

Legal Opinion: GCB-0004

Index: 1.500
Subject: Section 312 Program--Debt Collection

October 24, 1991

Honorable Timothy C. Murphy
Associate Deputy Attorney General
Department of Justice
10th and Constitution Avenue, N. W.
Room 4208
Washington, D.C. 20530

Dear Judge Murphy:

Thank you for your May 23, 1991, letter to John Daly which enclosed a letter to you from J. Philip Klingeberger, Chief of the Civil Division in the United States Attorney's Office in the Northern District of Indiana, about difficulties in collecting on debts referred to his office arising from the Section 312 rehabilitation loan program. You requested our thoughts on the issues he raised in his letter.

Specifically, Mr. Klingeberger was concerned about the use of a form affidavit entitled "Affidavit Regarding Lost or Misplaced Document," declaring that the original promissory note and mortgage with respect to the specific loan could not be located. Mr. Klingeberger went on to explain that the use of a form affidavit in such instances led him to conclude that the loss or misplacement of notes and mortgages is a relatively common occurrence indicating the apparent lack of an effective tracking and internal record keeping procedure necessary for effective debt collection. He also believed this presents a potential for fraud.

In an attempt to ascertain how HUD could assist the Department of Justice with this problem, a member of my staff called Mr. Klingeberger, to inquire whether it would be advantageous for us to attempt to provide him with an individualized affidavit or supporting documentation of the indebtedness in lieu of the "form affidavit." Mr. Klingeberger indicated to the attorney that his primary concern was the potential for fraud by the Department of Housing and Urban Development's (HUD) collection agent.

As explained in the letter, Mr. Klingeberger believes a HUD collection agent could fraudulently withhold the debt instruments and refer cases to the Department of Justice with the affidavit. If the Department of Justice declines prosecution because of the difficulties raised in not having the debt instruments, the collection agent could close his files and notify HUD that the debts are uncollectible. HUD would then write off the debts. Mr. Klingeberger believes the collection agent would then be in a

position to use the improperly withheld debt instruments to extract repayment from the debtors for his own gain without the knowledge of the Department of Justice or HUD.

In response to the concerns raised by Mr. Klingeberger, we obtained the following information from our program office.

Over the life of the section 312 program, HUD has obligated approximately 70,000 loans. These loans were originated by local public agencies which then transferred the documents to HUD. Thereafter, the legal documents for these cases were maintained in the various Field Offices until 1985. About 40,000 remain active in the current portfolio. Because of difficulties in obtaining the legal documents to service or satisfy the various loans, HUD directed the Field staff to transfer all files to the program's Master Servicer, National Loan Servicer, Inc. (NLS) in Washington, D. C., in an effort to effectively manage the remaining files and to secure files on new loans. Unfortunately, some of the original legal documents are missing from the files because of their transfer to HUD, among the Field Offices, and among elements within the various Field Offices, prior to concentration of the files with the current loan servicer. The files are now maintained in a facility which contains not only the legal files but separate loan servicing and origination files as well. The total file count is over 100,000.

While nothing can be done at this point about files which were lost in the past, the files (and file information) are now maintained in the single facility by a staff of six employees. Files are managed by an automated system on a mainframe computer. All documents are checked out and returned via the computer management program which fully tracks the location of the document and/or file. If the needed documentation is in the file, it can be retrieved from the facility within 30 minutes. The Department has invested heavily in this system to assure full control over the existing program documentation.

In addition, HUD initiated a tightly controlled cash management system in 1985 which will not allow construction funds to be drawn down and disbursed without the transmittal of final loan settlement documents to the Master Servicer. This management technique has greatly improved the integrity of the loan files and related legal documentation for loans made in the last six years.

It should also be noted that the vast majority of loans over the years have been secured, and since approximately March 1978, only secured loans have been made. For secured loans, the public record contains evidence of the original loan amount and terms, which should be acceptable to the court if the original documents are lost.

The potential for fraud presented in Mr. Klingeberger's

letter appears to be predicated on his understanding that these loans are not evidenced by government instruments, but rather by instruments payable to the order of a private party. We should point out in this regard that all section 312 rehabilitation loans are in fact direct Federal loans evidenced by a note payable to HUD.

Thank you very much for bringing this matter to our attention.

Very sincerely yours,

A. Heaton Nash
(Acting) Associate General Counsel
Office of Assisted Housing
and Community Development