

Legal Opinion: CIM-0118

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SUBJECT: Portfolio Reengineering Demonstration, Sizing of
Partial Payment of Claim

October 6, 1999

MEMORANDUM FOR: Kevin McNeely, Demonstration Program
Manager, H

FROM: John J. Daly, Associate General Counsel
for Insured Housing, CI

SUBJECT: Portfolio Reengineering Demonstration, Sizing of
Partial Payment of Claim

This is in response to two memoranda from you dated September 20, 1999 requesting legal advice. In one memorandum you requested clarification regarding the sizing of a partial payment of claim under the statute authorizing the Portfolio Reengineering Demonstration Programs. In the second memorandum, you requested confirmation of the resolution of a number of issues that were raised in a meeting between our offices on September 17, 1999.

Regarding the sizing of a partial payment of claim, you have requested an interpretation of paragraph IV.D.1 which applies to the FY 1998 Portfolio Reengineering Demonstration Program and which appears in the Transition Program Guidelines published in the Federal Register at Page 36131, Volume 63, Number 126, dated July 1, 1998. That paragraph obligates HUD to require a new second mortgage to the extent it determines that such a mortgage can reasonably be expected to be repaid. The paragraph goes on to state:

To the extent that the combination of the new first mortgage and the new second mortgage is less than the outstanding principal balance of the existing insured mortgage, immediately before it is restructured or refinanced, HUD will consider debt forgiveness or budget basing, or a combination of these

This paragraph is not a limitation on total amount of payments that can be made by the Department under the FY 1998 Portfolio Reengineering Demonstration Program but rather a statement that reflects that there is a limit on the size of the first and the second mortgage loans that result from a debt restructuring transaction. Although the partial payment of claim in a debt restructuring transaction is limited to no more than the remaining principal balance of the insured mortgage loan, there is legal authority for

the Department to pay a greater amount in the overall debt restructuring transaction. Section 212(h)(1)(C) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1997 (the "FY 1997 Appropriations Act") allows the Department to:

incur such costs, make such grants . . . and other payments, and provide other valuable consideration as may reasonably be necessary for owners, lenders, servicers, third parties, and other entities to participate in the demonstration program.

This provision in the FY 1997 Appropriations Act also applies to debt restructurings under the FY 1998 Demonstration Program pursuant to Section 522(b) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1998 (the "FY 1998 Appropriations Act"). Therefore, the total sum of the payments by the Department are limited only by what is "reasonably necessary" to allow the required participants to enter into a debt restructuring transaction.

Our responses to the issues raised in your memorandum entitled "Confirmation of Determinations" are presented below in the order that you asked them:

1. The language in Section 212(h)(1)(C) of the FY 1997 Appropriations Act and Section 522(b) of the FY 1998 Appropriations Act, cited above, provide legal authority to make a direct loan pursuant to the FY 1997 and the FY 1998 Portfolio Reengineering Demonstration Programs.

2. There is no statutory provision specifying whether simple or compound interest shall be charged on either the Transaction Costs Note or the Contingent Repayment Note. Therefore, it is a policy decision for Housing to make on how to calculate interest due under the notes.

3. Both a Contingent Repayment Note and a Shared Proceeds Note represent that portion of HUD's claim payment which cannot reasonably be expected to be repaid by the owner following a restructuring. Housing has made a decision to require a note in these instances to allow for the possibility of recovery by the Department in the event that funds become available in the future. These notes are not required by statute so it is a matter for a Housing administrative determination about whether they should be booked.

4. The mortgagee of record is legally entitled to receive a mortgage insurance claim. The mortgagee of record

may direct HUD to make the claim payment to a third party, including an escrow agent. We recommend that delegations of authority include authority to make payments for direct loans and authority to make payments to escrow agents for the mortgage of record.

5. Under the language quoted above for Section 212(h)(1)(C) of the FY 1997 Appropriations Act and Section 522(b) for the FY 1998 Appropriations Act, the Department may include prepayment penalties in a debt restructuring transactions for the FY 1997 and the FY 1998 Demonstration Programs. Implementation and applicability of prepayment penalties are matters for administrative determination by Housing.

If you have any questions regarding the above issues, please contact Debbie Brain at x5420 or Ed Ferguson at x5241.