

Insurance Claim--Excess Mortgage Proceeds

Legal Opinion: GHM-0079

Index: 3.400, 3.405

Subject: Insurance Claim--Excess Mortgage Proceeds

April 14, 1993

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Huntington Center  
41 South High Street  
Columbus, OH 43215

Re: Skylake Ranch  
FHA Project No. 101-46015  
(L-1356)

Dear Mr. Saad:

This responds to your November 5, 1992 letter to Sam Rothman of the Office of General Counsel, Office of Program Enforcement, in which you asked HUD to respond to several matters regarding the insurance claim payment for the captioned project.

First, you maintained that there should not have been a reduction in the insurance benefits paid to the mortgagee as the result of a reduction of the maximum insurable mortgage amount. You stated that, once HUD insures advances of mortgage proceeds, the mortgagee is protected by the insurance contract against loan loss. To demonstrate the protections the mortgagee enjoys, you referred to section 207.25(a)(3) of the regulations and paragraph 3 of the Agreement and Certification (Form No. 3306). Section 207.25(a)(3) provides that the mortgagor shall agree to apply in reduction of the outstanding balance of mortgage principal any excess of mortgage proceeds over statutory limitations based on actual costs. The Agreement and Certification provides that the mortgagor will pay any excess mortgage proceeds to the mortgagee and the mortgagee agrees that the contract of insurance is reduced by the amount of the excess.

It is our opinion that while the regulations and the Agreement and Certification establish that the mortgagee must use excess proceeds to pay down the mortgage balance, there is a condition precedent to reduction of the mortgage amount, namely, that the mortgagor must first pay the excess proceeds to the mortgagee before the mortgagee is able to apply such proceeds to the mortgage balance. In August, 1991, we advised HUD's Office of Mortgage Insurance Accounting and Servicing ("MIAS") that the principal amount of the mortgage should be the amount determined after cost certification because the approval of advances is not considered to be a final approval. Rather, final approval of amounts advanced comes during the cost certification stage, which may result in a reevaluation of the legality of the amounts advanced. However, in arriving at this conclusion, it was assumed that the mortgagor was

able to remit the excess mortgage proceeds to the mortgagee. But if the mortgagor does not repay the excess mortgage proceeds to the mortgagee, the mortgagee is not obligated to pay down the mortgage balance. We have requested MIAS to make the appropriate adjustments to the insurance payment.

Second, you agreed with the Office of Inspector General ("OIG") report that the mortgagee officially notified HUD of the default on November 20, 1987. It is our understanding that you also agree that interest appropriately was curtailed from March 1 to November 20, 1987, but you question HUD's failure to pay interest for the period after November 20, 1987. HUD regulations, at 24 C.F.R. section 207.259(b)(1)(iii), state that interest will be paid on the claim -

"except that when the mortgagee fails to meet any one of the applicable requirements of 207.256 and 207.258 within the specified time and in a manner satisfactory to the Commissioner, the interest allowance in such cash payment shall be computed only to the date on which the particular required actions should have been taken or to which it was extended."

This office has interpreted this provision to mean that if a requirement was not met by the established deadline, interest will be curtailed on the claim on the deadline and will not begin to accrue again. In the instant case, the date of default was January 1, 1987. Section 207.256(a) of the regulations provides that if the default is not cured within 30 days of the date the payment is due, the mortgagee shall, within 30 days thereafter, notify the Commissioner in writing of such default. Therefore, under the regulations, the mortgagee should have notified HUD of the default no later than March 1, 1987. Because notification of the default was not sent to HUD until November 20, 1987, interest appropriately was curtailed after March 1, 1987. Also, you have asserted that the OIG report concluded "that interest accruing between March 1 and November 20, 1987 should be disallowed, but not interest accruing thereafter." However, we wish to clarify that the OIG report did not draw any conclusion with regard to the payment of interest after November 20, 1987.

If you have additional questions, please call Monica Jordan on (202) 708-4107.

Very sincerely yours,

Donald A. Franck  
Chief Attorney, Loan Management and  
Property Disposition Section