



U.S. Department of Housing and Urban Development

District Office of the Inspector General  
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Audit Related Memorandum  
Control No. 96-AT-119-0801

May 10, 1996

MEMORANDUM FOR: Raymond C. Buday Jr., Assistant General  
Counsel-Southeast/Caribbean, 4AC

FROM: Kathryn Kuhl-Inclan  
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Review of Excess Insurance Proceeds  
Southeast/Caribbean

We are participating in a nationwide effort led by the District Inspector General for Audit (DIGA) in the Great Plains to identify and seek recovery of excess insurance proceeds for HUD. The effort is supported by the Deputy Assistant Secretary (DAS) for Multifamily Housing Programs. We have completed a review to identify excess proceeds in the Southeast/Caribbean District, and are requesting your assistance in attempting to collect the proceeds identified.

BACKGROUND

The excess insurance proceeds are associated with defaulted, tax-exempt bond financed, HUD insured projects. By excess insurance proceeds, we refer to funds which sometimes remain in bond accounts after the trustee applies HUD insurance proceeds to redeem the underlying bonds after a mortgage default. We believe it is inequitable for anyone other than HUD to receive such funds since HUD paid the insurance claim used to retire the bonds. Some trust indentures specified the disposition of remaining funds, others did not. Even when trust indentures specified recipients of excess funds, the recipients' claim to the funds, especially project owners who defaulted on the mortgage, appears questionable as a matter of equity. In some cases, because of unclear wording in trust indentures or other reasons, trustees have held the funds for years.

The review was originally aimed only at cases where owners, as opposed to third parties, received or were designated to receive excess funds. The Great Plains DIGA and Counsel 1 succeeded in recovering excess funds from owners using a legal theory combining the Uniform Commercial Code financing statements and security agreements, civil double damages statute (12 USC 1715z-4a) and criminal equity skimming statute (12 USC 1715-19). We elected to gather information on all cases with excess funds regardless of who the recipient was or is designated to be, in the event it was later deemed feasible to attempt recovery of funds from

other than owners. Efforts have since begun to recover payments to GNMA, and efforts appear warranted for other cases we identified.

### SCOPE

Working with a list of 480 defaulted and assigned Southeast/Caribbean multifamily projects, we determined from HUD field office records that 89 projects had mortgages backed by tax-exempt bonds. From the bond trustees for the 89 projects, we obtained information regarding the existence or disposition of excess funds and copies of relevant documents, including trust indentures, transaction statements, regulatory agreements as to tax exemption, checks disbursing excess proceeds, security agreements and related assignments, and Uniform Commercial Code documents and related assignments. We had to obtain the information by administrative subpoena from some uncooperative trustees.

### SUMMARY

We identified 31 Southeast/Caribbean projects with excess funds totaling \$4,703,255. Of this total, trustees had disbursed \$3,598,360 and were holding \$1,104,895 as shown in the tables below. (The totals include two projects with excess funds totaling \$344,020 paid to HUD, which obviously require no action.) The attached spreadsheet provides details of the 31 cases identified, including the amount and disposition of excess funds, and trust indenture provisions, if any, for disposing of the funds. We request your assistance in recovering the excess funds identified, or, in some cases, coordinating with the Offices of General Counsel and Housing on recovery efforts already begun. John Daly from the Office of Counsel has agreed to provide whatever assistance is needed for recovering the excess funds. In addition, we ask your assistance in reviewing an unusual situation in Georgia involving the tax exempt status of bonds still outstanding even though the owners defaulted on the mortgages.

### RESULTS OF REVIEW

The following trustees were holding \$1,104,895 of excess funds, including the approximate \$1 million your office has been attempting to collect from First American National Bank in Nashville, which you are familiar with and we will not further detail here:

| <b>Trustees Holding Funds</b>  | <b>No. Projects</b> | <b>Amounts</b>      |
|--------------------------------|---------------------|---------------------|
| First American - Nashville, TN | 8                   | \$ 1,027,528        |
| Bank of New York - Atlanta, GA | 1                   | 16,317              |
| Deposit Guaranty - Jackson, MS | <u>2</u>            | <u>61,050</u>       |
| Total                          | <u>11</u>           | \$ <u>1,104,895</u> |

The trustees had been holding the excess proceeds several years although bondholders had long since been paid. Deposit Guaranty held the funds even though the trust indentures specify HUD as recipient. A bank representative stated HUD refused to accept the funds, but we were unable to locate anyone at the Mississippi State Office who was aware of the funds. The \$16,317

held by the Bank of New York was transferred to them December 4, 1995, when the Bank of New York purchased the trust operation of Nations Bank.

The following table summarizes, by recipient, funds paid out by trustees:

| <b>Recipient of Funds</b> | <b>No. Projects</b> | <b>Amounts</b>     |
|---------------------------|---------------------|--------------------|
| Project Owners            | 2                   | \$212,669          |
| HUD (FHA)                 | 2                   | 344,020            |
| GNMA                      | 8                   | 1,939,418          |
| Bond Insurer              | 2                   | 194,277            |
| Bond Purchaser            | 1                   | 188,431            |
| Lender                    | 1                   | 540                |
| Bond Issuer               | 2                   | 5,219              |
| Sun Bank                  | 1                   | 469,092            |
| FNMA                      | <u>1</u>            | <u>244,694</u>     |
| Total                     | <u>20</u>           | <u>\$3,598,360</u> |

GNMA aggressively collected excess funds for co-insured projects. In most of these cases the trust indenture specified that the "lender" receive any excess funds. In one such case involving over \$1 million, the trustee (Nations Bank) filed an interpleader action because the owners also claimed the funds. However, GNMA, represented by the Justice Department, prevailed. We believe FHA has a better claim to excess proceeds since GNMA claimed full mortgage insurance proceeds from FHA, and FHA, not GNMA, incurred the losses from disposition of the projects. The Great Plains DIGA began working with Associate General Counsel (AGC) John Daly and DAS for Multifamily Housing Programs Chris Greer in March 1996 to collect the funds from GNMA. We suggest you coordinate with AGC Daly on GNMA collection efforts.

In most cases, the trustees disbursed funds in accordance with trust indenture requirements. A notable exception was \$244,694 Nations Bank disbursed to Federal National Mortgage Association (FNMA). Nothing in Nations Bank's files support the disbursement, and the trust indenture specifies any excess funds will be paid to the lender. As in all cases, HUD became the lender after mortgage assignment. We believe FNMA should be required to support their claim to the funds. Should they be unable to do so, HUD may have a claim against Nations Bank for not acting in accordance with the trust indenture. In most other cases where the trust indenture specified the lender as recipient, GNMA received the funds.

First Union Bank disbursed \$200,348 to two general partners in 1995/1996 after holding the excess proceeds several years. First Union obtained an outside legal opinion as to who should receive the excess proceeds, and apparently disbursed the funds to the owners based on that opinion. We do not believe the owners have an equitable claim to the funds; we would like you to review whether they have a supportable legal claim, and consider using the legal theory employed by Great Plains Counsel to recover the funds.

Another case of questionable equity involves \$188,431 of excess proceeds First American National Bank paid to Benton & Company, the bond purchaser, as provided by the trust

indenture. First American was still holding funds for two other projects where the trust indenture also specifies the bond purchaser (Benton & Company) should receive the funds.

\* \* \*

We also request your assistance on a separate matter not described in the attachment. In looking for excess funds, we noted six Georgia bond issues still outstanding and current even though the owners defaulted on the mortgages. HUD subsequently sold the mortgage notes for all six projects. Bond counsel told us the bonds remained current without mortgage payments because a bond insurance company made the monthly payments. From our perspective, there are no excess bond proceeds as long as the bonds remain outstanding. However, at issue is whether the tax-exempt status of the bonds was or should have been affected when the owner defaulted. Auditor David Butcher discussed this with Donnie Murray and Dhoya Bentley of your staff, who suggested we obtain copies of the applicable trust indentures and tax exemption regulatory agreements. We obtained representative copies of these documents for one of the six projects and would like someone on your staff to review them.

We obtained copies of most trust indentures, disbursement records and other relevant documents for all cases on the spreadsheet except the two where FHA already received the excess funds. This information should prove useful in collection attempts. Trustees did not supply all data we asked for, but we have some documents pertaining to each issue, and trustees may yet provide additional data. The information will be in our office here in Atlanta; we will make it available to you whenever you wish. David Butcher, from our Knoxville office will also be available to answer questions or provide whatever other assistance you might require.

We are not controlling these matters through the DAAMS; however, we ask that you keep us apprised of your efforts and progress in this undertaking.

If you would like to meet to discuss this effort in more detail, or if you have any questions, please call me or Assistant District Inspector General for Audit Rudy McBee at (423) 545-4368.

Attachments:

- 1 - Spreadsheet w/Footnotes
- 2 - Distribution















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