MORTGAGE FRAUD REVISITED

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As the Housing Market Returns, So Does the Threat of Fraud

A REALTOR® friend of mine was recently told by a mortgage loan officer that he did not want to see the GAR Form "Amendment to Address Concerns With Property" signed by the buyer and seller. Surprised, my friend asked if her buyer was not obligated to provide all amendments to the purchase and sale contract to the mortgage lender. The response of the mortgage loan originator was that the REALTOR® could do whatever she wanted but providing the amendment might create issues in underwriting and cause the lender not to make the mortgage loan on the property. My REALTOR® friend was concerned that not giving the lender all of the amendments to the purchase and sale agreement might be mortgage fraud. However, she was not sure and needed the transaction to close to pay her bills. In the end, she chose not to provide the amendment to the purchase and sale agreement. She rationalized her decision by convincing herself that the loan originator was an authorized representative of the mortgage lender and could thus speak for the lender.

In the same week, another REALTOR® posed a different question about mortgage fraud. In an all cash deal a builder wanted to show the sales price of the home at $1,250,000 and then provide a credit to the buyer of $250,000. The builder wanted to do this so that his other houses would appraise at a higher sales price. The REALTOR® wanted to know if this could possibly be mortgage fraud even though no mortgage was being originated as part of the transaction.

As our residential housing market continues to strengthen, REALTORS® are getting busier and questions about mortgage fraud are again beginning to arise. Since mortgage fraud was part of what helped kill the goose that laid the golden egg in terms of undermining our housing market, it is important that we all be vigilant in stopping mortgage fraud. This article will review our residential mortgage fraud laws to help ensure that no REALTOR® unwittingly ends up on the wrong end of an unwanted criminal prosecution.

THE LAW

The Georgia Residential Mortgage Fraud Act (O.C.G.A. § 16-8-101) only applies to residential mortgage loans. Under the statute a residential mortgage loan is one that is secured by a deed to secure debt or mortgage upon any interest in a one to four family residential property located in Georgia. So, for example, if the loan is made in Georgia but the secured property is located in South Carolina, the Georgia statute does not apply. Similarly, if a buyer is getting a mortgage on an office building or retail center, the Georgia law does not apply.

In Georgia, a person commits the crime of mortgage fraud when he or she, with the intent to defraud, does any of the following:

(1) Knowingly makes any deliberate misstatement, misrepresentation, or omission during the mortgage lending process with the intention that it be relied on by a mortgage lender, borrower, or any other party to the mortgage lending process;

(2) Knowingly uses or facilitates the use of any deliberate misstatement, misrepresentation, or omission, knowing the same to contain a misstatement, misrepresentation, or omission, during the mortgage lending process with the intention that it be relied on by a mortgage lender, borrower, or any other party to the mortgage lending process;

(3) Receives any proceeds or any other funds in connection with a residential mortgage closing that such person knew resulted from a violation of paragraph (1) or (2) of this Code section;

(4) Conspires to violate any of the provisions of paragraph (1), (2), or (3) of this Code section; or

(5) Files or causes to be filed with the official registrar of deeds of any county of this state any document such person knows to contain a deliberate misstatement, misrepresentation, or omission.

WHAT THE LAW MEANS

So, what does the above statute mean when applied to real world situations? Let's go back and re-examine the two examples above. A mortgage loan originator is asking a REALTOR® not to provide the loan underwriter with an amendment to the real estate contract that is required to be provided to the mortgage lender. The question the REALTOR® should be asking is why does the mortgage loan originator want the REALTOR® to do this? If the answer is that the loan originator wants to hide the amendment because giving it to the loan underwriter may cause the loan to be denied. Then the REALTOR® has just heard a great reason, if he or she values not going to jail, to provide the amendment to the underwriter. If the REALTOR® intentionally works with the loan originator so that the loan underwriter does not get information required by the lender in the mortgage loan application, it gets way too close to the line where the REALTOR® is facilitating "the use of any deliberate . . . omission . . . during the mortgage lending process with the intention that it be relied on by a mortgage lender . . . ." It also sounds like the mortgage loan originator and the REALTOR® might be conspiring together to violate our mortgage fraud laws.

What is most troubling about the scenario discussed above is that the person asking the REALTOR® to withhold information from the underwriter works for the mortgage lender. Obviously, when loan originators and loan underwriters have differing goals and are working at cross purposes it is not in the best interests of the mortgage lender, the borrower or the REALTOR® involved in the transaction.

Can a mortgage lender ever possibly be defrauded when a mortgage loan originator who works for the same lender is the one asking that information not be provided to the loan underwriter? While there is no case on point, the broad language of the mortgage fraud statute leaves open the possibility of this type of prosecution. Certainly, if the mortgage loan originator later denies advising the REALTOR® to withhold the amendment or denies even knowing about

the amendment the REALTOR® could be left to hang out to dry if the REALTOR® cannot prove otherwise.

In defense of mortgage loan originators, part of their job is to present information to underwriting in a way that is most likely going to get the loan approved. They are also under tremendous pressure from REALTORS® to find a loan for every buyer of every property. In being advocates for getting loans approved, it is not surprising that some mortgage loan originators might occasionally view their own lender's requirements as guidelines.

The key question in this discussion is where is the line between lawfully assisting the borrower in putting his or her best foot forward and unlawfully misrepresenting or omitting material information that could affect whether or not a loan is made?

Some REALTORS® have argued that so long as the initial contract between the parties is provided to the lender, there is no need to provide amendments to the lender. Other REALTORS® have stated that they only provide the base contract to the lender and do not even worry about providing exhibits to the purchase and sale contract to the lender. The smart answer in this area is to determine what information the borrower is required to provide the mortgage lender, and if the REALTOR® is helping get this information to the lender, to ensure that required information in the REALTORS®'s possession is given to the lender. Therefore, if the loan application requires the borrower to provide the lender with the entire purchase and sale agreement, the entire purchase and sale agreement, including all exhibits, should be provided. If the loan application requires the borrower to update all required loan information, this would mean that all amendments to the purchase and sale agreement should be provided to the lender. With the law criminalizing material omissions, any other answer is fraught with legal risk.

It should be noted that some REALTORS® may be needlessly getting their borrowers into trouble by providing the lender with information the mortgage lender is <u>not</u> requesting. For example, most mortgage lenders do not require a copy of an inspection report on the property if it is not a part of the purchase and sale agreement. However, they usually require a copy of all amendments to the contract. Therefore, if the inspection report is made an exhibit to the Amendment to Address Concerns With Property, and, thus made a part of the purchase and sale agreement, the report would have to be provided to the lender. While the report may not have been required, once the lender has it, the lender will likely consider it. In so doing, this may create problems for the borrower that might have been avoided had the report not been made a part of the contract.

What is the solution here? Obviously, if the lender does not require a copy of the property inspection report, it would make the most sense for the buyer to ask for specific repairs to the property without incorporating the inspection report into the Amendment to Address Concerns with Property. In this way, the report is not a part of the purchase and sale agreement and does not have to be provided to the lender. Of course, the inspection report can still be provided to the seller if the seller wishes to see it. However, it can simply be sent to the seller rather than making it part of an exhibit to an amendment to the contract.

Before discussing the second example of the seller increasing the sales price to create a better comparable, it should be noted that the Residential Mortgage Loan Act has now been tested in court and we are starting to be some appellate court interpretations of that statute.

The case of *Gilford v. State*, 295 GA. App. 651 (2009) is clearly the most significant case in this area. In *Gilford* a borrower falsely stated that none of the $13,000 down payment was borrowed. However, the money for the down payment was advanced to the borrower by Gilford, who was a mortgage loan officer, prior to closing. Clearly, this made the borrower liable for mortgage fraud. Gilford worked for Countrywide Home Loans where the borrower initially applied for a residential home loan. The borrower was turned down for the loan because she had insufficient funds to close. The borrower then submitted another loan application to New Century Mortgage Corporation. Although Gilford did not work for New Century Mortgage, the paralegal who worked for the law firm which closed the loan testified that Gilford was the loan officer responsible for the sale. The closing attorney also testified that he talked with Gilford "in coordinating some parts of the closing". Investigators discovered that $13,000 had been withdrawn from Gilford's account on March 28, 2006. The next day, three different deposits were made at three separate bank branches into the borrower's account.

After being convicted of mortgage fraud by a trial court, Gilford appealed her conviction to the Georgia Court of Appeals. She argued that there was no evidence she knowingly made any deliberate misstatement or misrepresentation during the loan application process. While Gilford may have assisted the borrower in defrauding the lender, Gilford's argument appeared to be that she could not be guilty because she was not the one making direct misstatements to the lender. The Georgia Court of Appeals made short shrift of this argument and found that Gilford could be guilty of making deliberate misstatements and misrepresentations because "she was a party to the crime". The Georgia Court of Appeals then cited to O.C.G.A. § 16-2-20 which provides that:

(a) Every person concerned in the commission of a crime is a party thereto and may be charged with and convicted of commission of a crime.

(b) A person is concerned in the commission of a crime only if he . . . (3) intentionally aids or abets in the commission of the crime; or (4) intentionally advises, encourages, hires, counsels, or procures another to commit the crime.

Therefore, based upon this case, it does <u>not</u> matter if the party helping a fraudster does not directly represent or misrepresent anything to the mortgage lender. Aiding and abetting, advising, encouraging or counseling the fraudster is enough to cause the helper to also be convicted of the crime of mortgage fraud.

Based on the broad interpretation of our mortgage fraud statute by our Georgia Court of Appeals in *Gilford,* participating in any deception of the mortgage lender can put a REALTOR® at risk. So, for example, let's say that a buyer tells you that he just quit his job and is worried about whether this could affect his ability to get a mortgage to close on the purchase of a home the following week. If the REALTOR® advises the buyer not to reveal this information to the mortgage lender, it would certainly appear that the REALTOR® was aiding and abetting in the commission of a crime. What if the REALTOR® advises the borrower to disclose the job loss to the lender and the borrower chooses not to do so? Does the REALTOR® have an obligation to disclose to the lender that it is being defrauded? While there is not yet a case on this point, our mortgage fraud statute also prohibits a REALTOR® from receiving "any proceeds or any other funds in connection with a residential mortgage closing that such person knew resulted from "a deliberate misrepresentation or omission". Therefore, based upon this section of the statute, the REALTOR® would be well advised not to take a commission in this situation since the commission could arguably be seen as being paid with the proceeds of a mortgage closing.

Similarly, if the REALTOR® recommends to a buyer that the sales price of the property be increased to reflect the value of personal property being left with the property (where the personal property is then given a zero value), this misstatement could also potentially be seen a mortgage fraud. Going back to the original example discussed earlier in this article, the seller and the listing broker working together to make the comparables look better than they truly are could also be seen as mortgage fraud based upon the ruling in the *Gilford* case.

So, what are the penalties for mortgage fraud? Georgia law provides that violators are guilty of a felony and shall be punished by imprisonment for not less than one year or more than ten years, by a fine not to exceed $5,000 or both. Participating in a pattern of mortgage fraud increases the penalty to not less than three years nor more than 20 years, by a fine not to exceed $100,000 or both. Each instance of mortgage fraud is seen as a separate violation.

The 800 pound gorilla in the room that has not yet been discussed is that underwriting standards are, in some cases, so conservative, it is easy to rationalize gaming the system to get a loan approved. However, with mortgage fraud being a felony in Georgia, this is not an area where prosecutors are likely going to be forgiving of even the smallest white lies. Sadly, underwriting standards will likely only be loosened when loan officers start to lose deals to lenders with more reasonable underwriting standards. Then pressure will be brought to bear on the underwriters to be more realistic. Of course, with REALTORS® and mortgage lenders alike, relying on fewer deals to feed their families, no REALTOR® or loan originator wants to see any loan not approved.

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Our mortgage fraud statute was written at a time when mortgage fraud was rampant. Mortgage fraud is in the same category of crimes as murder, assault and bank robbery. Our Legislature wrote a law that criminalizes even the slightest deception of the lender and puts anyone who either knew of or participated in the deception at great risk. To protect our industry and ourselves, REALTORS® must use extreme care to comply with the law. REALTORS® should not take comfort in the fact that others may not be following the strict requirements of the law. As my mama used to say, “Just because 64,000 people are doing a stupid thing, it still makes it a stupid thing.”

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