



**Office of Appeals
U.S. Department of Housing and Urban Development
Washington, D.C. 20410-0001**

In the Matter of:

West Penn Financial Service Center Inc.,

Petitioner.

HUDOA No. 10-H-NY-LL03
Claim No. 7-207053510A

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For Petitioner

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For the Secretary

DECISION AND ORDER

On October 19, 2009, West Penn Financial Service Center Inc. ("Petitioner") was notified that, pursuant to 31 U.S.C. §§ 3716 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 satisfaction of a delinquent and legally enforceable debt allegedly owed to HUD.

On October 29, 2009, Petitioner made a timely request for a hearing concerning the existence, amount or enforceability of the debt allegedly owed to HUD. The Office of Appeals has jurisdiction to determine whether Petitioner's debt is past due and legally enforceable pursuant to 24 C.F.R. § 17.170(b). The administrative judges of the Office of Appeals have been designated to conduct a hearing to determine whether the debt allegedly owed to HUD is legally enforceable. 24 C.F.R. §§ 17.152 and 17.153. As a result of Petitioner's hearing request, this Office temporarily stayed referral of the debt to the U.S. Department of Treasury for offset on October 29, 2009. (Notice of Docketing, Order and Stay of Referral ("Notice"), dated October 29, 2009.)

Background

In 2002, HUD's Quality Assurance Division ("QAD")/Lender Monitoring Team conducted a review of Petitioner's mortgage finance operation to determine whether Petitioner – a HUD-authorized Direct Endorsement mortgage lender–complied with HUD's rules and regulations when underwriting and issuing HUD/FHA-insured mortgages. (Secretary's Statement ("Sec'y Stat."), filed January 29, 2010, ¶ 2; Ex. A, Declaration of Michael C. DeMarco, Director of Insurance Operations Division, HUD Financial Operations Center ("DeMarco Decl."), dated January 21, 2010, ¶ 4.) During its review, the QAD found that Petitioner engaged in non-compliant lending activities and exposed HUD to an unacceptable level of risk when Petitioner underwrote the mortgage of Michael T. Basenyi (FHA Case No. 442-2080919). (DeMarco Decl. ¶ 4.)

To resolve the QAD's findings, Petitioner entered into an Indemnification Agreement ("the Agreement") with HUD dated April 24, 2002. (Sec'y Stat. ¶ 4; DeMarco Decl. ¶ 4.) In the Agreement, Petitioner agreed to "indemnify HUD for losses which have been or may be incurred related to FHA Case No. 442-2080919 where this loan goes into default within five years from the date of endorsement..." (Sec'y Stat. ¶ 5.) On August 1, 2004, Michael T. Basenyi defaulted on the mortgage which was then being held by Midland Mortgage Co. ("Midland"). (DeMarco Decl. ¶ 5; *attaches*. FHA Case Details Report at p. 2.) In January 2006, Midland obtained a judgment of foreclosure, and in May 2006, Midland transferred the property to HUD. (Sec'y Stat. ¶ 7.) HUD paid insurance benefits to Midland in May and June 2006 totaling \$57,381.32. (*Id.*) On September 13, 2006, HUD sold the property for \$14,001. (Sec'y Stat. ¶ 8) HUD's loss aggregates \$48,048.77. (*Id.*)

Pursuant to the terms of the Agreement, HUD sought indemnification from Petitioner in the amount of \$48,048.77. (Sec'y Stat. ¶ 9.) Petitioner failed to make payment as agreed in the Agreement and is currently in default. (Sec'y Stat. ¶ 10.) The Secretary alleges that Petitioner is indebted to HUD in the following amounts:

- (a) \$48,048.77 as the unpaid principal balance as of December 31, 2009
- (b) \$5,925.63 as the unpaid interest on the principal balance at 4% per annum through December 31, 2009;
- (c) \$3,921.25 as unpaid penalties as through December 31, 2009;
- (d) \$141.33 as unpaid administrative costs as of December 31, 2009; and
- (e) interest on said principal balance from January 1, 2010 at 4% per annum until paid.

(Sec'y Stat. ¶ 11.)

On October 19, 2009, a Notice of Intent to seek offset of federal payments was sent to Petitioner. (Sec'y Stat. ¶ 12.) On October 29, 2009, Petitioner filed a timely request for a hearing with this Office. (Petitioner's Letter ("Pet'r's Letter"), filed October 29, 2009.)

Discussion

The Deficit Reduction Act of 1984, 31 U.S.C.A. §3720, provides federal agencies with a means of collecting debts owed to the United States Government. Petitioner bears the initial burden of submitting evidence to prove that the alleged debt is unenforceable or not past due. 24 C.F.R. § 17.152(b). Petitioner disputes the existence of the debt and asks this Office to find: “the Indemnification Agreement void or in the alternative, [find that] the debt is not past due and does not total \$48,048.77, but an amount set by the Office of Appeals after consideration of the foregoing.” (Petitioner’s Response to Secretary’s Statement (“Pet’r’s Resp.”), filed February 16, 2010.)

I. HUD BREACHED THE INDEMNIFICATION AGREEMENT

Petitioner argues that the actions taken by Midland, HUD’s servicer, “inured to the detriment of West Penn Financial Service Center, Inc. and constitute a breach of the Indemnification Agreement which should void any liability on West Penn Financial.” (Petitioner’s Letter (“Pet’r’s Letter”), filed October 29, 2009.) Specifically, Petitioner claims that:

“damage to the property was the result of improper servicing activities which allowed the property to suffer freeze damage. This event would be a breach of the Indemnification Agreement in that HUD requirements for servicing were not met as provided for in paragraph 1(a) of said Indemnification Agreement.”

(Pet’r’s Letter.) Paragraph 1(a) states, in relevant part, that,

“[a]ll HUD requirements for servicing and payment of mortgage insurance premiums will be observed with respect to such mortgages.” The Secretary argues that by “[r]eading Paragraph 1(a) in its entirety, it is apparent that it was intended to limit Petitioner’s ability to file an insurance claim...[and] intended to require Petitioner to continue to service Mr. Besenyi’s loan and pay mortgage premiums.” (Sec’y Stat. ¶ 17.)

The meaning of paragraph 1(a) is irrelevant to the outcome of this case and this Office need not determine what was contemplated by either party. However, even if the language of paragraph 1(a) is construed in favor of Petitioner, the non-drafting party, this Office has held that “violations of agency handbooks and regulations do not independently give rise to a cause of action; [however] such violations are considered in determining the reasonableness of HUD’s actions. *Birmingham Bancorp Mortgage Corp.*, HUD Case No: 09-M-CH-KK23 (April 30, 2010) at 3; *see also*, *Cambridge Home Capital, LLC*, HUDOA No. 06-D-NY-GG004 (June 18, 2009), at p. 3-4 (holding that HUD is not required to follow non-promulgated regulations or guidelines). Thus, I find that, based upon the evidence presented, HUD did not breach the indemnification agreement.

II. THE “COMMERCIALLY REASONABLE” STANDARD APPLIES

The standard for determining the reasonableness of the foreclosure proceedings is the “commercially reasonable” standard. *See, Birmingham Bancorp Mortgage Corp.; Cambridge Home Capital, LLC.* Under this standard, Midland (as HUD’s servicer) “need not seek out the optimum conditions for resale nor hold out for the property’s fair market value.” *The American Eagle Mortgage Corp.*, HUDOA No. 09-M-CH-KK09 (June 4, 2009) at 3 (citing *Robinson and Florida Businessmen’s Ass’n v. United States*, 305 F. 3d 1330, 1333 (Fed. Cir. 2002)). Proper inquiry is whether Midland made “those efforts that are fair and reasonable under the circumstances.” *Cambridge Home Capital, LLC.*, at p. 4 (citing *Robinson and Florida Businessmen’s Ass’n v. United States*, at 1333).

The Secretary argues that “the diminution in value of the subject property was the result of diminished property values market wide, and not the result of anything Midland did or did not do during the roughly five months it held title to the property.” (Sec’y Stat. ¶ 23.) The Secretary contends that the REO appraisal for the subject property was substantially in compliance with HUD appraisal guidelines. (Sec’y Stat., attachs. Letter from Cheryl B. Walker, Director, Real Estate Owned Division, U.S. Department of Housing and Urban Development (“Walker Letter”), dated January 19, 2010.) The appraisal used three “comparable sales,” which were all REO sales. (*Id.*) One of the “comparable sales,” which was also used in the origination appraisal, sold for \$31,000 in September 1998 but only sold for \$12,500 in May 2005. (*Id.*) The Secretary concluded from the appraisals that although the value of the subject property “appears to be weighted towards the lower end of the range of adjusted sales prices of the comparable sales, [it was] still within range and credible.” (*Id.*)

Petitioner claimed that “the comparables utilized by the appraiser were foreclosures and do not represent the value of property not damaged by freezing.” (Pet’r’s Resp. ¶ 4, A.) After Petitioner provided this Office with residential comparables of properties sold in 2009, this Office ordered Petitioner to “[p]rovide comparables showing that at the time of the sale of the property in question, there were comparable properties in the *same condition*, and of *structural similarities*, that were not sold within the same price range as the property that is the subject of this proceeding.” (emphasis added) (Order, dated March 12, 2010, ¶ 2.) Petitioner subsequently submitted real estate assessments of seven properties located in close proximity to the subject property. (Pet’r’s Suppl. Evid.) The assessments submitted by the Petitioner show a sales range of \$45,620 and \$89,500. (*Id.*) However, Petitioner failed to show that the comparable properties were in the same condition as the subject property but still sold at the higher range. Such a showing could suggest that the appraised value of the subject property was unreasonable. *See, Cambridge Home Capital, LLC.*, at 3 (finding that the appraisal is a key consideration on the reasonableness of a sale since lenders rely on the appraised value to determine the appropriate sales price for the property).

However, Petitioner does not argue that the appraised value of the subject property was unreasonable. Rather, Petitioner claims that it was unreasonable for Midland to allow the property to suffer freeze damage, which resulted in the diminution of the value of the property. (Pet’r’s Letter.) Petitioner also claims that the freeze damage occurred after the mortgagor

vacated the property and before Midland conducted its inspection on January 20, 2006. (Pet'r's Resp. ¶ 4.) Petitioner further claims the mortgagor vacated the property in mid-December and, as evidence, Petitioner files a document from the Allegheny County Sheriff's Department, which shows that as of January 5, 2006, the mortgagor had moved out. (Pet'r's Resp., attach Allegheny County Sherriff's Department Document.) Petitioner also submitted an opinion of an industry expert, where the expert found that it would be:

“absolutely possible [for] a frozen pipe to burst and saturate a floor... Water sitting on the floor would cause it to pit or twist... Seeing that the temperature had risen to the mid 50's in January it would actually make this process worse....”

(Petitioner's Supplemental Evidence (“Pet'r's Supp. Evid.”), filed March 29, 2010; *attach.* Letter from Orlando W. Burge, Owner, Generations Home Repair and Remodeling (“Burge Letter”), dated March 23, 2010.) The Burge Letter also included weather reports showing the extreme changes in temperature from December until January 20, 2006. (“Burge Letter”). The evidence submitted by Petitioner is persuasive and suggests that damage to the property was caused by freeze damage and not mortgagor neglect. However, while the freeze damage suffered by the property is unfortunate, Petitioner does not submit any evidence to show that the freeze damage was caused by Midland's failure to act in a commercially reasonable manner during that roughly one-month period.

Therefore, I find that it is highly likely that the diminution of the property was not due to mortgagor neglect but instead caused by freeze damage. However, the freeze damage alleged by Petitioner does not demonstrate a breach on the part of HUD that is sufficient to void the Agreement. Accordingly, I further find that the Agreement is binding on both parties and Petitioner must indemnify HUD for its loss.

III. THE DEBT DOES NOT TOTAL \$48,048.77

Petitioner asks this Office to find that the debt in this case does not total \$48,048.77. (Pet'r's Resp.) Paragraph 1(a) states that “[i]n the event of a claim for insurance from a transferee of mortgages covered by this Agreement, indemnification will be in accordance with paragraph (b), or (c), whichever applies.” The Secretary argues that paragraph 1(c) applies and this Office agrees. Paragraph 1(c) of the Agreement applies for cases, “[w]here a HUD/FHA insurance claim has been paid in full and the property has been sold by HUD to a third party....” In May of 2006, Midland Mortgage Co. (“Midland”) transferred the property to HUD after obtaining a foreclosure judgment. HUD paid a total of \$57,381.32 in insurance benefits to Midland Mortgage Co in May and June of 2006. On September 13, 2006, HUD sold the property to a third party for \$14,001. (Sec'y Stat. ¶ 7-8.)

Paragraph 1(c) also states that, “the amount of indemnification is HUD's investment as defined in paragraph (b), minus the sales price of the property.” Paragraph 1(b) defines HUD's investment as including, but not limited by: “the full amount of the insurance claim; any loss mitigation partial claims; all taxes and assessments; all maintenance and operating expenses, including costs of rehabilitation and preservation; and all sales expenses, where applicable.” In

this case, HUD paid the following amounts: \$43,862.02 (partial settlement—part A claim payment); \$13,519.30 (final settlement—part B claim payment); \$478.78 (taxes); \$3,061.67 (maintenance and operation); and \$1,128.00 (sales expenses). (DeMarco Decl. ¶ 6.) HUD's expenses under paragraph 1(b) of the Agreement total \$52,049.77. After the sales price of \$14,001 is deducted from HUD's expenses, HUD's loss is calculated to be \$48,048.77. Accordingly, I find that the amount of the debt alleged by the Secretary in this case is accurate and Petitioner is liable for the full amount due under the Agreement.

ORDER

It is hereby **ORDERED**, for the reasons set forth above, that the Order imposing the stay of referral of this matter to the U.S. Department of the Treasury for administrative offset is **VACATED**.

The Secretary is authorized to seek collection of this outstanding obligation by means of administrative offset of any federal payments due to Petitioner, to the extent authorized by law.

/s/

Vanessa L. Hall
Administrative Judge

July 29, 2010