

Great Loan?.....On the Wrong Property?

By Joffrey Long

Maybe it's never happened to you.....that you're aware of.

What if the loan isn't secured by the property you based your lending decision on?

It's the "Collateral Description Nightmare," where you've closed the loan with an incorrect/incomplete legal description in your lender's instructions to escrow, your recorded deed of trust, and/or your policy of title insurance. You're now exposed to denial of title insurance coverage and an inability to sell the loan, or foreclose if necessary – not to mention the possibility of litigation.

When making a loan - you look at a loan package, your appraiser sees the property and the prelim shows the legal description and property address. It all seems pretty clear.

But what if:

- applicants accidentally, (or intentionally) gave a wrong or incomplete legal description?
- escrow, source broker, or seller provided a wrong or incomplete address, leading to title's prelim, and the whole subsequent documentation chain being incorrect or on the wrong property?
- in a purchase, the property the borrower negotiated to purchase isn't completely/correctly described in the contract, escrow and prelim?
- the same owner owns contiguous parcels and you were accidentally provided with the legal for the "lot next door"?
- the "highest and best use" of your property requires having parcel "C" which happens to be the parking lot, and was left out of the legal description?
- the appraiser followed the incorrect information and either appraised a wrong or incomplete parcel, or described it incorrectly?

What can you do to prevent lawsuits, denied title coverage and compromised bargaining positions that result from incorrect descriptions? How can you help ensure the collateral you (and your investor) want to loan on is correctly described?

Ways to prevent problems in this area fit into three categories, based on where they would occur in the origination process:

- pre-screening: what you can do while looking over a loan request before actually investing time and resources into processing it
- processing of a loan request: procedures you can add to this stage of origination, as part of assembling and verifying information
- loan closing: what to do while getting documents signed, handling closing details and obtaining title insurance

Pre-screening and application phase:

Here, you've received a loan package, an initial application, or just some facts and figures by phone.

There are two parts of this process where expensive problems and a waste of time can be avoided. You can quickly develop a better idea of what property the borrower (originally) acquired and you can get the borrower's written confirmation of what exact property they're applying to encumber. (Often, initial applications only have the property address handwritten or abbreviated.) This can be important later if you run into a borrower or title insurer dispute as to what collateral was to be encumbered.

Before even waiting for a preliminary title report, obtain copies of all recorded acquisition documents along with any other recorded documents from the customer service department of the title company. This gives you an immediate idea of who's on title, how they acquired title and what property description was originally conveyed to them.

Reviewing and comparing information on the recorded documents of record also helps prevent mistakes caused by an incorrect preliminary title report. (Just last month, this enabled me to call a title company's attention to a (very significant) grant deed transfer they had missed – Oops!)

Consider adding an addendum to the loan application, signed by the borrower, in which they clearly identify the collateral they are applying to encumber, by address, legal description and by assessor's parcel number. Review the application legal description prior to closing and if a different description has somehow developed, have them acknowledge in writing any change in the description of the collateral from time of application to closing. This reduces the ability of the borrower or title insurer to later point to discrepancies in the event of a dispute.

The “processing” phase:

Here, you're fully investigating the loan request, verifying information and obtaining final data needed to close.

With access to more information, you can now compare the legal description on the borrower's acquisition grant deed, any existing deeds of trust recorded against the property, purchase contract and/or escrow instructions, preliminary title report and plat map, appraisal, property tax bill and/or title company tax roll printout.

When reviewing the plat map, look for both the legal description parcel number as well as the property tax assessor's parcel number on the actual lot you're loaning on, and compare it to your other documentation.

Confirm the address on tax bill, purchase contract and/or escrow instruction, preliminary title report, appraisal and plat map information. Confirm on plat map whether your address is a street, avenue, road, etc.

With multiple addresses, such as a fourplex, list all addresses, as in, "8450 Fountain Avenue, Units 1, 2, 3, and 4." If there are more than four units, state "Units 1 through 25." Also, consider a one line description of the improvements, such as "an eight unit residential dwelling," or "a commercial retail building and parking." This may provide additional prevention against description disputes. Also, if the title insurance policy reflects a description of improvements, it may assist you later in recovering on a title claim.

Coordinating appraisal and prelim plat map descriptions: With any parcel more complex than a simple tract lot, consider having the appraiser include as part of his/her appraisal, an outline on a plat map, of the lot. Then, have title provide the same plat map outline of the lot they're offering to insure. This prevents denial by either party of what parcel (based on the visual plat map outline) they were referencing. Match the two outlines to make sure they're both referencing the same lot boundaries.

Your closing process:

Here, you're drawing loan documents, obtaining final signatures, issuing lender's instructions to title and escrow, and recording documents.

Part of the closing process should be to go all the way back to the "pre-screening and application" and "processing" stages. Review all documents from day one for discrepancies in the legal description, assessor's parcel number or addresses. Make a decision as to whether or not to document the variances, how the correct answer was determined and then document what was done to correct them.

Title insurance – denial of claims: When you submit a claim for title insurance coverage, they'll review your entire file. (looking for ways not to pay) The property description addendum to the original loan application, as well as correcting and supporting documentation, may help prevent denial of your claim.

Make sure your closing procedure includes follow up for the final policy of title insurance, review of the policy against documentation already in the file, and resolution of any problems.

Unlike many of the problems we face, most incorrect property description problems CAN be prevented with relatively little effort. You could save tens, maybe hundreds of

thousands of dollars in litigation and related losses, just with a few simple procedures, checklists and follow up methods.

Where some of this is very basic, I hope you've found at least one new idea that will help you. If you have other ways to prevent legal / property description, or other loan documentation problems, I'd like to hear about them at info@asksw.com or (818) 366-5200. With your permission, I'll share them in a follow up article.

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