

False Loan Applications? Go to Jail and Pay a \$1,000,000 Fine! **by Dale S. Alberstone, Esq.**

Over the past year, defaults in loans secured by real property have soared and foreclosures have risen to record levels. While that might be disastrous for those owning property burdened by sub-prime mortgages, it is, nevertheless, working to the advantage of first-time home buyers and others looking to acquire multi-unit investment properties as a discount.

In the existing market, a buyer's zeal to obtain financing for an attractively priced property sometimes exceeds his or her better judgment. In that regard, it is not uncommon for purchasers to provide inflated financial statements and occasionally deliver false income tax returns to lenders when applying for a loan. That is particularly true with lenders who still have "easy qualifying" program whereby if the applicant provides a high down payment, the lender will not ask to verify all of the income which the applicant states he receives.

While credit has tightened in recent months with lenders curtailing such easy qualifying programs, those financing opportunities still exist. Borrowers applying for easy qualifying loans should be careful to furnish accurate information to their lenders.

Once the loan is made, lenders usually never again look at the financial condition of the borrower -- unless the loan goes into default. (There are exceptions to this general rule in that some lenders, even after the loan has been made, conduct a further investigation into the borrower's financial wherewithal.) Once a loan is defaulted, and justifiably fearing that the lender's ability to collect is in jeopardy, lenders often scrutinize the loan application and other indices of the borrower's financial condition. In cases where the lender determines that the borrower has submitted a false loan application, the tranquility of a borrower's life may turn into an unsettling nightmare.

If the borrower's loan application was deceitful, he or she may be subjected to three types of sanctions:

1) Lender Foreclosure: Even if the loan is not otherwise in default, some deeds of trust provide that if a borrower has submitted false information in his loan application, the lender may declare a default of the provisions of the deed of trust, accelerate the outstanding principal, and require the borrower to pay the loan off in full at that time. If the borrower fails to pay the loan in full, the lender may either commence a trustee's sale or file a judicial foreclosure (and seek a deficiency judgment for personal liability against the borrower.) The borrower will defend such proceedings by filing a motion with the court to enjoin the foreclosure on the basis that, even though the loan application may have been false, the lender's security (i.e. the real property) is not jeopardized and, therefore, it would work an inequitable hardship on the borrower if the foreclosure were allowed to complete.

If the court refuses to enjoin the foreclosure (which is likely), then the borrower could be personally liable for any deficiency which remains after the completion of the judicial option. Competent counsel should be sought to defend against such deficiency litigation.

Incidentally, no deficiency judgment is allowed following a non-judicial foreclosure, i.e., a trustee's sale. By statute, a borrower may only be exposed to a deficiency after the completion of a judicial foreclosure.

2) Forfeiture Proceedings by the United States: Under federal law (18 U.S.C. 981(a)(1)(C)), the United States, acting independently of the lender, has a right to seek a forfeiture of the borrower's property based on false information having been provided to a federally insured lender, such as a bank or savings and loan association.

Procedurally speaking, a United States Deputy Attorney General will file a civil lawsuit against a borrower for forfeiture of the property based on the false loan application. Even though the borrower may not be in default of the loan at the time the litigation is commenced, federal law provides that the property is nevertheless "subject to forfeiture to the United States." The forfeiture is not mandatory, and, as in most cases, that sanction is within the discretion of the individual judge who decides the case. In order to save his property from forfeiture, a borrower will need to argue that he is current with his payments and that even though he may be in technical violation of the law for having filed a false application, no one has been injured. The borrower would further argue that the lender is continuing to receive payments and the federal agency insuring the financial institution has not lost any money in connection with the transaction. Given those facts, the judge is likely to give the borrower a break and not forfeit the property to the United States.

3) Criminal Sanctions: The submission of a false loan application or other false statements to a lender is a federal crime. Prior to 1989, the maximum penalty was \$5,000, imprisonment for not more than two years, or both. Because of the catastrophic failure of numerous savings and loans and banks during the early and mid-1980's, in 1989 the sanctions were increased to a fine of up to \$1,000,000, imprisonment up to 20 years, or both. In 1990, the incarceration penalty was raised to a maximum of 30 years.

As the law now stands, submission of false statements to a lender can carry a \$1,000,000 fine, imprisonment up to 30 years, or both (18 U.S.C. 1014). It is clear from these sanctions that the government of the United States means business.

As can be seen from the foregoing discussion, the submission of false information to a lender contained in a loan application is very serious and can result in severe penalties. A borrower should exercise thoughtful discretion and restraint in his zeal to obtain a loan based information which he knows is not accurate.

Dale Alberstone is a prominent real estate attorney who has practiced real property and business law in Century City for the past 31 years. He has been appointed to periodically serve as a judge pro tem of the Los Angeles Superior Court and is a former arbitrator for the American Arbitration Association. He also testifies as an expert witness for and against other attorneys who have been accused of legal malpractice.

Mr. Alberstone has been awarded an AV rating from Mardindale-Hubbell. An AV rating,

registered through Reed Elsevier, reflects an attorney who has reached the heights of professional excellence and is recognized for the highest levels of skill and integrity.

The foregoing discussion is intended as a general overview of the law and may not apply to the reader's particular case. Readers are cautioned to consult an advisor of their own selection with respect to any particular situation.

Address correspondence to Dale S. Alberstone, Esq., ALBERSTONE & ALBERSTONE, 1801 Avenue of the Stars, Suite 600, Los Angeles, California 90067. Phone: (310) 277-7300.