

MD Affordable Housing Trust and HUD Closing Contractors

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Subject: MD Affordable Housing Trust and HUD Closing Contractors

March 16, 1993

Ms. Margaret McFarland
Principal Counsel
Maryland Department of Housing
and Community Development
100 Community Place, Suite 2.300
Crownsville, MD 21032-2023

Dear Ms. McFarland:

The recently enacted law creating the Maryland Affordable Housing Trust (MAHT) has been brought to our attention, and June Auerbach of my staff has discussed it with David Rawle of your office. According to the law, the creation of MAHT was for the purpose of assisting in the provision of affordable housing in the State. The law provides that a title insurer, or its agent or approved attorney shall pool and commingle trust money received from clients in connection with escrows and closings if a separate deposit of the trust money would generate interest of \$50 or less.

As we advised Mr. Rawle, HUD acquires the titles to properties through our mortgage insurance operations. We then sell the properties and we have contracts with attorneys, escrow companies or the title companies to close our sales transactions. These contracts contain the following requirements:

"The Contractor title company, escrow company or attorney shall establish a separate non-interest bearing escrow account for all proceeds in the name of the Contractor with the restriction 'As Trustee for the U.S. Department of Housing and Urban Development'. Since it is a matter of individual bank policy rather than a standard operating procedure on the length of time a check is held, most certified/cashier's checks will clear in overnight processing. The escrow account, therefore, shall be established in a bank that gives credit for the deposited check immediately upon clearance, will issue a receipt for the deposit and which has the capacity to transmit all of the information contained in SAMS Form 1103, Wire Transfer Transmittal, in the exact format shown. If at any time the Contractor is unable to continue compliance with these requirements, the Contractor shall immediately notify the GTR. Such notification shall describe the efforts exerted by the Contractor to comply and shall include proposed actions to achieve compliance. . . . On the day of closing or the

next banking day, deposit the sales proceeds and using the SAMS 1103, Wire Transfer Transmittal, provided by the Field Office, initiate the request for the wire transfer of the proceeds due HUD via FEDWIRE in accordance with instructions provided by Treasury and are presently being used by the private sector banking community in effecting wire transfers of funds within the Federal Reserve System."

Our instructions concerning closing contractors provide that if the depository bank does not immediately wire the deposited sale proceeds, the closing contractor must obtain an official dated receipt for the deposit and wire transfer request. At the time of the actual wire transfer, the closing contractor must obtain a proper dated confirmation of the wire transfer, to verify proper and timely transfer of funds.

These requirements were established in 1990 as a result of very large losses to our insurance fund through closing contractors who embezzled our funds. The absorption of million dollar losses, plus the resulting adverse publicity, were very detrimental to the accomplishment of the goals of the Department. Many hours were spent by HUD Program, Administrative and Inspector General's offices, as well as our office, to arrive at suitable requirements to eliminate the risk of HUD's suffering any such losses in the future. Since our new requirements have been established, we have fortunately not had any more such losses.

There is no situation under which the Department would ever again permit closing contractors to commingle funds from closings of FHA-acquired properties with the contractor's other escrow funds. We consider that our protection of our insurance fund (Mutual Mortgage Insurance Fund) mandates that the proceeds from the sale of our properties be deposited in a separate non-interest bearing trust fund.

Ms. Auerbach advised Mr. Rawle that HUD closing contractors would not be able to comply with the new Maryland law. In Ms. Auerbach's discussion with Mr. Rawle, he asked whether HUD had legislation or regulations which were specific on the point of the requirement for the separate trust funds. As Ms. Auerbach explained then, and as we have stated in this letter, the requirement is contained in our contract with closing contractors. Mr. Rawle called Ms. Auerbach subsequently and advised that the position of his office was that HUD must comply with the Maryland law. Since HUD cannot comply and in order that there be no question with respect to the priority between any state's requirements and those of HUD involving the handling of our sales proceeds by our closing contractors, we are publishing a regulation that contains our requirement with respect to the separate non-interest bearing trust account. We plan to have the regulation published in the Federal Register as an interim rule in April and, then after the comment period, published as a final rule.

We are certainly in agreement with the proposed use of the interest which is earned on the MAHT accounts and laud your efforts to assist low-income home buyers. However, as much as we would

like to assist you, HUD must take the steps which are necessary to protect its own funds from possible fraud or dishonesty on the part of the contractors who handle the funds. In addition, considering our requirement that the funds be wire transferred to a Treasury account as soon after deposit as possible, we do not think that there would be much interest, if any, generated on the funds deposited in connection with the sales of our properties in the State of Maryland.

We are going to advise our field offices which have jurisdiction over Maryland properties that our closing contractors in those areas must continue to adhere to the requirements of their contracts with HUD and that they are not to place any HUD funds in a MAHT account.

If you would care to discuss this matter further, feel free to call me or Ms. Auerbach at 202-708-3070.

Very sincerely yours,

Bruce S. Albright
Assistant General Counsel
Home Mortgage Division