



U.S. Department of Housing and Urban
Development Office of Counsel Los
Angeles Field Office, Region IX 611
W. 6th Street, Suite 1306 Los Angeles,
CA 90017

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PRIVILEGED AND CONFIDENTIAL

MEMORANDUM FOR: File

FROM: Carl Kao, Senior Attorney-Advisor, 9DC

SUBJECT: HUD Prohibition Against Offshore Deposit Accounts

This memo memorializes the authority of HUD to prohibit project funds from being deposited in branch accounts outside of the United States.

Background

For a Section 232 portfolio, a Deposit Account Control Agreement ("DACA") with a large U.S. national bank as the Depository Bank ("Bank") designated the deposit account to be maintained with the Bank's Cayman Islands Branch. When instructed by the HUD closing attorney to change the designation to a branch in an American state that has adopted the U.C.C., lender's counsel responded, "Please provide us with the HUD requirements that prohibit their account from being in the Cayman Islands. We are not familiar with that rule."

As we researched HUD policy on this point, we found that many DACAs with references to accounts in the Cayman Islands have been proposed, and sometimes inadvertently accepted, nationwide.

Legal and Policy Analysis

The Office of Healthcare Programs ("OHP") does not allow DACA accounts to be held in an offshore deposit account. This has been a long time practice of the Department. This practice is reflected in the Borrower's Regulatory Agreement.

HUD 92466 (11/2002) paragraph 9(g), sentence 1 states:

"All rents and other receipts of the project shall be deposited in the name of the project in a financial institution, whose deposits are insured by an agency of the Federal Government."

HUD 92466-E (3/92), paragraph 9(h), sentence 1 states:

"All receipts of the project shall be deposited in the name of the project in a bank, whose deposits are insured by the FDIC."

This practice is now published in the new Section 232 Final Rule published in the Federal Register. The Final Rule is published in 77 Fed. Reg. 55120 et. seq. (September 8, 2012). Section 232.1013(a) states in part:

"Deposit of funds. An operator must deposit all revenue the operator receives directly or indirectly in connection with the operation of the healthcare facility in an account with a financial institution whose deposits are insured by an agency of the Federal Government..." *ibid.* 55137.

Section 20 of the new Operator's Regulatory Agreement HUD 92466A ORCF (Rev 3/13) states in part:

"The account must be with a financial institution whose deposits are insured by an agency of the federal government..."

Accounts in the Cayman Islands are not insured by the FDIC. Project funds therefore cannot be held in accounts in the Cayman Islands or other offshore locations.

Statutory Consideration

In addition to the above discussion, mortgages insured under Section 232 are also subject subsection 207(g) of the National Housing Act, which sets forth requirements for a mortgagee to collect mortgage insurance benefits for defaulted mortgages. To be entitled to collect mortgage insurance benefits, a mortgagee must, among other things, assign, transfer and deliver to the Secretary, "any cash or property held by the mortgagee, or to which it is entitled, as deposits made, for the account of the mortgagor and which have not been applied in reduction of the principal of the mortgage indebtedness." (NHA §207(g)(5)).

DACA funds held in offshore accounts are beyond the jurisdiction of the United States, and it is questionable how the mortgagee would be able to perfect its security interest in those funds. If the mortgagee is unable to deliver to the Secretary all of the cash or property it is entitled to, under §207(g)(5), the mortgagee should be denied coverage or at best only be allowed to make a partial claim for mortgage insurance benefits.

NHA §207(g) [12 U.S.C. 1713(g)]

(g) Payment of insurance after default. The failure of the mortgagor to make any payment due under or provided to be paid by the terms of a mortgage insured under this section shall be considered a default under such mortgage and, if such default continues for a period of thirty days, the mortgagee shall be entitled to receive the benefits of the insurance as hereinafter provided, upon assignment, transfer, and delivery to the Secretary, within a period and in accordance with rules and regulations to be prescribed by the Secretary of (1) all rights and interests arising under the mortgage so in default; (2) all claims of the mortgagee against the mortgagor or others, arising out of the mortgage transactions; (3) all policies of title or other insurance or surety bonds or other guaranties and any and all claims thereunder; (4) any balance of the mortgage loan not advanced to the mortgagor; (5) any cash or property held by the mortgagee, or to which it is entitled, as deposits made for the account of the mortgagor and which have not been applied in reduction of the principal of the mortgage indebtedness; and (6) all records, documents, books, papers, and accounts relating to the mortgage transaction. Upon such assignment, transfer, and delivery the obligation of the mortgagee to pay the premium charges for mortgage insurance shall cease, and the Secretary shall issue to the mortgagee a certificate of claim as provided in subsection (h), and debentures having a par value equal to the original principal face amount of the mortgage plus such amount as the mortgagee may have paid for (A) taxes, special assessments, and water rates, which are liens prior to the mortgage; (B) insurance of the property; and (C) reasonable expenses for the completion and preservation of the property and any mortgage insurance premiums paid after default, less the sum of (i) that part of the amount of the principal obligation that has been repaid by the mortgagor, (ii) an amount equivalent to 1 per centum of the unpaid amount of such principal obligation, and (iii) any net income received by the mortgagee from the property: Provided, That the mortgagee in the event of a default under the mortgage may, at its option and in accordance with regulations of, and in a period to be determined by, the Secretary, proceed to foreclose on and obtain possession of or otherwise acquire such property from the mortgagor after default, and receive the benefits of the insurance as herein provided, upon (1) the prompt conveyance to the Secretary of title to the property which meets the requirements of the rules and regulations of the Secretary in force at the time the mortgage was insured and which is evidenced in the manner prescribed by such rules and regulations, and (2) the assignment to him of all claims of the mortgagee against the mortgagor or others, arising out of the mortgage transaction or foreclosure proceedings, except such claims that may have been released with the consent of the Secretary. Upon such conveyance and assignment, the obligation of the mortgagee to pay the premium charges for insurance shall cease and the mortgagee shall be entitled to receive the benefits of the insurance as provided in this subsection, except that in such event the 1 per centum deduction, set out in (ii) hereof, shall not apply. Notwithstanding any other provision of this Act, upon receipt, after the date of enactment of the Housing Act of 1964 [enacted Sept. 2, 1964], of an application for insurance benefits on a mortgage insured under this Act, the Secretary may terminate the mortgagee's obligation to pay premium charges on the mortgage.