Methods of Disposition for Coinsured Lenders

Legal Opinion: GHM-0077

Index: 3.500, 3.600
Subject: Methods of Disposition for Coinsured Lenders

April 9, 1993

Maribeth Stahl
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Integrated Funding, Inc.
The CRI Building
11200 Rockville Pike
Rockville, Maryland 20852

Dear Ms. Stahl:

This letter is in response to your February 22, 1993 letter asking whether a coinsuring lender, after acquiring marketable title to a project, may sell the project back to the borrower who defaulted on the loan for the higher of the two appraised values. After review by our office in conjunction with the Office of Housing, we have concluded that it would be violative of Departmental policy and public policy for a coinsuring lender who has acquired titled to a project to sell the project back to the defaulted borrower.

The facts as I understand them from our telephone conversations are that the borrower defaulted on a mortgage coinsured by Integrated Funding, Inc. ("Integrated") and HUD. Integrated is attempting to foreclose and the borrower threatened to file bankruptcy if Integrated proceeded with foreclosure. The borrower then offered to give Integrated a deed-in-lieu of foreclosure on the condition that Integrated sell the project back to the borrower at the higher of the two appraised values.

Handbook 4566.2, "Management, Servicing and Disposition Requirements for Projects with 223(f) Coinsured Loans," lists the methods of disposition a lender may use after acquiring title to the property. The lender may dispose of the property through either a competitive bid procedure or a negotiated sale.

These two methods of disposition are also the only methods identified in the coinsurance regulations. (See 24 CFR 251.822(f)(1) and (2); 255.822(f)(1) and (2).) The borrower's proposal does not fit into either category. It is obviously not a competitive bid procedure. It is also not a negotiated sale because a negotiated sale assumes that the sale is an arms length transaction. An arms length transaction refers to the bargaining position of two parties that are unrelated and whose mutual dealings are influenced only by the independent interest of each. It assumes that each party is dealing in good faith in the ordinary course of business. The borrower's deal is a one-sided threat, that is not made in good faith. Integrated's decision to foreclose should not be dependent upon whether the borrower files bankruptcy.

The proposal by the borrower is violative of public policy because it encourages a borrower to contrive a default and consequently trigger a coinsurance claim. As a result, the proposal would allow the borrower to avoid its obligations under the regulatory agreement and mortgage, and would enable the borrower to acquire the property for less than the redemption value, which the borrower would have to pay at foreclosure to acquire the property. A lender's acceptance of less than the amount required to redeem the property would also raise a serious question of whether the lender was engaging in a practice that was not a prudent lending practice. Section 25.9(p) (24 CFR 25.9(p) (1992)) of the regulations requires lenders to participate in business practices that conform to generally accepted practices of prudent lenders.

Therefore, it would be against Departmental policy and public policy for a coinsuring lender who has acquired title to a project to sell the project back to a defaulted borrower.

Sincerely,

Donald A. Franck
Chief Attorney
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Disposition Section