet until a final solution can be found, acres of condominium ghost towns will still display "Now Leasing" banners in an effort to persuade home buyers to come into an area tainted by the Empire failure.

The biggest victims of the condo glut have undoubtedly been the cities. In a largely symbolic act, Garland purged the Faulkner name from all city streets and neighborhoods, yet can do little else to mitigate the effects of 6000 condominiums within tis city limits. So far it has lost $355,000 in city taxes and $300,000 in school district tax role as a result of property revaluations totaling $130 million.[175] Also the hope and vision of the balanced development of the I-30 corridor transforming the city into a major commerce center have been shattered. As Garland Mayor Charles A. Mathews commented, "this has hurt our city, but we're working very hard to correct it."[176]

The area of appraisals was one of the most investigated aspects in the entire Empire saga. Not only did the appraisals boost land values for the loans, but they have since been used as comparables in other valuations.

One appraiser later said, "its a vicious cycle. The inflated appraisal supports an inflated loan for an inflated land sale, and soon these land sales are used as comparables for other land sales."[177]

An immediate result of the swift investigation of the three responsible appraisers has been the indictment and conviction of Larry Hutson for "assigning an arbitrary value"[178] to land. In the case, it was revealed that in addition to his other improprieties, Hutson once received a huge bonus for making up a property value just hours before a title closing. Hutson was sentenced to a jail term and fined $300,000 payable to the FSLIC.[179] This sentence was reached after Hutson agreed to turn state's evidence in the prosecution of the other appraisers. Indictments on Tannehill and Formann are expected soon.

Another group that has come under severe attack has been the money brokers. Although the House subcommittee did not find that brokered deposits led to the failure, the FHLBB and the FDIC nonetheless enacted tight restrictions on the activities of brokers, despite a massive lobbying effort to prevent them. These rules, which include limitations on the the amount a single broker may place in one institution to $100,000, were later contested in court.[180] In this case, the plaintiffs, FAIC Securities and Securities Industries Association, won a crucial victory over the regulators when it was ruled that the agencies had overstepped their statutory powers in passing the new rules. Later, the FDIC modified portions of these enjoined regulations and had them incorporated into "The Financial Services Competative Equity Act", which was later defeated on the Senate floor.[181] Since then, there have been no comprehensive retriction enacted against money brokers.

While unable to act against brokered deposits, the FHLBB, along with the Texas Savings and Loan Commission have enacted some rules changes to promote greater regulatory efficency. From the FHLBB, these revisions include changes in net worth requirements, to control thrift growth, and changes in insurance requirements for de novo institutions.[182] Similarly, the occasions in which a temporary cease and desist order can be issued have been modified to include many of the recommendations the sub-committee made. Also the FHLBB has taken a more assertive role in determining accounting rules and proceedures for the agency. Finally, all examiners are now required to take an adapted version of the Society of Real Estate Appraisers (SREA) Course 201 in addition to the lower level SREA Course 101.[183] However, for the examiners, their greatest appraisal knowledge will come through increased exposure and experience, since there is a significant difference between appraisal academics, and appraisal practice in the real world. Major rules changes at the state level have not been as numerous as at the federal level, and have focused on situations in which a cease and desist order may be issued. Part of this inaction may be due to the timing of sessions of the Texas legislature.[184]

While these changes are steps in the right dirction, much more needs to be accomplished. The FHLBB must practice uniform nationwide enforcement of its rules, including R-41b. Similarly, greater coordination between federal agencies, as well as with state agencies, is required to prevent situations where the left hand doesn't know what the right is doing. Finally, until the changes in the cease and desist order are complete, the agency needs to learn how to effectively use its current powers on a timely basis.

Throughout the Empire story, there have been numerous reports made by the local media. Television stations have done many stories on the area one reporter dubbed the "Corridor of Greed".[185] Yet the most persistant investigations have been conducted by Allen Pusey and Christi Harlan of the Dallas Morning News. Using sophisticated computer models and painstaking research, both these reporters have produced a series of articles, dating back to the original expose in November 1983, detailing the activities of Blain Sinclair and the appraisers. Their efforts have been praised by many individuals as the epitome of investigative journalism.[186]

Many of their recent stories have focused on what has happened to the people who established Empire as a paper giant, and the less fortunate individuals who have been indicted for criminal activities. Danny Faulkner, the original I-30 developer, purchased First National Bank of Garland in January 1984, just as the Empire fiasco was making front page headlines. Suprisingly, the Office of the Comptroller of the Currency approved this transaction without any idea that Faulkner was the subject of a series of federal investigations.[187] Today he still owns First National, and is essentially doing little else but "running his bank".[188]

Spencer Blain is "retired" and managing his assets, most of which came from his dealings at Empire, and include a house and condominium in Steamboat Colorado.[189] He is prevented from ever being a bank officer again, due to the Order of Removal and Prohibition he signed on February 28. Ken Caswell and Earnie Hughes are both still in real estate. Caswell is, in fact, the leasing agent for the old Empire building in Mesquite, which is proving hard to rent due to the Empire stigma. As an associate puts it, "its hard to find a Jack in the Box restaurant that needs a drive up window and a vault."[190]

Both Jim Toler and Clifford Sinclair have already fought legal battles related to Empire. Toler was named in a suit by contracter John Zervas, along with Faulkner and Blain, for racketeering. He was later dismissed after he made an out-of-court settlement.[191] Sinclair has had to fight a more difficult struggle. After he reorganized five of his development firms under Chapter 11 protection in federal bankruptcy court, the state initiated a renewed effort to have him extradicted to Alabama for prosecution for his earlier crimes. Although Governor White approved the extradition order Sinclair successfully had it blocked by a visiting Alabama judge.[192]

While the troubles of Faulkner, Blain, Toler, and Sinclair may for the moment seem dormant, the FBI has organized a special criminal investigation unit to collect further evidence for criminal indictments against these principle players, in addition to the private and civil suits already pending.

One of the most promising sources of evidence the FBI and other law officials are relying on is in the prosecution of minor people involved with Empire, including the investors and appraisers, in the hope that they will turn state's evidence rather than receive stiff penalties. This has already occurred in the Hutson case.

The collapse of Empire is proving to be disasterous for the 200 investors who signed for the loans. Within months, dozens of these tiny investor corporations filed for Chapter 11 protection in an effort to absolve them of an responsibility for their loans. Others were granted releases from their liabilities by the FSLIC in exchange for agreements from them not to block the planned foreclosure sales.[193]

Finally in early 1985, the FBI began to hand down indictments to many of the 60 organizations that reorganized, charging the investors with filing false financial statements to secure loans. These 15-20 indicments came after months of investigation into the supoenaed records of the Rowlett office of the Dallas Title Comapny, Kitco and Peak Investments.[194] It is expected that more charges will be filed in the near future, and from the indictments of these "little fish" in the Empire sea, that enough evidence will result to pyramid up to the leaders of the association and the related developers.[195]

One of the investors, and a link in the Empire chain was state Senator Ted Lyon. He is currently under investigation by a federal grand jury in several areas, including land flips he took part in with Jensen, Hughes and Sinclair, development loans he signed for from Bell Savings, and the activities of his law office that formed a majority of the investor corporations.[196] As of May 1985, no indictments had been made.

Not suprisingly, the FHLBB and the FSLIC have also come under legal attack. As a result of the frank testimony of Chairman Gray, in which he admitted the negligence of his agency in the supervision of Empire, both he and the FHLBB were sued by investors and developers for not controlling Empire and not warning the borrowers of its condition. Also the FSLIC was sued by contractors for payments due on construction to the condominiums.[197] Both these cases are unresolved.

One of the unusual results of all this legal action has been the tremendous boom in legal services. Paul Juensen, who is under investigation, recently hired the prominant and flamboyant Houston attorney Richard "Racehorse" Haynes to represent him.[198] According to Billy Ravkind, attorney for both Blain and Faulkner, "this is the single greatest event in the history of the legal profession in Dallas. Its like Christmas to the retailers."[199]

The failure of Empire Savings and Loan Association of Mesquite affected not only the southwestern financial community, but damaged the towns and reputation of the real estate market it invested in. The overdevelopment of a small suburban Dallas region not only helped boost Empire into a role of leadership and prestige within the industry, but also involved several dubious land transactions and lending practices that relied on the services of appraisers and the funds of money brokers to make them work. Although the final losses of this insolvency are still unknown, it is estimated that they could reach $1 billion.[200] From this tragedy have come recommendations for change in the regulatory process that proved woefully inadaquate in handling the association's sudden growth. Similarly, state and federal authorities are continuing to investigate civil and criminal actions against the people who created and funded the condo glut in the hope of bringing the Empire story to a final end. However, as more facts are uncovered, it is felt that the true impact of Empire will never be fully understood, or that a similar insolvency will not occur again. Yet, as Chairman Gray observed,

> We must recognize that Empire was not a typical failure. Rather Empire involved a fraudulent scheme on a massive scale funded by large ammounts of freely available brokered deposits where the institution continued, for some time, to appear on paper to be operating profitably and increasing its assets and net worth.[201]

From this analysis it is clear that the insolvancy occurred as the result of a complex chain of events, and that based on the timing of these events, analysts have unquestionably established Empire as the "Penn Square of Thrifts."

Appendix A

INTERVIEW WITH L. LINTON BOWMAN III

Commissioner, Texas Savings and Loan Board

How did the condominium boom originate?

Faulkner was building condominiums out there and building them right, not overinflating them and not taking anything except the profits out. Initially he was the first player out there. Faulkner Point One and Two are perfectly good. There is nothing wrong with them. Everyone who invested in them made money and then sold out.... Somewhere along the line somebody said if it works at this level just think how it will work at this level. Sinclair has been named as the guy who pushed the deals, but there are people on Sinclair's side who will say sure he did, but everytime Sinclair made a dollar on something, 50 cents of that would be kicked to Danny.

Why do the land flips?

The reason for the flips has always been a big question mark. Why take it through five flips in one day, each transaction with insiders who knew each other, were closely aligned, and sometimes were in the same corporate entity. Why do that? Why not take it from $4.00 to $12.00 once? Why do it from $4.00 to $6.00 to $7.00 to

$8.50 then $12.00? They did it because the comparables were created with each flip. Also, in my opinion, those things were done to establish a share of the profits. In other words they were essentially unrecorded liens on those properties. Then when the flips were done, it was decided that this entity gets this much of the final proceeds - this entity gets so much based on $7.00 a square foot, and he gets so much based on $8.00 a square foot. And in the end everybody's slice was dictated by the flip itself.

Did deregulation effect the collapse of Empire?

The only part of deregulation that fueled what happened was the deregulation of money funds, because everything they were doing was ostensibly in the regulations. The fact was what we had at Empire were people who were supposedly operating within the rules.

Describe the loans-to-one borrower rules.

Here is the loans-to-one borrower situation. They realized that if you take a ten acre tract and cut it up or develop it into ten acres of condominiums you've got an enormous loans-to-one borrower problem for an association like Empire which had no substantial net worth, which sets up what a loans-to-one borrower is. Okay, there are two things you do and Blain did both of them. First of these was you don't close a loan until you've got it all sold or if you're going to keep ten percent, that's fine, because that doesn't violate your loans-to-one borrower. So you arrange to have the excess of your loans to one borrower sold off before your closing. That makes it a qualifying loan. The second thing to do was to subdivide the land, which led to your checkerboard effect. You take that ten acres and divide into ten one acre projects, instead of one ten acre project. Now its still one ten acre project when you look at it, but you got little sections there, and thats where you get your three investors or two investors to go in there and sign all the papers, or take all the liability and walk away with $20,000 to $40,000. These people were making it possible for that to be made into ten projects instead of one project, which again was a way to circumvent the loans-to-one borrower rule.

Describe Paul Jensen's role at Empire.

Jensen was in the mortgage business while he was in California. He at one point had been manager to the Osmond Brothers, then he moved to California and organized Mountain States Mortgage. That led him to do business with Empire in some fashion. I don't know what that fashion was but Spencer Blain and Paul Jensen knew each other.

How well, no one can say. As Blain said to me "I met him once or twice." But he was concerned enough about him that Blain went to San Francisco and went through the offices of Mountain State Mortgage just to make sure it really existed. It was more than just a casual concern.

How was Danny Faulkner able to buy his bank, given all the investigations into Empire?

That's an interesting story. The day he bought the bank, it was announced in the paper and everybody went crazy. They called us and said are you telling me the Office of the Comptroller of the Currency did not trade information with the FSLIC. That's exactly what I told them. Then I got a call from the Comptroller's office in Dallas saying can't you start talking to us on a regular basis and I said sure. I'm still waiting to hear from them. But nevertheless he did buy that bank in Garland after the Empire failure and after all the newspaper coverage it got. He then got his associates to organize a new bank charter called Faulkner Corners National Bank or Faulkner Corners NA.

Could Empire have survived if there wasn't a housing surplus in the I-30 corridor?

You mean Blain's argument? Not in my opinion because to create that much product in that short a period of time was made necessary by the fact that the flips themselves had heated the market up to the point that there had to be construction. In other words, you had to have that next loan, you couldn't wait. That next loan then carried that amount of money plus the interest necessary to carry that amount of money for a year or two years, so that bought you time. At that point you had the loan but you also had the interest built in, so for the first time since the thing started you'ld reach a cooling off period, but you could not wait a year to build them out. The problem was that you couldn't wait to make payments on the note because at the end of the year the time bomb goes off and there's no more interest built in, and someone has to be responsible for the debt. So they had to build to make the payments; the investors had no choice. They had the obligation out there and with 6000 potential units coming out of the ground, in my opinion there was no way for the Dallas market to absorb it. If they had got all those condos occupied thay would have created slums, but they had to keep saying to the investors and participants that the condos were selling, so they called the condos occupied simply because they put mini-blinds in the windows. Staff members put on lights in selected units at night and chanbed the angle of the blinds to make it look like it was lived in. They bought cars that couldn't even run and put them out there. The problem was they didn't pay attention to them and in 2-3 weeks all the tires would go flat. But they still tried to make everybody believe the units were moving.

Would you describe the tone at the hearings as hostile?

I think what you see when they're [the subcommittee] investigatating what they consider to be a regulatory breakdown that they do adopt a hostile posture. One of the things that caused a lot of concern in Gray's camp to the extent that he asked me to get up to Washington to discuss anything before the hearing, was I had pointed out to him much earlier my concerns about Empire on the 9th of June 1983 during the [Texas Savings and Loan League] convention at the Registry in Dallas. He said that he thought it was unusual to be driven to the convention in Rolls Royce owned by a S&L manager. So we discussed Empire at that time, but later he said that I did not make it apparent to him there were any great concerns about that problem out there. If I failed to impress on him the severity of the problem I thought perhaps the Rolls Royce would do it.

I told Gray, that initially the problem with Empire on the federal side was in the fact that the Little Rock Bank was moving to Dallas, and was losing 80% of personnel, and that some things we're going to slip through the cracks. Unfortunately Empire came along exactly at the wrong time for the FHLBB.

<u>How are the criminal investigations proceeding?</u>

The F.B.I. is working from the bottom up. In other words they feel they will get more information from the people who were not involved in anything but the ultimate deal, in the hopes they can build a pyramid back up to the top. A lot of people are going to try and get off by saying they came in late and were just doing the same as everybody else. But I'm confident that they will get indictments on everyone involved.

<u>What have been the major state regulatory changes?</u>

The S&L Commission now has the authority to define what is unsafe and unsound and one of the things they will define as unsafe is a failure to maintain proper books and records in accordance with the regulations. They didn't have that spelled out before. If they had, the day we went in and saw the disarray in the records at Empire, we could have said your unsafe and unsound, issued a cease and desist, and said you are out of business. We knew all along the line that what ever we did would have to be supportable in court. The stakes were too high not to. The other thing is we don't have involuntary conservatorship rights. We don't have that until September 1, 1985. Had the board not asked for voluntary supervisory control which we got on January 9, our next step would have been to go to district court. You see the way you go into receivorship is on the basis of imminent insolvency. Now Empire supposedly had $20 million in net worth and we knew it didn't have it, but we would have had to go into court and prove it and that's a Dallas County Court against Dallas County residents. Spencer's attorney Billy Ravkin was the one who told them to go into supervisory control in January and he finally, late one night, got them to agree to it. If he hadn't done that we never would have gotten there in the first place. Even after that it still took the FHLLB 60 days to get in there to take over.

<u>What are the major federal regulatory changes?</u>

They have asked for authority from Congress for a number of items Gray referred to that day when he said "you've deregulated the industry but you haven't deregulated the regulators." They're still, however, in the congressional process at this time. But I've got to tell you something. The best tool they have is to go into the front door and say we are cancelling your insurance of accounts and we will tell the press. Now it presently takes 2-6 years to cancel insurance which is ridiculous.

It takes away every bit of teeth they've got, except if they announce that they are going to do it and start an investigation, then nobody would put his money in that association. But the problem is you've got the loans still outstanding. Its a damned if you do, damned if you don't situation. But it has got to be changed since its too clumbsy right now as it is.

Appendix B

INTERVIEW WITH W. KENNETH LAW

Attorney, and past president of Bell Savings

Describe the environment S&Ls were facing prior to Empire.

The elements for the success of Empire and the success for the fraud against Bell were really established during the past years and did not just spring up. For years the industry was hurting and struggling for ideas prior to Empire. Prior to 1979, S&L's only had about three good years, and in 1979 we went into the interest rate crunch and partial deregulation of savings accounts. Now you have to understand that we were still making mostly fixed rate mortages, because for so long we had been beat in the head to make nothing but single family homes loans. We couldn't do nything in commercial lending and very little about consumer lending.

So when 1979 rolled around and interest rates began to climb on savings, we started paying on savings accounts at a comparable rate to T-Bills. Up to that time the highest paying C.D. we had was at 8% for 8 years with a minimum $1000 deposit....Then they created the money market certificate with a $10,000 minimum, indexed to the 26 week T-Bill auction rate. But the bottom line was that it had a 6 month maturity....So at a time when rates were climbing, we started to pay out C.D.s at 8 1/2% with 6 month maturities, but our average mortgage loan yield was only about 7 1/2%.

It just about decimated our industry, because what you had was an industry with fixed rate very, very, secure portfolios and on the other side was the savings side that was slowly being deregulated. And it started like a snowball. You had a minor deregulation that threw an entire industry in the red, and then you had major deregulations in 1980 and 1982 that further descimated the industry.... Weekly you started reading about little thrifts that were in trouble. You also started reading about the accounting games, the use of goodwill as net worth, little games that the accounting profession came up which, and the FHLBB blessed because it made them look okay politically.

Then they introduced ARMs to help S&Ls still do the single family loans by allowing them to adjust with the costs. But this was a token effort by the FHLBB, because we were still strapped with the huge fixed rate portfolios and many S&Ls knew they couldn't survive waiting for the adjustments to come....and they continued to deregulate savings and didn't give any real consideration to the asset side. So what you had now was a situation where the average yield was 9 1/2% and the average cost was 12%.

In 1980 if you look at the Texas Savings and Loan league directory that posts all financial statements, you'll see, I believe, that over 50% of the S&Ls in the state were less than 60 million in total assets. And so many of these were little one man shops, including mine, with limited talents and limited ability to maneuver out of that fixed rate portfolio. These S&Ls sufferd like that for two to four years, with pressures from the [Federal Home Loan Bank] Board, pressures from stockholders, and management. And every meeting I went to would be dismal, dismal, dismal.

Then about mid-1981 every meeting started having a section devoted to joint ventures and real estate projects in which you shared in the profits. The big S&Ls had all survived by using this joint venture project scheme. Little S&Ls started wanting to get in on it also because they were desparate.

Remember, at that time there wasn't any place you could turn, except to sit and watch your net worth go down, until you get a letter from the FHLBB, when you reach a certain point, saying "In another 10-12 months you're going to be out of net worth. Please send us a letter and tell us what you're going to do about this situation."

Imagine! Here's this poor guy whos been running his shop for 10 years, his reports are spotless, he's been doing what he's been told to do by the FHLBB, and none of this is his fault and he gets a letter from them saying you're so stupid, why don't you tell us what you're going to do about this. It was beneath insulting!...It was the worst of a damned if you do, damned if you don't situation.

Well, the big S&Ls started selling participations in their joint ventures to the little S&Ls, and then the little S&Ls started trying to organize their own participations. Bell also did some little ventures with Murray Savings. But then I got the letter from the FHLBB so I made it known that Bell could be purchased.

Well at that time nobody wanted to buy an S&L, and of those stocks that were traded, they usually only received 30% of book value. Then a consultant let us know of an S&L in Lancaster that had this mortgage banker on their board who was looking for a S&L to buy and I said, "Oh perfect. A mortgage banker, with capital and a good track record. The FHLBB ought to love him." So he set up a meeting with me and Paul Jensen.

Decribe Paul Jensen.

He's a fascinating guy. Very boyish looking. I don't know all about his background because some things he said were true some weren't. He had been educated as a sort of medical technician, working a kidney machine, and he told us he was an actual medical doctor. But he was very intelligent and a whale of a salesman. He once said in an interview he could sell ice boxes to eskimos....We checked up on him, and found out that he had several six figure accounts in thrifts in California, and any check he would write would clear, be it for $75,000 or $500,000.

Now he was from Utah originally, with connections to the Osmond family, and was a big mormon who lived strictly by the tenants of the church....In fact all those people with Empire claimed to be the biggest Christians in the world. Jensen talked of mormon doctrines, Cliff Sinclair, and Waylon York [condominium builder] even used to wear this big heavy cross on a gold chain outside his tie, and all of them gave megabucks to charities and churches. In fact Toler established his own children's orphanage.

Well anyway Jensen said he wanted to pay us 1.7 times book for Bell in cash, which was amazing because in those days nobody wanted an S&L. We then set up an informal agreement for him to by Bell. Then later, he asked us to close some loans as joint ventures, saying we'll get 4-5 points up front just for closing them. And I said, well that's fine but we don't have enough savings in cash to make those kind of loans and I didn't want to get hung up in any more fixed rate lending, and he told me "No problem. These are acquisition and development loans and that he could get a California S & L to make a commitment to take out everything." Even though he didn't have the commitments ready at closing, we just had to close them now.

Well, I took a look at them, and although all the papers were there, it wasn't as good as I wanted, so he made some improvements....Pretty soon, we were closing a bunch of loans all of which were going to be taken over when construction started. We were warehousing a ton of land. Then it started to smell wrong, and it was apparant we had bit a bad apple, and it was strictly from a management stand point at that time. In February 1983 we discovered Jensen in a land flip; he was third or fourth in line. After that we didn't close any more loans, and we told him that we didn't want him to buy Bell. And he fought us! He wanted to buy us and get rid of me for being such a rat, because by this point in time his ego and pocketbook had gotten so big that he thought he was above everything.

Well, needless to say these contract letters that were to take out our loans couldn't be fulfilled because the borrowers didn't have the resources.

Why would any S&L lend in the I-30 area given what was going on?

Spencer Blain [Chairman of Empire Savings] at this time was running from border to border in the state bragging about how great things were up there, driving his Rolls Royce and two jets and a helicopter, and how his S&L made so much money, and it looked like he flat hit that pocket in the market. It happens in North Dallas all the time; it happens today! Guys are up there without a nickle in their pocket and next year they'll be legitimate millionaires and nobody defrauded anybody to do it.

The point was Spencer Blain, an intelligent, very intelligent guy, and very articulate native son of the industry comes up and says "Guys I have found the formula, here it is, and its great, and I'm doing good, and this and that, and tell you what. Since were such good friends I'll let you in on it." Well for alot of people, it was hard not to be persuaded.

Describe the deals Bell was involved in.

We only got the points but not high rates. That was a part the regulators wouldn't allow. But this is what really gets me mad. They indicated that because the way the deals were offered they had to be bad. Not true!

They should go and check the rates back then. If you get an interim loan at all back then you paid 18% and a 2% loan fee, <u>and</u> a 10% compensating balance. Now you could get that to come out to 18% and 4-5 points, but it made more sense for them to say "look at how greedy they were." Yes they were good deals and good offers, but that's what the deals were making at the time. The point was if you take everything out of context it looked crazy, even though the deals though weren't all that out of line.

<u>What happened at Bell then?</u>

Well after Jensen left we knew we were going to face a big workout ahead. So we staffed up and began to build condos and tried to work the secondary market. Ernie Hughes then came to us and wanted to be project manager for our buildings. But when he started getting into it it was obvious he didn't know what he was doing.

All this time the interest meter was ticking which required cash and incuring costs because the budgets given us were all wrong since they were done on a mini-computer by Kitco from non-comparable projects. But again all the paper was there and even a civil engineer letter that verified the estimated budget based on the figures from Kitco. Sinclair must be one of the luckiest boobs or the biggest purposeful fraud that ever was. But he was able to find - ready for this - a surveying industry that was hurting because building was down, a building industry that was on its knees, appraisal business that was bad, title insurance was bad. The chemistry of it was just right, right place, right time.

One of the elements prior to the Empire I meant to give earlier was that given the credentials of an MAI appraiser, any S&L would accept and rely on his appraisal as gospel. Also financial statements, credit reports, and all the vehicles to do underwriting are basically a joke. You can do the best you can, but sooner or later you get to a point where you have to decide, do I lend money to that person or not, and here's the collateral. This was particularly important in the joint ventures situation because you're betting on that person's perceived ability to see it through. So when financial statements have been manipulated and falsified, and the same is true with the appraisals, and you're confronted with a desparate lender, well, the environment was just ripe for disaster. If the industry was well off this never would have happened.

<u>When did Bell collapse?</u>

We never gave up the faith, seriously, until we started falling in October 1984. By then it was abundantly clear the FHLLB wouldn't accept our Business Plan we submitted in July of last year. Until that point we believed we could manage our way out with our five year plan. But to do that we had to have the support of the Bank Board since we were already in regularory violation, and we knew that. It was stupid that they kept throwing that fact up in our face as the reason for not working with us. We said we recognize that, and we're trying to work it out, because we believed we could find a way out. But there was no way they would work with any management of an S&L who make that kind of error, and I did make an enormous error. It was a heck of a big one.

But we still tried to work it out. The staff that I had was so good that we handled our brokered deposits and a million other things. We worked our brokered money down from 77% of deposits down to 40% of last year. We weathered the storm of media attention, and was ready for the broker deposet run when it happened, and handled it! We also discovered new sources of funds....Part of our ability to do this was due to the staff we had. Our chief financial officer was one of the most brilliant guys I know and he exuded such confidence that everyone believed that we could succeed.

Anyway, when we recognized our problems in May 1983, after Jensen left, we geared up to weather the storm. We started investing in staff and faculties to accept the growth. We even had a mortgage company in Dallas and placed a branch there. We even own the only Century 21 in Texas and possibly the country. The reason why we did that was to access their secondary market to market our condos....All of this, and a million other things, were done to prove that a billion dollar S&L could manage its problems, but the FHLBB never went for it. They were in a mind set prior to our saying anything, but didn't reveal this to us, because they knew we had some good points.

How did you plan to get out of your problems?

We came up with a great plan we got with Ed McBirney, Chairman Sunbelt Savings, very solidly successful S&L, because Ed has a large group of land developers. So we went to him and asked if there was anything he could do about it. He thought about it for about two months, and came back and said here's what you do: you have this piece of land here thats got a $10 million loan on it and now have an honest appraisal that says its worth $5 million now. You've now got a $5 million loss. Over here, I got a developer and he wants to build a project on land he bought a year or two ago for $2 a foot and its now worth $4. He wants to take that land and build apartments. Now the land is $2 million and an appraised value $8 million, so he's got a $6 million potential equity profit. So we will finance this guys land over here and then sell it in the secondary market. Then he takes that money, and buys our land for $10 million, and the cross collateral insures the positive equity in that land against the negative equity in this piece. Then it just sits there and appreciates over three or five years, because in Dallas, land in that area is going to be worth $12.00 to $15.00 per square foot in five years. So if you hold it long enough it will wash. But this is a simplified version of our plan.

Problem: making loans to same borrower in excess of our limit, because for a period of time between when the loan was made and when its sold in the secondary, we would be in violation. Furthermore, they reasoned that, if the deals didn't work, the FSLIC would be deeper in the hole if they had to come and bail us out. The simple fact was they just didn't want us spending more of their money.

But we fooled ourselves. We were so determined, and believed in ourselves so much that we could work it out. And we worked so hard. My goal then became as soon as this was under control I was going to get out. I don't know <u>what</u> the heck I did to deserve this but maybe its good for me. I need a couple of years to get over it. Its going to be a long, lengthy process.

Appendix C

COMPARATIVE FINANCIAL STATEMENTS FOR EMPIRE SAVINGS AND LOAN ASSOCIATION

Source: Federal Home Loan Bank. Dallas, Texas
FHLBB No. 7375

FINANCIAL INFORMATION SYSTEM

COMPARATIVE STATEMENT OF CONDITION

DISTRICT 09 DOCKET 7375
EMPIRE S & LA
MESQUITE TX
ASCL: 2 PAGE 1
REPORT ID: ANT45J DATE 82-09-13

	AS OF JUNE 30, 1982			AS OF DECEMBER 31, 1981			AS OF JUNE 30, 1981		
	ASSN.	% TO T.A.		ASSN.	% TO T.A.		ASSN.	% TO T.A.	
	AMOUNT	ASSN.	P.G.	AMOUNT	ASSN.	P.G.	AMOUNT	ASSN.	P.G.
ASSETS									
MORTGAGE LOANS AND CONTRACTS	27,470,617	87.39	78.14	13,012,973	76.74	79.61	9,508,496	71.72	79.93
NON-MORTGAGE	2,582,100	8.21	5.38	2,511,044	14.81	5.41	2,672,959	20.16	5.41
REPOSSESSED PROPERTY	118,799	.38	.16	-63,490	-.36	.13	1,316	.01	.13
REAL ESTATE INVESTMENTS	0	.00	.24	0	.03	.14	0	.00	.12
CASH ON HAND IN BANKS AND									
INVESTMENT SECURITIES:									
ELIGIBLE FOR LIQUIDITY	852,334	2.71	11.09	1,147,912	6.77	13.46	452,462	3.41	10.74
INELIGIBLE FOR LIQUIDITY	0	.00	1.50	0	.00	1.03	0	.00	.67
INVESTMENT IN SUBSIDIARIES AND									
SERVICE CORPORATIONS	50,000	.16	.47	50,000	.29	.27	50,000	.38	.27
STOCK IN FHLB	71,000	.23	.69	74,500	.44	.70	81,100	.61	.72
FIXED ASSETS	116,367	.37	1.57	96,734	.57	1.65	468,891	3.54	1.56
OTHER ASSETS	174,842	.56	.77	129,140	.76	.59	21,971	.17	.46
TOTAL ASSETS	31,436,059	100.00	100.00	16,957,783	100.00	100.00	13,257,194	100.00	100.00
LIABILITIES									
WITHDRAWABLE SAVINGS									
EARNING ABOVE REGULAR RATE	14,574,528	46.36	77.02	11,206,336	66.08	77.07	10,184,094	76.82	76.82
EARNING REGULAR RATE OR BELOW	2,693,194	8.57	11.38	1,644,742	9.70	11.28	1,406,859	10.61	11.56
ADVANCES FROM FHLB	1,300,000	4.14	2.14	300,000	1.77	2.65	700,000	5.28	2.85
OTHER BORROWED MONEY	0	.00	1.75	0	.00	1.56	0	.00	1.01
LOANS IN PROCESS	11,583,547	36.85	1.15	2,737,815	16.14	.75	27,324	.21	.60
DEFERRED CREDITS	176,836	.56	.53	46,818	.28	.44	44,628	.34	.45
SPECIFIC RESERVES	0	.00	.03	0	.00	.03	0	.00	.03
OTHER LIABILITIES	270,195	.86	1.61	243,490	1.42	1.47	129,759	.97	1.62
SUBORDINATED DEBT	0	.00	.03	0	.00	.00	0	.00	.00
TOTAL LIABILITIES	30,598,301	97.34	95.66	16,176,201	95.39	95.25	12,491,664	94.23	94.95
NET WORTH									
PERMANENT STOCK	600,000	1.91	.63	600,000	3.54	.64	600,000	4.53	.62
PAID-IN SURPLUS	446,745	1.42	.39	446,746	2.63	.35	446,746	3.37	.29
MUTUAL AND INCOME CAPITAL CERT.	0	.00	.00	0	.00	.00	0	.00	.00
RESERVES	103,120	.33	2.82	106,091	.63	3.01	99,593	.75	3.12
UNDIVIDED PROFITS(EARNED SURPLUS)	-312,108	-.98	.66	-371,245	-2.18	.74	-380,806	-2.86	1.09
NET UNDISTRIBUTED INCOME	0	.00	-.16	0	.00	.02	0	.00	-.07
TOTAL NET WORTH	837,758	2.66	4.34	781,582	4.61	4.75	765,530	5.77	5.05
TOTAL LIABILITIES AND NET WORTH	31,436,059	100.00	100.00	16,957,783	100.00	100.00	13,257,194	100.00	100.00

NOTE: THE ABOVE ASSET AND LIABILITY CLASSIFICATIONS INCLUDE APPROPRIATE ACCRUAL AND ALLOWANCE ITEMS. RATIOS COMPUTED WITHIN APPLICABLE CATEGORIES ON SCHEDULES 3A AND 3B DO NOT INCLUDE SUCH ITEMS.

F I N A N C I A L   I N F O R M A T I O N   S Y S T E M

DISTRICT 39 DOCKET 7375
EMPIRE S & LA
MESQUITE TX

COMPARATIVE STATEMENT OF OPERATIONS

ASCL: 2 PAGE 2
REPORT ID: ANT45K DATE 82-09-13

	SEMIANNUAL PERIOD ENDING JUNE 30, 1982			SEMIANNUAL PERIOD ENDING DECEMBER 31, 1981			SEMIANNUAL PERIOD ENDING JUNE 30, 1981		
	ASSN.	% TO A.A.		ASSN.	% TO A.A.		ASSN.	% TO A.A.	
	AMOUNT	ASSN.	P.G.	AMOUNT	ASSN.	P.G.	AMOUNT	ASSN.	P.G.
INTEREST INCOME									
MORTGAGE LOANS AND CONTRACTS	923,852	6.81	8.04	587,267	7.77	7.90	563,913	8.90	7.64
OTHER LOANS	212,917	1.76	.70	197,038	2.61	.70	187,706	2.96	.58
INVESTMENTS AND DEPOSITS	20,132	.17	1.66	44,225	.59	1.66	42,567	.67	1.62
LOAN FEES	301,478	2.49	.28	49,403	.65	.28	38,118	.60	.29
TOTAL YIELD	1,358,399	11.23	10.66	877,903	11.62	10.52	832,331	13.13	10.10
OTHER OPERATING INCOME									
LOAN SERVICING FEES AND OTHER CHAR	10,907	.09	.08	12,932	.17	.08	12,838	.20	.10
OTHER	24,620	.20	.33	74,403	.99	.24	65,633	1.04	.14
TOTAL OTHER OPERATING INCOME	35,527	.29	.38	87,335	1.16	.32	78,471	1.24	.22
GROSS OPERATING INCOME	1,393,916	11.52	11.04	965,238	12.78	10.84	910,772	14.37	10.34
OPERATING EXPENSE									
COMPENSATION	110,491	.91	.72	84,765	1.12	.74	65,495	1.03	.72
DIRECTORS, OFFICERS & EMP. EXPENSE	18,548	.15	.02	4,143	.05	.02	5,813	.09	.02
OFFICE OCCUPANCY, FURNITURE, FIXTURES AND EQUIPMENT	71,772	.59	.32	43,171	.57	.30	32,311	.51	.28
ADVERTISING	3,424	.03	.06	4,558	.06	.08	4,173	.07	.08
OTHER	51,151	.42	.43	33,756	.45	.43	45,193	.71	.36
TOTAL OPERATING EXPENSE	255,366	2.11	1.52	170,393	2.26	1.54	152,983	2.41	1.46
NET OPERATING INCOME BEFORE									
COST OF MONEY	1,138,550	9.41	9.52	794,845	10.52	9.30	757,789	11.95	8.86
LESS: CAPITALIZED INTEREST	0	.00	.00	0	.00	.03	0	.00	.03
COST OF MONEY									
WITHDRAWABLE SAVINGS	861,619	7.12	10.24	792,539	10.49	10.06	684,300	10.79	9.06
ADVANCES AND BORROWED MONEY	50,969	.42	.44	52,251	.69	.46	54,859	.87	.38
TOTAL COST OF MONEY	912,588	7.54	10.68	844,750	11.18	10.52	739,159	11.66	9.44
NET OPERATING INCOME	225,962	1.87	-1.16	-49,915	-.65	-1.22	18,630	.29	-.58
NON OPERATING ITEMS									
NON OPERATING INCOME	0	.00	.22	66,525	.88	.16	3,497	.06	.14
NON OPERATING EXPENSE	169,786	1.40	.12	558	.01	.06	44,593	.70	.06
NET NON OPERATING INCOME	-169,786	-1.39	.10	65,967	.87	.10	-41,096	-.64	.10
NET INCOME BEFORE TAXES	56,176	.46	-1.04	16,052	.21	-1.12	-22,466	-.34	-.48
INCOME TAXES	0	.00	-.14	0	.00	-.16	0	.00	.00
NET INCOME	56,176	.46	-.93	16,052	.21	-.98	-22,468	-.34	-.48

NOTE: ALL RATIOS APPEARING ON THIS PAGE AND APPLICABLE RATIOS ON PAGES 3 AND 4 HEREIN, ARE ANNUALIZED BY MULTIPLYING X 2

FINANCIAL INFORMATION SYSTEM

SCHEDULE # 39 - GENERAL RATIO ANALYSIS

DISTRICT 09 DOCKET 7375
EMPIRE S & LA
MESQUITE TX
ASCL: 2 PAGE 4
REPORT ID: ANT45M DATE 82-09-13

RATIO NO.	RATIO DESCRIPTION	JUNE 30, 1982 ASSN. RATIO	JUNE 30, 1982 P.G. AVER.	JUNE 30, 1982 DIST. AVER.	DECEMBER 31, 1981 ASSN. RATIO	DECEMBER 31, 1981 P.G. AVER.	DECEMBER 31, 1981 DIST. AVER.	JUNE 30, 1981 ASSN. RATIO	JUNE 30, 1981 P.G. AVER.	JUNE 30, 1981 DIST. AVER.
008	NOI/AVER ASSETS	1.87	-1.15	-1.45	-.76	-1.24	-1.54	.27	-.58	-.75
013	NOI/INT INCOME	83.82	89.36	89.44	89.71	88.29	88.38	93.86	87.69	88.33
015	ML INT/AVER ML	17.54	10.76	11.26	13.10	10.40	10.77	13.79	10.04	10.37
016	ML INT - LF/AVER ML	8.95	10.41	10.75	12.08	10.05	10.35	12.92	9.70	9.92
017	OTH LN INT/AVER OL	17.24	13.34	14.08	15.62	13.17	13.61	14.61	10.95	12.23
019	INV INC/AVER INV	4.03	13.86	12.99	11.37	14.80	13.90	17.63	14.33	13.26
020	INT INCOME/AV LNS&INVT	16.67	11.30	11.59	13.46	11.07	11.22	14.13	10.60	10.75
021	LOAN FEE INCOME/NET INC	556.00	-40.18	-61.34	398.33	-36.92	-50.35	-226.79	-75.37	-120.99
023	SER COR INC/AVER SC	.00	16.68	12.14	200.00	18.27	8.79	.03	2.44	8.38
040	ML INT/GOI	80.73	75.24	78.59	66.46	75.48	78.95	66.21	76.54	79.23
046	TOTAL INT/GOI	97.45	96.56	95.55	91.64	97.19	96.65	91.54	97.83	96.81
048	LOAN FEE INCOME/GOI	22.41	3.31	4.77	6.51	3.32	4.22	5.60	3.56	4.63
055	NET INC/NET WORTH	14.37	-18.69	-20.95	4.19	-18.54	-19.23	-5.70	-9.15	-7.98
064	OPER EXP/GOI	18.32	13.72	14.54	17.79	14.19	14.58	16.83	14.21	14.43
065	COMPENSATION/GOI	7.93	6.49	6.56	8.85	6.81	6.59	7.29	6.89	6.83
066	D, O & E EXP/GOI	1.33	.17	.16	.43	.21	.17	.64	.22	.19
067	OFF BLDG EXP/GOI	5.15	2.88	3.18	4.51	2.82	3.14	3.55	2.80	3.02
069	ADVERTISING/GOI	.24	.63	.88	.48	.71	1.38	.46	.76	1.04
071	COST OF SAVGS/AVER SAVGS&DEPS	11.44	11.56	11.88	12.97	11.37	11.63	12.47	10.24	10.54
072	COST OF BM/AVER BM	12.74	11.54	12.44	20.70	12.33	12.93	15.67	10.19	10.83
074	COST OF MONEY/GOI	65.47	96.71	98.64	88.18	97.28	99.73	81.29	91.44	92.84
213	LIP/ASSETS	.00	.04	.05	.03	.03	.06	.03	.04	.07
227	SLOW INS & GTD/ASSETS	.00	.03	.03	.00	.03	.00	.00	.00	.00
228	CONSUMER CREDITS/ASSETS	5.29	2.67	3.21	12.23	2.34	3.36	16.37	2.08	2.84
229	SLOW CONV/ASSETS	.00	.45	.48	.53	.43	.40	.14	.45	.37
233	OTHER SCHLD ITM/ASSETS	.03	.00	.00	.30	.03	.00	.03	.03	.03
237	GNL/MTG LNS	.00	8.16	11.32	.03	7.33	8.29	.03	6.83	8.06
241	+4 CONV/MTG LNS	14.34	12.45	17.31	23.60	12.15	15.32	11.59	12.23	15.83
255	BORROWINGS/SAVGS&DEPS	7.53	4.44	13.18	2.33	4.77	13.03	6.04	4.37	10.31
256	BORROWINGS/SAVGS,DEPS&RM	7.00	4.25	11.65	2.28	4.55	11.53	5.73	4.19	9.34
260	CTF SAVINGS/SAVGS&DEPS	84.40	87.12	86.25	87.20	87.23	86.10	87.86	86.93	85.52
262	NET WORTH/SAVGS&DEPS	4.85	4.91	4.80	6.55	5.38	5.22	6.50	5.71	5.71
265	CASH&SEC/SAV,DEPS&BORR	4.59	11.86	8.41	8.71	11.10	7.52	3.68	11.45	7.97
300	CHANGE IN TOT ASSETS	85.39	4.93	8.09	27.91	2.86	5.10	9.57	2.79	5.11
302	CHANGE IN TOT LIAB.	89.16	5.54	8.57	29.50	3.49	5.74	10.43	2.66	5.52
304	CHANGE IN NET WORTH	7.19	-9.66	-2.63	2.10	-8.23	-7.59	-2.85	-4.19	-2.63
310	CHANGE IN SAVINGS	34.37	4.62	6.77	10.87	2.51	3.28	11.98	2.02	3.92
315	CHANGE IN BM	333.33	3.61	7.53	-57.14	26.78	31.03	.00	6.42	16.88
340	CHANGE IN ML	111.45	3.12	5.55	36.94	2.46	4.32	13.51	2.43	5.63
342	CHANGE IN CONV MTG LENDING	111.45	2.16	1.84	36.94	2.49	3.81	13.51	2.23	5.42
343	CHANGE IN SFD MTG LENDING	139.36	.78	-.21	47.54	2.34	3.12	-8.25	1.88	4.73
344	CHANGE IN M-FAM CONV-LENDING	26.28	7.56	12.07	11.58	2.65	5.62	162.44	3.64	8.05
370	CHANGE IN NET INCOME	249.96	12.59	14.50	-171.44	139.56	136.27	-134.45	-2571.61	-370.18
375	CHANGE IN GOI	45.51	3.55	8.19	5.36	7.41	9.89	45.23	9.07	10.87
380	CHANGE IN OPER EXPENSES	49.87	.93	8.89	11.38	5.71	11.17	16.84	2.94	9.74
385	CHANGE IN COST OF MONEY	8.93	4.58	7.70	14.29	15.43	18.07	47.80	17.72	21.95
390	CHANGE IN TOT NET SCHED ITEMS	-29.55	6.02	22.39	4.95	5.95	24.55	53.57	-5.10	5.12

F I N A N C I A L   I N F O R M A T I O N   S Y S T E M

DISTRICT 09 DOCKET 7375
EMPIRE S & LA
MESQUITE TX
ASCLI 4 PAGE 1
REPORT ID: AH145J DATE 84-03-27

COMPARATIVE STATEMENT OF CONDITION

	AS OF DECEMBER 31, 1983 ASSN. AMOUNT	% TO T.A. ASSN.	% TO T.A. P.G.	AS OF JUNE 30, 1983 ASSN. AMOUNT	% TO T.A. ASSN.	% TO T.A. P.G.	AS OF DECEMBER 31, 1982 ASSN. AMOUNT	% TO T.A. ASSN.	% TO T.A. P.G.
ASSETS									
MORTGAGE LOANS AND CONTRACTS	437,228,416	131.49	82.59	257,904,128	144.52	77.84	85,064,061	125.67	80.78
LESS: LOANS IN PROCESS	105,745,472	31.80	8.57	81,342,671	45.58	4.92	29,989,999	44.30	4.15
OTHER CONTRA ITEMS	7,936,464	2.39	1.45	6,104,973	3.42	1.66	1,640,370	2.42	2.25
NON MORTGAGE LOANS	3,106,137	.93	7.10	2,850,702	1.60	6.28	2,337,912	3.45	5.89
LESS: LOANS IN PROCESS	0	.00	.05	0	.00	.02	0	.00	.01
OTHER CONTRA ITEMS	0	.00	.32	0	.00	.09	0	.00	.26
REPOSSESSED PROPERTY	176,242	.05	.32	165,704	.09	.40	31,428	.05	.26
REAL ESTATE INVESTMENTS	457,633	.14	.45	367,808	.21	.49	100,000	.15	.60
CASH ON HAND IN BANKS AND INVESTMENT SECURITIES:									
ELIGIBLE FOR LIQUIDITY	3,660,616	1.10	9.01	3,268,408	1.83	11.19	11,194,070	16.54	9.13
INELIGIBLE FOR LIQUIDITY	0	.00	2.77	0	.00	2.60	0	.00	1.26
INVESTMENT IN SUBSIDIARIES AND									
SERVICE CORPORATIONS	50,000	.02	1.60	50,000	.03	1.09	50,000	.07	1.41
SERVICE CORP. APPRAISAL INCREMENT	0	.00	.01	0	.00	.00	0	.00	.01
FIXED ASSETS	199,987	.06	1.44	264,192	.15	1.55	130,210	.19	1.32
FIXED ASSET APPRAISAL INCREMENT	0	.00	.11	0	.00	.27	0	.00	.17
OTHER ASSETS,NET DEFERRED CREDITS	1,315,364	.40	4.93	1,038,011	.58	4.98	413,160	.61	5.58
TOTAL ASSETS	332,512,459	100.00	100.00	178,461,306	100.00	100.00	67,690,472	100.00	100.00
LIABILITIES									
WITHDRAWABLE SAVINGS									
EARNING ABOVE REGULAR RATE	291,409,508	87.64	65.58	139,053,655	77.92	63.33	48,437,355	71.56	70.22
EARNING REGULAR RATE OR BELOW	12,041,140	3.62	22.23	19,758,606	11.07	23.61	12,873,849	19.02	14.39
ADVANCES FROM FHLB	0	.00	3.30	0	.00	4.66	800,000	1.18	5.89
OTHER BORROWED MONEY	0	.00	2.84	0	.00	2.36	0	.00	3.86
OTHER LIABILITIES	17,366,482	5.22	2.26	11,448,264	6.41	2.31	3,511,476	5.19	2.19
TOTAL LIABILITIES	320,817,130	96.48	96.20	170,260,525	95.40	96.51	65,622,710	96.95	96.35
REGULATORY NET WORTH									
PERMANENT STOCK	600,000	.18	.12	600,000	.34	.13	600,000	.89	.09
PAID-IN SURPLUS	446,746	.13	.40	446,746	.25	.32	446,746	.66	.46
MUTUAL CAPITAL CERTIFICATES	0	.00	.00	0	.00	.00	0	.00	.00
INCOME CAPITAL/NET WORTH CERT.	0	.00	.06	0	.00	.02	0	.00	.00
QUALIFYING SUBORDINATED DEBENTURES	0	.00	.03	0	.00	.02	0	.00	.00
APPRAISED EQUITY CAPITAL	0	.00	.18	0	.00	.27	0	.00	.17
RESERVES	20,487	.01	1.74	20,487	.01	2.01	94,416	.14	2.35
UNDIVIDED PROFITS(EARNED SURPLUS)	10,628,095	3.20	1.07	7,133,548	4.00	.69	926,600	1.37	.50
NET UNDISTRIBUTED INCOME	0	.00	.19	0	.00	.03	0	.00	.06
TOTAL REGULATORY NET WORTH	11,695,328	3.52	3.80	8,200,781	4.60	3.49	2,067,762	3.05	3.65
TOTAL LIABILITIES AND REGULATORY NET WORTH	332,512,459	100.00	100.00	178,461,306	100.00	100.00	67,690,472	100.00	100.00

NOTE: THE ABOVE ASSET AND LIABILITY CLASSIFICATIONS INCLUDE APPROPRIATE ACCRUAL AND ALLOWANCE ITEMS. RATIOS COMPUTED WITHIN APPLICABLE CATEGORIES ON SCHEDULES 3A AND 3B DO NOT INCLUDE SUCH ITEMS.

FINANCIAL INFORMATION SYSTEM

CCMPARATIVE STATEMENT OF OPERATIONS

DISTRICT 09 DOCKET 7375
EMPIRE S & LA
MESQUITE TX
ASCL: 4 PAGE 2
REPORT ID: AN145K DATE 84-03-27

	SEMIANNUAL PERIOD ENDING DECEMBER 31, 1983			SEMIANNUAL PERIOD ENDING JUNE 30, 1983			SEMIANNUAL PERIOD ENDING DECEMBER 31, 1982		
	ASSN. AMOUNT	% TO A.A. ASSN.	% TO A.A. P.G.	ASSN. AMOUNT	% TO A.A. ASSN.	% TO A.A. P.G.	ASSN. AMOUNT	% TO A.A. ASSN.	% TO A.A. P.G.
INTEREST INCOME									
MORTGAGE LOANS AND CONTRACTS	16,068,568	12.58	8.34	11,510,590	18.70	8.10	2,815,101	12.89	8.84
OTHER LOANS	302,290	.24	1.00	292,809	.48	.86	199,526	.91	.88
INVESTMENTS AND DEPOSITS	110,436	.09	1.18	70,672	.11	1.10	40,141	.18	1.04
LOAN FEES	5,279,614	4.13	.92	4,020,805	6.53	.72	1,516,432	6.94	.64
TOTAL YIELD	21,760,928	17.03	11.49	15,894,876	25.83	10.78	4,571,200	20.93	11.38
OTHER OPERATING INCOME									
LOAN SERVICING FEES AND OTHER CHAR	382,171	.30	.18	241,328	.39	.20	58,712	.27	.10
OTHER	75,224	.06	.56	50,129	.08	.38	89,899	.41	.73
TOTAL OTHER OPERATING INCOME	457,395	.36	.72	291,457	.47	.58	148,611	.68	.86
GROSS OPERATING INCOME	22,218,323	17.39	12.16	16,186,333	26.30	11.38	4,715,811	21.61	12.24
OPERATING EXPENSE									
COMPENSATION	348,266	.27	.78	157,806	.26	.80	425,443	1.95	.80
DIRECTORS, OFFICERS & EMP. EXPENSE	67,518	.05	.02	30,602	.05	.02	26,219	.12	.02
OFFICE OCCUPANCY, FURNITURE, FIXTURES AND EQUIPMENT	207,370	.16	.36	93,974	.15	.38	91,785	.42	.40
ADVERTISING	33,304	.03	.08	15,099	.02	.10	7,012	.03	.12
OTHER	3,095,819	2.42	.56	1,394,022	2.27	.52	356,032	1.63	.52
TOTAL OPERATING EXPENSE	3,752,277	2.94	1.82	1,691,503	2.75	1.82	506,491	4.15	1.68
NET OPERATING INCOME BEFORE									
COST OF MONEY	18,466,046	14.46	10.34	14,494,830	23.55	9.56	3,813,320	17.46	10.36
LESS: CAPITALIZED INTEREST	0	.00	.00	0	.00	.00	0	.00	.02
COST OF MONEY									
WITHDRAWABLE SAVINGS	13,152,149	10.30	8.86	5,986,434	9.73	8.64	2,259,225	10.34	9.66
ADVANCES AND BORROWED MONEY	54,605	.04	.64	24,759	.04	.82	81,857	.37	1.26
TOTAL COST OF MONEY	13,206,754	10.34	9.50	6,011,193	9.77	9.46	2,341,082	10.72	10.92
NET OPERATING INCOME	5,259,292	4.12	.84	8,483,637	13.79	.10	1,472,238	6.74	-.54
NON OPERATING ITEMS									
NON OPERATING INCOME	0	.00	.62	0	.00	.60	43,250	.20	1.02
NON OPERATING EXPENSE	0	.00	.26	0	.00	.22	3,595	.02	.24
NET NON OPERATING INCOME	0	.00	.34	0	.00	.38	39,655	.18	.78
NET INCOME BEFORE TAXES	5,259,292	4.12	1.20	8,483,637	13.79	.50	1,511,893	6.92	.22
INCOME TAXES	1,764,745	1.38	.24	2,350,618	3.82	.10	281,889	1.29	-.08
NET INCOME	3,494,547	2.74	.94	6,133,019	9.97	.38	1,230,004	5.63	.32

NOTE: ALL RATIOS APPEARING ON THIS PAGE AND APPLICABLE RATIOS ON PAGES 3 AND 4 HEREIN, ARE ANNUALIZED BY MULTIPLYING X 2

F I N A N C I A L   I N F O R M A T I O N   S Y S T E M

DISTRICT 09 DOCKET 7375
EMPIRE S & LA
MESQUITE TX

SCHEDULE # 3E - GENERAL RATIO ANALYSIS

ASCL: 4 PAGE 4
REPORT ID: AN145P DATE 84-03-27

RATIO NO.	RATIO DESCRIPTION	DECEMBER 31, 1983 ASSN. RATIO	DECEMBER 31, 1983 P.G. AVER.	DECEMBER 31, 1983 DIST. AVER.	JUNE 30, 1983 ASSN. RATIO	JUNE 30, 1983 P.G. AVER.	JUNE 30, 1983 DIST. AVER.	DECEMBER 31, 1982 ASSN. RATIO	DECEMBER 31, 1982 P.G. AVER.	DECEMBER 31, 1982 DIST. AVER.
008	NOI/AVER ASSETS	4.12	.84	.51	13.79	.10	.16	6.74	-.56	-.84
013	NOI/INT INCOME	84.86	90.43	89.66	91.19	88.65	89.49	83.42	91.04	90.61
015	ML INT/AVER ML	17.79	12.93	12.54	28.36	12.21	12.15	25.63	12.50	12.03
016	ML INT - LF/AVER ML	13.39	11.64	11.53	21.02	11.22	11.26	16.66	11.72	11.30
017	OTH LN INT/AVER OL	20.74	15.41	14.89	23.18	14.33	14.16	16.72	15.41	15.21
019	INV INC/AVER INV	6.38	9.48	9.72	1.95	9.27	9.68	1.33	10.98	11.01
020	INT INCOME/AV LNS&INVT	17.66	12.63	12.31	26.65	11.96	11.94	21.66	12.59	12.11
021	LOAN FEE INCOME/NET INC	162.02	116.21	132.57	69.49	238.25	141.05	128.06	254.37	-1452.35
023	SFR CCR INC/AVER SC	.00	17.70	14.30	.00	9.90	12.58	.00	17.00	13.73
040	ML INT/GOI	96.08	76.21	77.02	95.95	77.54	77.18	91.77	77.48	76.90
046	TOTAL INT/GOI	97.94	94.05	93.99	98.20	94.84	94.17	96.85	93.03	93.51
048	LOAN FEE INCOME/GOI	25.48	9.04	7.75	26.33	8.06	7.19	33.37	6.60	5.09
055	NET INC/NET WORTH	85.22	26.91	18.21	593.20	11.22	16.31	293.64	9.43	-1.26
064	OPER EXP/GOI	16.89	14.94	15.73	10.45	15.93	15.72	19.21	15.31	15.28
065	COMPENSATION/GOI	1.57	6.43	6.68	.97	7.04	6.82	9.01	6.59	6.53
066	D, O & E EXP/GOI	.30	.24	.25	.19	.24	.21	.56	.19	.19
067	OFF BLDG EXP/GOI	.93	2.96	3.11	.58	3.31	3.20	1.94	3.29	3.24
069	ADVERTISING/GOI	.15	.72	.82	.09	.84	.86	.15	.95	.87
071	COST OF SAVGS/AVER SAVGS&DEPS	11.38	10.10	10.04	10.88	10.07	10.11	11.50	11.48	11.49
072	COST OF BM/AVER BM	.00	10.54	10.68	12.38	10.07	10.55	15.59	12.76	12.41
074	COST OF MONEY/GOI	59.44	78.16	79.99	37.14	83.17	82.89	49.60	89.27	91.81
213	LTF/ASSETS	.00	.04	.05	.00	.03	.05	.00	.04	.05
227	SLOW INS & GTD/ASSETS	.00	.01	.01	.00	.01	.01	.00	.00	.01
228	CONSUMER CREDITS/ASSETS	.37	4.66	4.01	.68	3.87	3.80	1.79	3.76	3.59
229	SLOW CONV/ASSETS	25.52	1.06	.82	.84	.59	.60	.00	.46	.54
233	OTHER SCHLD ITM/ASSETS	.00	.00	.00	.00	.00	.00	.00	.00	.00
237	GML/MTG LNS	.00	12.47	13.42	.00	13.37	14.37	.00	13.12	13.26
241	+4 CONV/MTG LNS	38.76	31.19	30.67	52.14	23.29	24.46	49.44	21.72	21.15
255	BORROWINGS/SAVGS&DEPS	.00	7.02	11.19	.00	8.10	10.87	1.30	11.29	13.23
256	BORROWINGS/SAVGS,DEPS&BM	.00	6.56	10.07	.00	7.49	9.80	1.29	10.14	11.68
260	CTF SAVINGS/SAVGS&DEPS	96.03	74.68	74.31	87.56	72.85	72.15	79.00	82.99	83.24
262	NET WORTH/SAVGS&DEPS	3.85	4.33	5.00	5.18	4.01	4.61	3.37	4.31	4.71
265	CASH&SEC/SAV,DEPS&BORR	1.21	9.46	9.55	2.06	12.03	11.72	18.02	9.57	9.89
300	CHANGE IN TOT ASSETS	86.32	15.90	11.07	163.64	17.32	17.36	244.03	14.29	11.68
302	CHANGE IN TOT LIAB.	88.43	15.89	10.83	159.45	17.61	17.38	248.35	14.24	11.01
304	CHANGE IN NET WORTH	42.61	16.06	16.82	296.60	9.72	16.76	146.82	15.52	8.47
310	CHANGE IN SAVINGS	91.08	16.12	11.19	159.03	20.50	19.15	255.06	15.82	12.43
315	CHANGE IN BM	.00	17.83	14.63	-100.00	-11.40	-2.46	-38.46	4.94	8.35
340	CHANGE IN ML	68.64	19.71	14.31	202.76	15.82	16.72	202.19	13.27	9.71
342	CHANGE IN CONV MTG LENDING	68.64	21.10	15.32	202.76	14.35	15.04	202.19	10.87	7.34
343	CHANGE IN SFD MTG LENDING	115.77	9.51	4.01	2197.65	6.12	7.82	-77.75	2.51	.90
344	CHANGE IN M-FAM COMM-LENDING	25.37	44.19	37.94	68.48	37.18	33.43	1874.16	38.50	26.50
370	CHANGE IN NET INCOME	-43.02	66.41	10.07	398.62	142.31	3885.86	2089.55	-150.52	-93.61
375	CHANGE IN GOI	37.27	23.11	16.50	242.94	9.57	10.85	238.60	18.83	13.40
380	CHANGE IN OPER EXPENSES	121.83	23.15	16.17	86.60	13.22	13.64	254.98	21.81	18.71
385	CHANGE IN COST OF MONEY	119.70	19.50	13.57	156.77	-.17	.02	156.53	10.63	6.41
390	CHANGE IN TOT NET SCHED ITEMS	4997.03	74.28	38.10	775.53	41.03	29.63	60.32	21.75	16.61

Appendix D

EMPIRE SAVINGS AND LOAN ASSOCIATION BROKERED DEPOSITS
Mesquite, Texas FBLBB No. 7375. March 14, 1984

Broker	No. of Accounts	Principle	% Total
First United Fund	1,404	$159,090,037	53%
FAIC Securities	317	34,882,732	12
Continental Funding	117	11,700,000	4
Long Beach Savings	81	9,000,000	3
Continental	88	6,935,062	2
First Empire Funding	65	6,500,000	2
National Money Market	46	4,622,373	2
A M Money Market	34	3,400,000	1
Pennesula Savings	33	3,300,000	1
International INV	20	2,014,300	1
Harper Wilder Associates	9	900,000	1
Penn S&L	3	300,000	>1
Connie Tate	1	100,000	>1
Metro Securities	1	100,000	>1
TOTAL BROKERED	2289	251,752,544	83
TOTAL NONBROKERED		51,179,583	17
TOTAL SAVINGS		$302,942,127	100%

Source: Hearings. p. 245.

Appendix E

CONSRTUCTION AND LAND LOANS OF EMPIRE SAVINGS

Subdivision/Project	Units	% Complete	Map No.
Faulkner Meadows West			1
Highbrook *	32	95%	
Woodhaven *	32	95	
Meadowwood *	32	90	
Stonegate *	32	80	
Parkwood *	32	80	
Sunscape *	32	80	
Pepperwood	32	80	
Springwood	32	70	
Woodcrest	26	60	
Autumn Ridge	30	65	
Northgate	26	75	
Trailwood	32	55	
Northview	33	55	
Cedarwood *	18	55	
Fernwood	21	50	
Woodglen	18	50	
Rose Gardens			2
Woodlake Village	14	50	
Bridgeport *	30	60	
Kelman Estate *	28	55	
Sky Rose *	30	50	
Spring Crest *	28	50	
Castle Glen			3
Phase IV	24	100	
Phase IVB	24	100	
The Park			4
30 Proposed *	806	raw land	
14 Proposed *	413	raw land	
The Summerhill			5
Summerhill	26	100	
Summerhill II *	28	100	
Windridge Courts	33	100	
Yorkcrest	28	100	
Newcastle	61	100	

* = foreclosed by FSLIC

Subdivision/Project	Units	% Complete	Map No.
Cheshire Creek		raw land	6
Willowbrook	commercial	raw land	7
LaPrada Terrace		raw land	8
Buckingham Courts	26	100	9
Creekview	24	100	10
Hill Top	24	73	11
Westridge	10	raw land	12
Country Side Planned Development			13
Phase I	14	100	
Phase II	16	100	
Phase III	10	100	
Metro East *	24	100	14
Papiago *	24	100	15
Kirby Mills *	39	raw land	16
Country Club *	32	100	17
Country Club Glen *	333	raw land	18
Indian Village	20	68	19
Country Place	21	100	20
Canyon Creek *	32	96	21
Eastfield Place	32	85	22
Cotton Wood Knoll			23
Phase I *	32	slab	
Faulkner Corners South			24
Cascade I *	32	100	
Cascade II *	32	5	
Cascade III *	28	8	
Cascade IV *	30	11	
Oak Meadows I	23	100	
Oak Meadows II *	19	100	

Subdivision/Project	Units	% Complete	Map No.
The Brook		raw land	25
The Oaks			26
Summerfield *	28	7	
The Chateau *	33	4	
Windstream	28	3	
Diamond Crest	28	6	
Country Hollow	26	3	
Orleans Circle *			27
1-A	office	50	
1-B	office	50	
The Place			28
Sun Place	30	90	
Lakeway Place	34	85	
Sun Ridge	26	65	
Lake Park	26	60	
Sunset Place	30	60	
The Terrace *	30	61	
The Landing	28	70	
Emarald Place	30	71	
The Lake			29
North Point on the Lake I	28	100	
North Point on the Lake II	48	98	
Faulkner Creek			30
Forest Landing *	24	100	
Forest Creek *	34	100	
Forest Brook *	36	100	
Shady Hollow	30	69	
Foxfire *	30	83	
Timberlakes II	36	100	
Creekbend *	26	100	
Bear Creek	38	100	
Bear Creek II		raw land	
Hill Top Manor	32	100	
Hill Top Manor II *	28	15	
Garden Creek	24	100	
Woodcreek I	36	100	
Woodcreek II	36	100	
Woodcreek III	36	100	

* = foreclosed by FSLIC

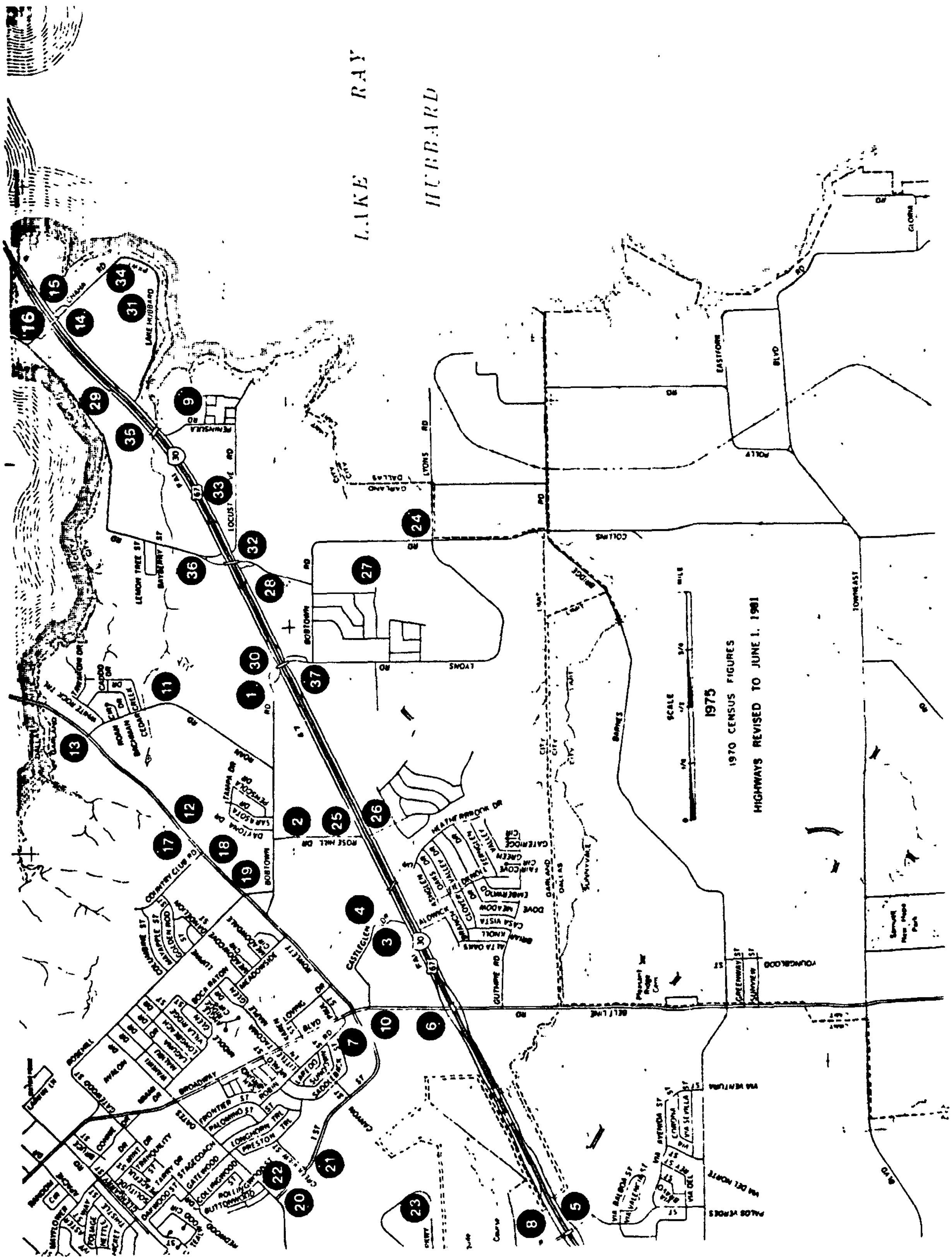
Subdivision/Project	Units	% Complete	Map No.
Lake Ridge			31
Phase I	32	59	
Phase II	33	59	
Country Meadows			32
Phase I	32	100	
Phase II	32	100	
Phase III	14	burned	
Faulkner Point West			33
Bluff Point *	28	70	
Westview *	28	85	
Islander II *	28	72	
Sunrise Point	24	100	
Lakeway Village	24	100	
The Islander	27	99	
Orleans Court	30	100	
Angel Cove I	26	100	
Angel Cove II *	42	85	
Angel Cave III *	39	85	
Orleans Court II	30	slab	
Lakeway Village II *	80	1	
Sunset Pointe II	24	2	
The Islander II *	26	raw land	
Faulkner Point			34
Hill Point II	32	100	
Snug Harbor II	28	100	
Snug Harbor I *	20	100	
West Point II	28	96	
Centre Point II	28	100	
High Point Landing	33	100	
Hill Point III *	28	90	
On the Point II *	32	82	
Windjammer II	32	100	
One Pentridge *	48	78	
Two Pentridge	64	86	
Three Pentridge *	20	67	
Four Pentridge *	64	87	
Canterbury Landing	58	100	
Phase II	60	54	
Lakepoint II	30	100	
Faulkner Point IV	24	100	

* = foreclosed by FSLIC

Subdivision/Project	Units	% Complete	Map No.
Faulkner Point North			35
Windward I	32	100	
Windward II	28	100	
Windward I Phase II *		raw land	
Windward Point I *		raw land	
Windward Point II *		raw land	
Windward Point III *		raw land	
Windward Point IV *		raw land	
Faulkner Meadows East			36
East Scape	24	62	
Heather Place	12	100	
Heather Place II	18	burned	
Faulkner Meadows			37
Meadow Glen	20	97	
Meadowland	30	100	
Fair Meadows	28	100	
Third Tier	30	99	
Meadowlake Village	28	59	
Falcon Ridge *	28	59	
Regency Manor	26	60	
Shady Meadow	26	raw land	
Sommerset Place	28	100	
West Meadows	60	99	
Meadowridge	retail	raw land	
East Meadows *	office	raw land	
Bobtown Village I	office	raw land	

* = foreclosed by FSLIC

Source: Kenneth Levanthal and Co. Dallas, Texas.


LAKE RAY HUBBARD
SCALE
1975
1970 CENSUS FIGURES
HIGHWAYS REVISED TO JUNE 1, 1981

Appendix F

ANATOMY OF A LAND FLIP

10-29-81	45 acres sold to Gary Sibley by Eric Veigel for $1.10 per square foot
12-21-83	Same land sold to Paul Jensen by Sibley for $1.10 per square foot
12-21-83	Jensen sells to Bjorner Fredriksen
12-21-83	Fredriksen sells to Kitco and Brenda Kennedy for Danny Faulkner
12-21-83	Faulkner sells to Kitco
12-21-83	Original 45 acres combined with 15 acres from Jensen and sold to Kitco Developers Inc.
12-21-83	Combined parcel sold to Earnie Hughes for Clifford Sinclair
12-23-83	The 60 acres is subdivided and sold at $8.00 per square foot and sold to 39 investor corporations

TOTAL INCREASE PER SQUARE FOOT 728%

A multiple land sale, called a land flip, involves a series of two or more sales of a single piece of property within a short period of time, often resulting in a higher land price. In the case diagrammed above, a 45 acre tract of land purchased for $1.10 per square foot in 1981, was resold in a land flip five times in a single day, December 21, 1982. On the same day it was combined with an additional 15 acre tract, then subdivided and resold for a total of $21,173,512 more than $8.00 per square foot of nearly $350,000 per acre.

Source: Dallas Morning News. November 27, 1983. p. 1.

Appendix G

THE AIREA STANDARDS OF PROFESSIONAL PRACTICE

The AIREA established the Code of Professional Ethics in 1933 as a response to the deteriorating image of real estate appraisers in the late 1920's and 1930's. The Code today consists of eight canons, four of which are stated in positive mandate and four are admonitory in their warnings.

POSITIVE CANONS

Canon 2. A member or candidate of the Institute must assist the Institute in carrying out its responsibilities to the users of appraisal services and to the public.

Canon 3. When performing a real estate appraisal assignment, a member or candidate of the Institute must perform such appraisal assignment without advocacy for the client's interests or the accommodation of his or her own interests.

Canon 7. In arriving at an analysis, opinion or conclusion concerning real estate, a member or candidate of the Institute must use his or her best efforts to act competently and comply with the Institute's standards of professional practice relating to competency.

Canon 8. On communicating an analysis, opinion or conclusion concerning real estate, a member or candidate of the Institute must comply with the Institute's standards of professional practice relating to written and oral reports.

ADMONITORY CANONS

Canon 1. A member or candidate of the Institute must refrain from misconduct that is detrimental to the real estate appraisal profession.

Canon 4. A member or candidate of the Institute must not violate the confidential nature of the appraiser-client relationship by improperly disclosing the confidential portions of a real estate appraisal report.

Canon 5. In securing real estate appraisal assignments and in promoting a real estate appraisal practice, a member or candidate of the Institute must refrain from conduct which is deceptive, misleading or otherwise contrary to the public interest.

Canon 6. A member or candidate of the Institute who has specific knowledge of the Institute's standards of professional practice must not deliberately or recklessly fail to observe such requirements.

Source: John Kokus. "Ethics for the Real Estate Appraiser." The Appraisal Journal. (October 1983). p. 541

Appendix H

PROVISIONS OF FHLBB MEMORANDUM R-41b as revised March 1982

Each appraisal report must

1. Be totally self-contained

2. Be a narative for major loans

3. Use all three approaches, or fully explain the rationale for not doing so

4. Consider and treat all appropriate deductions and discounts for any development property (This revision eliminates the 12-month sellout-occupancy threshold allowed by the previous edition of the memorandum)

5. Address itself to the market/economic feasibility prospects in sufficent detail to support an appraiser's forecast of probable success and the conclusion of highest and best use

6. Contain a detailed sales history of the subject if it is located in a highly speculative market that has experienced dramatic price increases

7. Address itself at all times to market value as defined in the revised edition of <u>Real Estate Terminology</u> published jointly by The American Institute of Real Estate Appraisers and The Society of Real Estate Appraisers to include situations involving special purpose properties and REO/LTF (Real Estate Owned/Loan to Facilitate)

8. For certain government subsidy programs where the project and product user represents a distinct and readily identifiable separate market, the appraiser may consider income-vacancy guarantees and financing. In subsidy situations the final estimate should not exceed replacement cost

Source: David C. Lennhoff, "What's all the Ruckus over R-41b?". The Appraisal Journal. (July 1984). p. 444

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