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B-167329, Oct. 6, 1969

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HOUSING--LOANS--DEFAULT--INSURANCE COVERAGE NOTE REPORTED FOR INSURANCE BY LENDER UNDER CREDIT INSURANCE CONTRACT WITH FEDERAL HOUSING ADMINISTRATION (FHA) UNDER TITLE I OF NATIONAL HOUSING ACT, WHERE U. S. ATTORNEY ADVISED BORROWERS FHA WOULD NOT REQUIRE FINAL PAYMENT AND FEDERAL JUDGE, IN CRIMINAL PROSECUTION OF CONTRACTOR FOR PROMISED KICKBACKS TO BORROWERS, EXPRESSED DESIRE BORROWERS NOT BE REQUIRED TO MAKE SUCH PAYMENT, MAY BE PAID TO LENDER ASSUMING HE IS INNOCENT THIRD PARTY WITH NO NOTICE OF FRAUD AT TIME OF MAKING LOAN, SINCE LENDER HAD MET DEMAND REQUIREMENTS OF ACT, AND OBVIOUSLY WOULD SUSTAIN LOSS IF NEITHER BORROWERS NOR ANYONE ELSE WERE REQUIRED TO PAY SUCH BALANCE. HOWEVER, IT APPEARING BORROWERS WERE NOT WITHOUT FAULT, FHA SHOULD RECOVER FROM BORROWERS, ANY AMOUNTS REIMBURSED TO LENDER.

TO MR. LESTER H. THOMPSON:

YOUR LETTER OF JUNE 17, 1969, REQUESTS OUR DECISION AS TO WHETHER YOU MAY CERTIFY FOR PAYMENT A VOUCHER IN FAVOR OF THE UPTOWN FEDERAL SAVINGS AND LOAN ASSOCIATION (LENDER), OF BALTIMORE, MARYLAND, IN THE AMOUNT OF $326.45. THE VOUCHER COVERS A CLAIM FOR REIMBURSEMENT OF A LOSS CLAIMED ON ACCOUNT OF A NOTE MADE BY JOHN A. AND OLIVE M. COOPER (BORROWERS).

THE NOTE WAS REPORTED FOR INSURANCE BY THE LENDER UNDER HIS CREDIT INSURANCE CONTRACT WITH THE FEDERAL HOUSING ADMINISTRATION (FHA) PURSUANT TO TITLE I OF THE NATIONAL HOUSING ACT, AS AMENDED, 12 U.S.C. 1702 ET SEQ., AND THE INSURANCE PREMIUMS WERE PAID. SUBSEQUENT TO THE MAKING OF THE LOAN, IT WAS DISCOVERED THAT FRAUD HAD BEEN PERPETRATED BY THE CONTRACTOR, IN THAT THE CONTRACTOR HAD PROMISED A CASH KICKBACK IN THE AMOUNT OF $400 TO THE COOPERS. THE CONTRACTOR WAS TRIED AND CONVICTED AND MR. COOPER APPARENTLY WAS A WITNESS IN THE TRIAL.

IN A LETTER DATED JANUARY 28, 1966, THE UNITED STATES ATTORNEY ADVISED THE COOPERS THAT THEY WOULD NOT BE REQUIRED TO PAY THE FINAL $400 DUE ON THEIR NOTE APPARENTLY BY REASON OF THE FACT THAT THEY HAD NEVER RECEIVED THE ILLEGAL PAYMENT THAT THE CONTRACTOR HAD BEEN CONVICTED OF OFFERING.

YOU STATE THAT WHILE THERE APPEARS TO BE NO QUESTION THAT THE ENFORCEABILITY OF THE NOTE HELD BY THE UPTOWN FEDERAL SAVINGS AND LOAN ASSOCIATION HAS NOT BEEN AFFECTED, THE QUESTION ARISES AS TO WHETHER OR NOT IT HAS ACTUALLY SUSTAINED A LOSS WITHIN THE MEANING OF THE STATUTORY REQUIREMENTS OF THE NATIONAL HOUSING ACT SUCH AS WOULD BE ELIGIBLE FOR INSURANCE COVERAGE.

IN VIEW OF THE FACTS AND CIRCUMSTANCES OUR ADVICE IS REQUESTED AS TO WHETHER IT IS PROPER TO CERTIFY THE ENCLOSED VOUCHER FOR PAYMENT.

SECTION 200.177, TITLE 24, CODE OF FEDERAL REGULATIONS (PERTAINING TO TITLE I LOANS) PROVIDES THAT:

"CLAIM FOR REIMBURSEMENT FOR LOSS ON AN ELIGIBLE PROPERTY IMPROVEMENT LOAN MAY BE MADE TO THE FEDERAL HOUSING ADMINISTRATOR BY THE LENDER AFTER THE BORROWER'S DEFAULT, PROVIDED DEMAND HAS BEEN MADE FOR THE FULL UNPAID BALANCE OF THE NOTE. THE CLAIM MUST BE MADE WITHIN A PRESCRIBED PERIOD AND BE ACCOMPANIED BY THE LENDER'S COMPLETE CREDIT AND COLLECTION FILE FOR THE TRANSACTION. THE NOTE AND ANY SECURITY HELD OR JUDGMENT TAKEN MUST BE DULY ASSIGNED TO THE UNITED STATES. AN EXAMINATION AND AUDIT OF EACH CLAIM IS MADE TO DETERMINE COMPLIANCE WITH THE PROVISIONS OF THE NATIONAL HOUSING ACT AND THE REGULATIONS.'

SECTION 201.11 (B) OF THE SAME REGULATIONS PROVIDES AS FOLLOWS:

"/B) CLAIM AFTER DEFAULT. CLAIM MAY BE FILED AFTER DEFAULT, PROVIDED DEMAND HAS BEEN MADE UPON THE DEBTOR FOR THE FULL UNPAID BALANCE OF THE NOTE. FOR THE PURPOSE OF DETERMINING THE DATE OF DEFAULT, ANY PAYMENTS RECEIVED ON AN ACCOUNT, INCLUDING PAYMENT ON JUDGMENTS PREDICATED THEREON, SHALL BE APPLIED TO THE EARLIEST UNPAID INSTALLMENT.'

THE RECORD BEFORE US DISCLOSES THAT BY LETTER DATED MARCH 14, 1969, THE LENDER MADE DEMAND UPON THE BORROWERS FOR THE ENTIRE BALANCE ($388.08) OF THE NOTE AND THE BORROWERS HAVE NOT MADE PAYMENT THEREOF TO THE LENDER. THUS, IT APPEARS THAT THE LENDER HAS COMPLIED WITH THE PERTINENT REGULATIONS IN CONNECTION WITH HIS CLAIM FOR REIMBURSEMENT FOR LOSS.

SINCE THE RECORD DISCLOSES THAT THERE IS DUE THE LENDER $326.45 ON ACCOUNT OF THE LOAN IN QUESTION, IT IS OBVIOUS THAT IF THE LENDER IS NOT PAID THIS AMOUNT BY THE BORROWERS OR SOMEONE ELSE IT WILL SUSTAIN A LOSS. ACCORDINGLY, AND ASSUMING THAT THE LENDER IN THIS CASE IS AN INNOCENT THIRD PARTY AND HAD NO NOTICE OF THE FRAUD INVOLVED AT THE TIME IT MADE THE LOAN, THE VOUCHER MAY BE CERTIFIED FOR PAYMENT, IF OTHERWISE CORRECT.

HOWEVER, IN CONNECTION WITH THE MATTER WE WOULD LIKE TO POINT OUT THAT SINCE THE FRAUD PERPETRATED BY THE CONTRACTOR WAS HIS PROMISE TO THE BORROWERS TO MAKE A CASH KICKBACK OF $400 TO THEM, IT DOES NOT APPEAR THAT THE BORROWERS CAN BE SAID TO BE WITHOUT FAULT IN THE MATTER. APPARENTLY, THE BORROWERS WERE WILLING TO BORROW $400 MORE THAN NECESSARY TO PAY FOR THE WORK INVOLVED, IN ORDER TO OBTAIN THE CASH KICKBACK FROM THE CONTRACTOR. THE FACT THAT THE BORROWERS NEVER RECEIVED THE ILLEGAL PAYMENT FROM THE CONTRACTOR WOULD APPEAR TO HAVE NO BEARING ON THE BORROWERS LIABILITY TO THE LENDER (OR TO FHA IF IT REIMBURSES THE LENDER FOR ANY LOSS ON THE NOTE) FOR THE FULL AMOUNT OF THE NOTE THE BORROWERS EXECUTED, ASSUMING THAT THE LENDER IN THIS CASE WAS AN INNOCENT THIRD PARTY.

MOREOVER, THE FACT THAT A FEDERAL JUDGE, IN A CRIMINAL ACTION BASED ON THE FRAUD PERPETRATED BY THE CONTRACTOR, EXPRESSED A STRONG DESIRE THAT THE BORROWERS NOT BE REQUIRED TO PAY THE ENTIRE LOAN TO THE LENDING INSTITUTION WOULD NOT BE CONTROLLING IN THE MATTER, SINCE IT DOES NOT APPEAR FROM THE RECORD THAT THERE WAS INVOLVED IN SUCH CRIMINAL ACTION THE LIABILITY OF THE BORROWERS TO THE LENDER ON THE NOTE.

NOR WOULD THE ADVICE OF THE UNITED STATES ATTORNEY TO THE BORROWERS BE CONTROLLING INSOFAR AS THE LIABILITY OF THE BORROWERS FOR REPAYMENT OF THE LOAN IS CONCERNED. WHILE THE UNITED STATES ATTORNEY IN HIS LETTER TO THE BORROWERS AND THE LENDER INDICATES THAT HE "EXPLAINED THE SITUATION" TO FHA, WE FOUND

NOTHING AFFIRMATIVE IN THE RECORD TO INDICATE THAT FHA CONCURRED WITH THE POSITION TAKEN BY THE UNITED STATES ATTORNEY.

UNDER THE CIRCUMSTANCES, AND ON THE PRESENT RECORD, IT WOULD APPEAR THAT FHA SHOULD RECOVER FROM THE BORROWERS ANY AMOUNT IT REIMBURSES THE LENDER FOR THE LOSS CLAIMED ON ACCOUNT OF THE BORROWERS FAILURE TO PAY THE NOTE IN QUESTION. IN THIS CONNECTION WE NOTE FROM THE RECORD THAT THE LENDER HAS ASSIGNED TO FHA A MORTGAGE GIVEN TO THE CONTRACTOR BY THE BORROWERS (TO SECURE THEIR INDEBTEDNESS TO THE CONTRACTOR) AND ASSIGNED BY THE CONTRACTOR (TOGETHER WITH THE DEBT SECURED THEREBY) TO THE LENDER.