UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF HEARINGS AND APPEALS

In the Matter of: **AMERICAN FINANCE RESOURCES, INC.,** Petitioner.	15-AM-0049-AO-013 Claim No. 7-207083960A May 17, 2016

DECISION AND ORDER

On February 2, 2012, American Financial Resources, Inc. ("Petitioner") was notified that, pursuant to 31 U.S.C. §§ 3761 and 3720A, the Secretary of the U.S. Department of Housing and Urban Development ("HUD," or "the Secretary") intended to seek administrative offset of any federal payments due to Petitioner in order to satisfy Petitioner's alleged debt to HUD.

On February 19, 2015, Petitioner requested a hearing concerning the existence, amount and enforceability of the alleged debt. The Office of Hearings and Appeals has been designated to determine whether the debt is legally enforceable. 24 C.F.R. § 17.69(c). As a result of the Petitioner's hearing request, referral of the debt to the U.S. Department of the Treasury for the administrative offset was temporarily was temporarily stayed by the Court on March 13, 2015, until the issuance of this written decision by the Administrative Judge. (Notice of Docketing, Order, and Stay of Referral ("Notice of Docketing"), dated March 13, 2015.

Background

On or about March 23, 2009, HUD's Quality Assurance Division ("QAD") conducted a review of Petitioner's Mortgage finance operation. (Sec'y Stat., ¶ 2; Declaration of Brian Dillon "Dillon Decl.", ¶ 4). During its review, the QAD found that while underwriting the mortgage of Courtney and Marlene Alexander ("Alexander Note"), Petitioner engaged in non-compliant lending activities, which exposed HUD to an unacceptable level of risk. (Sec'y Stat., ¶ 3; Dillon Decl., ¶ 4). To resolve the QAD findings, Petitioner entered into an Indemnification Agreement with HUD dated May 17, 2010. (Sec'y Stat., ¶ 4; Dillon Decl., ¶ 4). This Indemnification Agreement required the Petitioner to indemnify HUD for losses which have been or may be incurred related to a default of the Alexander Note, up to five years from the loan's date of

endorsement. (Sec'y Stat., ¶ 5; Indemnification Agreement, ¶ 1). The Alexander Note was endorsed for insurance on March 24, 2008 and went into default on November 1, 2008. (Sec'y Stat., ¶ 6; Dillon Decl., ¶ 5). On September 16, 2013, HUD sold the Alexander Note at a loss of $346,477.73 for $96,029.94. (Sec'y Stat., ¶ 8; Dillon Decl., ¶ 8). Pursuant to the Indemnification Agreement, HUD sought indemnification from Petitioner in the amount of $347,489.53, the amount of loss plus the acquisition cost. This amount was later reduced to $346,477.73, representing the amount HUD paid to Bank of America, minus the amount HUD received from the sale of the Alexander Note. (Sec'y Stat., ¶ 9.; Dillon Decl., ¶ 11).

Consequently, the Secretary alleges that Petitioner is indebted to HUD in the following amounts:

(a) $346,477.73 as the unpaid principal balance as of May 5, 2015;
(b) $8,288.17 as the unpaid on the interest on the principal balance at 5% per annum through May 5, 2015;
(c) $21,092.89 as unpaid penalties as of through May 5, 2015;
(d) $35.33 as unpaid administrative costs as of May 5, 2015; and
(e) interest on said principal balance from May 6, 2015 at 5% per annum until paid.

(Sec'y Stat., ¶ 11; Dillon Decl., ¶ 11).

Discussion

The Deficit Reduction Act of 1984, 31 U.S.C. § 3720A, provided federal agencies with the remedy of administrative offset of federal payments for the collection of debts owed to the United States government. Petitioner bears the initial burden of submitting evidence to prove that the debt is not past-due or legally enforceable. 24 C.F.R. § 17.69(b); Juan Velazquez, HUDBCA No. 02-C-CH-CC049 (Sept. 25, 2003).

Petitioner claims that the debt is not enforceable. (Pet'r's Res. Sec'y Stat.). Petitioner asserts that the inclusion of the Alexander Note in the Single Family Loan Sale 2013-1 ("SFLS 2013-1") caused the Alexander Note to be sold at a discount. (Pet'r's Res. Sec'y Stat.). Petitioner further maintains that the indemnification is over-valued because the servicer violated the terms of its Participating Servicer Agreement by including the Alexander Note in the pool of loans sold in SFLS 2013-1. Petitioner also claims that HUD violated the terms of its Servicing Agreement by not actively screening for loans with Indemnification Agreements. (Pet'r's Res. Sec'y Stat.; HUD's FOIA Response Request 1, dated May 13, 2015 ("FOIA Response")). Petitioner contends that the Secretary violated its duty to actively screen the loans for Indemnification Agreements, breaching the doctrine of avoidable consequences. (Pet'r's Res. Sec'y Stat.; FOIA Response at 16). Petitioner further argues that the Secretary's justification for the placement of the Alexander Note in the SLFS 2013-1, namely to maximize the recovery to the mutual mortgage insurance fund, is inapplicable here, as the Indemnification Agreement itself already covered this goal. (Sec'y Stat., ¶ 21; Pet'r's Res. Sec'y Stat.). Petitioner also

questions the Secretary's assertion that HUD received $96,029.94 for the sale of the Alexander Note. (Pet'r's Res. Sec'y Stat.; Declaration of John W. Lucey "Lucey Decl."). John W. Lucey stated that while defaulted notes are sold in pools, each loan is priced and bid on individually. (Pet'r's Res. Sec'y Stat.; Lucey Decl.). Petitioner maintains that this is inconsistent and illogical, as it is unclear how a pool can be sold as a whole, with the notes being priced and bid on individually. (Pet'r's Res. Sec'y Stat.). Petitioner asserts that the evidence provided gives no indication as to the amount HUD actually received for the Alexander Note. (Pet'r's Res. Sec'y Stat.).

In response, the Secretary asserts that Petitioner's debt is past due and enforceable pursuant to 31 U. S. C. § 3720A. (Sec'y Stat., ¶ 1). The Secretary further argues that the Alexander Note was sold in a pool at a market rate to qualified investors through a sealed bidding process, which automatically makes it unable to sell the note at a discount. (Supp. Sec'y Stat., ¶¶ 12 & 15; Lucey Decl., ¶¶ 5 & 7). The Secretary argues that as the sale is competitive, it would lead to the highest possible return which would most accurately reflect the market value; to argue this is a sale at a discount is illogical. (Supp. Sec'y Stat. ¶ 18). The Secretary states it is clear how much the Alexander Note sold for and that the mere lumping together of notes and assets does not impede HUD's ability to determine how much an individual note was sold for. (Supp. Sec'y Stat., ¶ 12; Lucey Decl., ¶ 8). The secretary explains that the FHA pools together defaulted single family loans and qualified investors can then bid on each loan within the pool on an individual basis. (Supp. Sec'y Stat. ¶13. Lucey Decl., ¶ 8). The winning investor is the one whose bids on each individual loan when aggregated are the highest. (Supp. Sec'y Stat., ¶ 14; Lucey Decl., ¶ 8).

The Indemnification Agreement did not include any language as to how the Alexander Note had to be sold. (Supp. Sec'y Stat., ¶ 25). Therefore, the Secretary argues, HUD's options to recoup were unrestricted. Id. The Secretary states that HUD is not required to follow any non-promulgated regulations or guidelines, when they are not specifically incorporated in the contract. (Sec'y Stat., ¶ 56). In support of his claim, the Secretary cites Cambridge Home Capital, LLC, HUDOA No. 06-D-NY-GG004 (Jun. 18, 2009), where the court followed this rule. Id. HUD had no obligation to find the best way to minimize the damages for the breaching party. (Sec'y Stat., ¶ 28) In support of his claim, the Secretary cites to Cambridge, where the court found that HUD does not have to "ferret out the single best situation which absolutely minimize[s] the breaching party's damages." Id., citing Ketchikan Pulp Cp. v. United States, 20 Cl. Ct. 164, 166 (Fed. Cl. 1990). Lastly, the Secretary asserts that Petitioner failed in proving that HUD violated the covenant of good faith and fair dealing, as Petitioner must prove that HUD acted with a "specific intent to injure" or that HUD was "motivated by animus" towards the Petitioner. (Supp. Sec'y Stat., ¶ 30). Again, the Secretary cites Cambridge, where the court found these requirements need to be met in finding such a violation. Id., (citing Keeter Trading Co. v. United States, 85 Fed. Cl. 613 (2009)).

Petitioner did not regard these explanations as sufficient. (Pet'r's Res. Suppl. Sec'y Stat.). Petitioner maintains that the sale procedure is confusing and does not allow the parties to be able to accurately assess the amount paid for the Alexander Note. (Pet'r's Res. Suppl. Sec'y Stat., ¶ 7). Additionally, considering the awarded bid was 62.09748% of the Broker Price Opinion values of all of the loans in pool 102 of SFLS 2013-1, Petitioner finds it apparent that this percentage would constitute a discounted sale. (Pet'r's Res. Suppl. Sec'y Stat., ¶ 9). Additionally, since the sale of the pool is given to the bidder with the highest aggregate bid on the entire pool, it means that there could have been higher individual bids on the Alexander Note, which did not end up being the winning bid because they ended up being lower than the overall aggregate bid. (Pet'r's Res. Suppl. Sec'y Stat. ¶ 7). Furthermore, Petitioner is contesting $8,210.23 in Mortgage Insurance Premium (MIP) payments, as these payments have already been made out from Bank of America to HUD. (Pet'r's Res. Suppl. Sec'y Stat., ¶ 10). Lastly, Petitioner continues its assertion that HUD's inclusion of the indemnified loan in SFLS 2013-1 was prohibited. Petitioner refers to the training materials which include references to HUD not including loans subject to an indemnification agreement, as well as the Servicer Participation Agreement prohibiting this inclusion. (Pet'r's Res. Suppl. Sec'y Stat., ¶ 11; Participating Servicer Agreement at 9 & 16). The Indemnification Agreement states: "All HUD requirements for servicing and payment of mortgage insurance premiums will be observed with respect to such mortgages." (Indemnification Agreement). Petitioner claims that the violation of the Servicer Participation Agreement and the policy laid down in the training materials constitute a violation of a HUD requirement with respect to the Alexander Note. (Pet'r's Res. Suppl. Sec'y Stat., ¶ 11).

The Court is not persuaded by Petitioner's assertions that the inclusion of the Alexander Note in the 2013-1 would logically lead to a sale at a discount. The sealed bidding process allows the loans to be bought for a value that is in accordance with their fair market value. Furthermore, there is no promulgated regulation or explicit text in the Indemnification Agreement which requires HUD to conduct the sale in any specific way. Additionally, Petitioner's claims that revolve around the dispute of the $8,210.23 in MIP payments are not sufficiently supported by evidence. It is unclear as to what the MIP payments by Bank of America actually pertain to, which makes it impossible for this Court to ascertain whether they exempt Petitioner from payment to HUD.

Since the Servicer Agreement as well the HUD training materials are not promulgated regulations, they are not binding on HUD's actions in this case. The Alexander Note was subject to the indemnification agreement and governed thereby. Therefore, we find in favor of the Secretary in this case.

ORDER

For the reasons set forth above, I find the debt that is the subject of this proceeding to be legally enforceable against Petitioner in the amount claimed by the Secretary. It is

ORDERED that the *Order* imposing the Stay of Referral of this matter to the U.S. Department of Treasury for administrative offset is **VACATED**. It is

FURTHER ORDERED that the Secretary is authorized to refer this matter to the U.S. Department of the Treasury for administrative offset of any payment due Petitioner.

SO ORDERED.

H. Alexander Manuel
Administrative Judge