Rural Housing Service Converts American Dream to a Nightmare

The Rural Housing Service (RHS), an agency in the U.S. Department of Agriculture (USDA), has been working with the Department of Treasury to administratively garnish the wages and offset federal benefits and tax refunds of borrowers who have defaulted on their RHS loans. Purportedly, the agencies are undertaking these collections under authority granted by the Debt Collection Improvement Act of 1996 (DCIA).[1] RHS' mission is to assist low- and moderate-income households in becoming successful homeowners through its direct and guaranteed home loan programs. Despite this mission, RHS has pursued collections even when borrowers have defaulted on loans for reasons beyond their control and without regard to the borrowers' income or capacity to repay the losses.

Given the dramatic decline in real estate values, the cost of foreclosures, and the fees that the agencies charge for collecting the losses, the amounts that RHS and Treasury are seeking to collect from borrowers may be nearly as much as the original loan amounts. In one recent case, RHS and Treasury sought to garnish a former borrower's wages to recover more than $174,000 when the original guaranteed loan was for $184,000. In that case, the single-parent borrower was in her 50s and was earning less than $12/hour from a part-time job.[2]

It is unknown when RHS and Treasury began the practice of administratively pursuing single-family home loan borrowers for losses and debts that the agency incurs under the direct and guaranteed home loan programs. Nor is it known how many former borrowers are pursued or the amounts that RHS and Treasury are recovering. RHS has simply not made any information available about its collection practices.[3] The only documents that are available are individual administrative appeal decisions in cases in which borrowers have sought to challenge a debt or seek deferrals of its collection by claiming hardship.[4] Several pieces of information can be gleaned from those decisions:

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[1]Pub. L. No. 104-34, 110 Stat. 1321 (Apr. 26, 1996) (codified at 31 U.S.C. § 3701 *et seq.*).
[2]The National Housing Law Project (NHLP) has obtained the borrower's file in this case, but cannot disclose details regarding the case for confidentiality reasons.
[3]NHLP filed a Freedom of Information Act request with the agency in December 2011 seeking information about the agency's collection practices. As of April 19, 2012, it has not received a response to its request.
[4]Copies of administrative law judge decisions in cases where borrowers have appealed RHS' efforts to collect debts can be accessed at http://www.dm.usda.gov/oaljdecisions/.

- RHS began these collection practices in the last years of the Bush Administration.[5]
- The sums the agency is seeking to recover from individual borrowers range from several thousand dollars to more than $100,000.
- In addition to the losses incurred on loans, the agencies also are seeking to collect up to 28% in collection fees.[6]
- The agencies are seeking to collect losses from direct and guaranteed borrowers who have received agency approval to conduct a "short sale."[7]
- The agencies are seeking to collect losses from direct borrowers who have received a moratorium on payments[8] and who, incidentally, are statutorily exempt from deficiency judgments.[9]
- These practices have created hardships for many of the affected borrowers.[10]

Regardless of RHS' authority to collect these losses administratively, discussed below, it is disturbing that RHS is pursuing low- and moderate-income borrowers without any significant assets who qualified for programs designed to assist very low-, low-, and moderate-income households. Moreover, RHS is doing so without effective notice to borrowers or the public. The Section 502 direct loan program is designed to assist only very low- and low-income households.[11] Forty percent of the borrowers who secure these loans have incomes below 50% of Area Median Income (AMI).[12] The other 60% can have incomes of up to 80% of AMI.[13] All borrowers under the program must certify that they are unable to secure loans from private lenders.[14] Moreover, most borrowers receive a 100% loan because they do not have assets to contribute to the purchase of their new homes,[15] and practically all direct borrowers receive interest subsidies to afford monthly payments without paying more than 25% of income for principal and interest. Yet, when a borrower defaults under the loan, the agency does not take into consideration the borrower's income or capacity to repay the debt, other than to decide whether to postpone collection if the borrower administratively appeals the decision to collect the debt.

Guaranteed loan borrowers may have somewhat higher incomes than direct loan borrowers, as the program can serve households with incomes up to 115% of AMI.[16] However, all guaranteed borrowers are unable to secure home loans without the RHS guarantee and most have meager or no assets with which to repay the RHS loss. Indeed, RHS authorizes the borrowers to receive a loan for 100% of the value of the house in recognition of the fact that guaranteed borrowers do not have assets that allow them to make a down payment.[17] Nonetheless, RHS does not take that into consideration when it pursues collection. In other words, while RHS' practice of recovering losses from borrowers may be authorized by law, the agency has implemented its administrative recovery program without deciding if it is compelled to do so or evaluating whether seeking to recover losses is consistent with its mission.

Curiously, RHS does not rely on the DCIA to collect losses from guaranteed borrowers. Instead, as explained below, it relies upon an indemnification contract that it requires borrowers to execute as part of the guaranteed loan closing. Under that agreement, borrowers agree to reimburse the agency for any losses that it pays out on the loan. However, the DCIA does not authorize RHS to force potential borrowers to execute an indemnification agreement. RHS never advised the public, through notice and comment, of its decision to require borrowers to execute an indemnification agreement, nor did it inform borrowers in a meaningful manner of the consequences of their default on RHS direct or guaranteed loans. In short, a very strong argument can be made that RHS and Treasury have violated the law in implementing the administrative collection process.

RHS' practices are particularly disturbing given that the agency has ample authorities and, arguably, mandates, to assist borrowers who default on their loans. RHS is authorized to extend, or require lenders to extend, moratoriums on payments[18] and refinancing opportunities.[19] In the case of guaranteed lenders, RHS is authorized to have the defaulted loan assigned to the agency.[20] Throughout the economic crisis that this country has endured since 2008, RHS has done nothing to provide special assistance

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[5]*In re* Terrell Carmouche, Jr., AWG Docket No. 08-0172 (Dec. 11, 2008), *available at* http://www.dm.usda.gov/oaljdecisions/081212%20AWG%2008-0172%20DO.pdf.

[6]*See, e.g.*, *In re* Rashon Carruthers, AWG Docket No. 09-0102 (Oct. 1, 2010), *available at* http://www.dm.usda.gov/oaljdecisions/091001_AWG_09-0102_do.pdf.

[7]*In re* Francine Draxton, AWG Docket No. 10-0161 (Aug. 16, 2010), *available at* http://www.dm.usda.gov/oaljdecisions/100816_AWG_10-0161_DO_Francine%20Draxton_-Final%20Order.pdf; *In re* Zachariah Easley, Docket No. 12-0196 (Mar. 12, 2012), *available at* http://www.dm.usda.gov/oaljdecisions/120307_12-0196_DO_ZachariahEasley.pdf.

[8]*In re* Terrell Carmouche, Jr., AWG Docket No. 08-0172 (Dec. 11, 2008), *available at* http://www.dm.usda.gov/oaljdecisions/081212%20AWG%2008-0172%20DO.pdf.

[9]42 U.S.C. § 1475 (Westlaw Apr. 18, 2012).

[10]*See, e.g.*, *In re* Christopher D. Pallente, AWG Docket No. 10-0061 (Feb. 4, 2010), *available at* http://www.dm.usda.gov/oaljdecisions/files/100204_AWG_10-0061DO.pdf.

[11]§ 1471 (Westlaw Apr. 18, 2012).

[12]§ 1472(d).

[13]*See* § 1471(b)(4).

[14]7 C.F.R. § 3550.53(h) (2009).

[15]*See* §§ 3550.68(c)-(d).

[16]42 U.S.C. § 1472(h)(2) (Westlaw Apr. 18, 2012).

[17]§ 1472(h)(6).

[18]§ 1475.

[19]§§ 1471(a)(4), 1472 (h)(9), 1472(h)(17).

[20]§ 1472(h)(15).

to borrowers who have defaulted because of unemployment, decreased income or increased expenses due to medical reasons. Moreover, it has done nothing to assist borrowers whose homes have gone underwater due to the dramatic decline in real estate prices. At the same time, the agency is diligently pursuing borrowers for losses that it has incurred under the homeownership programs.

This article will review RHS' authority to recover losses administratively and the manner in which the agency has implemented its collection process. Another article will be published in a future issue of the *Bulletin* that will review the bases by which borrowers and advocates can challenge RHS decisions to garnish borrowers' wages and offset federal benefits.

Debt Collection Improvement Act of 1996

Prior to 1996, federal agencies did not adequately pursue the collection of non-tax debts owed to the United States. In response, Congress passed DCIA, which centralized the government-wide collection of delinquent debts and gave Treasury new responsibilities for collecting non-tax debts. Specifically, it created the Treasury Offset Program (TOP), whereby Treasury matches federal program debtors to federal program payees and administratively offsets payments to the payees to satisfy debts.[21] Under the program, Treasury receives the names of non-tax debtors from other federal agencies and administratively offsets refunds made by the Internal Revenue Service, as well as federal retirement, federal salary, Social Security and other benefits. The DCIA also authorizes "cross-servicing," which uses a variety of collection tools to encourage debtors to repay the federal government. Federal agencies are required to refer delinquent (over 180 days) non-tax debts to Treasury for administrative debt collection action, if the agencies have not been successful at collecting those debts.[22] The types of referred debts include unpaid loans, overpayments or duplicate payments made to federal salary or benefit payment recipients, misused grant funds, and fines, penalties or fees assessed by federal agencies.

Specifically, § 3711(a)(1) of the DCIA[23] directs that the head of an executive agency "shall try to collect a claim of the United States Government for money or property arising out of the activities of, or referred to, the agency." The term "claim" is defined in § 3701(b)(1) of the DCIA as

> any amount of funds or property that has been determined by an appropriate official of the Federal Government to be owed to the United States by a person, organization, or entity.…A claim includes, without limitation—
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> A) funds owed on account of loans made, insured, or guaranteed by the Government, including any deficiency or any difference between the price obtained by the Government in the sale of a property and the amount owed to the Government on a mortgage on the property.

While the debts of direct loan borrowers under Section 502 of the Housing Act of 1949[24] are debts owed to the United States, it is questionable whether losses paid on guaranteed borrowers' loans are also covered by the DCIA. A loss paid by RHS to a lender after foreclosure is not "funds owed" to the United States. Neither is it a deficiency or any difference between the price obtained by the government in the sale of the property and the amount owed to the government on a mortgage on the property. Any deficiency on the loan, in states that do not have anti-deficiency statutes, is owed to the lender or servicer who holds the note and mortgage, not to RHS. In states with deficiency statutes, the deficiency is typically extinguished.

It appears that RHS may have had some misgivings about its capacity to recover directly losses that it paid to guaranteed lenders. Instead of simply declaring that losses paid to lenders are debts owed to the United States, it modified the Request for Single Family Housing Loan Guarantee form,[25] which guaranteed borrowers are required to sign at the loan closing, by including an indemnification agreement on that form. On page two of that form, under the heading "Applicant(s) Acknowledgments and Certifications," RHS included the following:

> I (we) certify and acknowledge that if the Agency pays a loss claim on the requested loan to the lender, I (we) will reimburse the Agency for that amount. If I (we) do not, the Agency will use all remedies available to it, including those under the Debt Collection Improvement Act, to recover on the Federal debt directly from me (us). The Agency's right to collect is independent of the lender's right to collect under the guaranteed note and will not be affected by any release by the lender of my (our) obligation to repay the loan. Any Agency collection under this paragraph will not be shared with the lender.[26]

Interestingly, when RHS pursues administrative recovery of its losses from guaranteed borrowers, it cites and relies on this indemnification contract to establish the borrower's liability.[27]

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[21] *See generally* http://www.fms.treas.gov/debt/top.html.
[22] *See generally* http://www.fms.treas.gov/debt/crosserv.html.
[23] 31 U.S.C. § 3711(a)(1) (Westlaw Apr. 18, 2012).

[24] 42 U.S.C. § 1472 (Westlaw Apr. 18, 2012).
[25] Form RD 1980-21 (Rev. 6-06).
[26] *Id*. RHS bolded this paragraph in a recent revision of the form. *See* Form RD 1980-21 (Rev. 10-11), *available at* http://forms.sc.egov.usda.gov/efcommon/eFileServices/eForms/RD1980-21.PDF.
[27] *See, e.g.*, *In re* Kevin Netzel, AWG Docket No. 10-0388 (Mar. 8, 2011)

The problem with the RHS practice with respect to both the direct and guaranteed programs is that it appears the agency has never complied with the provision of § 3701(b)(1) of the DCIA, which requires an appropriate agency official to make a determination that certain funds are owed to the United States and that they can be collected under the DCIA. Unlike another RHS program, where the agency has published a notice in the Federal Register with respect to its determination,[28] RHS has never published a similar notice regarding the direct or guaranteed single family home loan programs. Accordingly, there is a strong argument that the agency has violated the DCIA with respect to its collection activities under both programs.

Moreover, with respect to RHS guaranteed loans, the agency has never provided notice to the public, as required by the Administrative Procedure Act and 42 U.S.C. § 1490n, that it planned to modify the Request for a Single Family Loan Guarantee form to incorporate an indemnification contract that it plans to enforce against all defaulting borrowers. Clearly, this modification is one that affects borrowers, and the agency is required to publish it for notice and comment prior to making it effective.[29]

The failure to provide notice to the public is exacerbated by the fact that RHS does not even require lenders to inform or advise borrowers of the existence of this agreement in the request for a loan guarantee. Nothing in RHS regulations governing the guaranteed loan program[30] mentions the indemnification agreement, let alone requires lenders to advise borrowers about its existence or significance. In addition, given that a large number of RHS guaranteed borrowers speak languages other than English as their primary language, those borrowers have no opportunity to learn about the indemnification agreement since the request for a loan guarantee is exclusively in English.

When Treasury seeks to collect funds from guaranteed or direct loan borrowers, the borrower is advised that she may challenge the basis or size of the debt or request a postponement of the offset or garnishment when the collection would cause a hardship to the borrower's household.[31] Such a postponement defers any offset or wage garnishment for a period determined by the administrative judge, which frequently is less than two years.[32] Borrowers are, however, never informed that RHS can forgo collection for debts that are under $100,000. Subsection 3711(a)(3) of the DCIA authorizes the head of an executive agency to "suspend or end collection action on a claim [that is under $100,000] when it appears that no person liable on the claim has the present or prospective ability to pay a significant amount of the claim or the cost of collecting the claim is likely to be more than the amount recovered."

Overview of the Collection Process

Treasury and USDA have published extensive regulations regarding the TOPS and cross servicing collection programs,[33] and RHS has published a handbook chapter on special collection of delinquencies for the direct loan program.[34] The RHS Handbook authorizes the agency to transfer the collection of a debt to Treasury whenever a direct borrower is more than two months delinquent and the delinquency exceeds $25.[35] A similar regulation or handbook does not exist for the guaranteed loan program.

Once RHS decides to refer a debt to Treasury, the agency sends borrowers a notice that it intends to turn over collection of the outstanding debt or, in the case of guaranteed loans, the loss paid to the bank, to Treasury.[36] The notice advises borrowers that they have 60 days to appeal the agency's proposed action to the National Appeals Division under the USDA appeals process.[37] Borrowers may challenge the amount or basis of the debt at that hearing. They cannot, however, seek a hardship exemption through the NAD process.[38]

Unless borrowers prevail in the NAD hearing process, the debts are transferred to Treasury, which provides borrowers another opportunity to challenge the debt. Borrowers may do so before the department begins offsetting federal benefits or garnishing wages by filing an appeal within [illegible] days of the notice, or they may appeal after the offset or wage garnishment takes effect. In the former case, the request for the hearing postpones the commencement of any collection action. In the latter case, filing of the appeal will not suspend the collection.[39]

Treasury hearings are held before a USDA administrative law judge. The hearings may be in person or by

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(Decision and Order ¶ 4), *available at* http://www.dm.usda.gov/oaljdecisions/110308_10-0388_DO_AWG_KevinNetzel.pdf; *In re* Traci Zehnder, AWG Docket No. 11-0011 (Jan. 7, 2011). (Decision and Order ¶ 5), *available at* http://www.dm.usda.gov/oaljdecisions/110107_11-0011_DO_TraciZehnder.pdf.

[28]*See* Debt Collection Improvement Act—Treasury Offset and Cross Servicing, 69 Fed. Reg. 2,999 (Jan. 22, 2004). RHS amended regulations affecting the Rural Business-Cooperative Service loan and grant programs to clarify that any amounts paid on account of the liability of a guaranteed loan borrower will constitute a federal debt owing to the agency by the guaranteed loan borrower.

[29]*See* 5 U.S.C. § 552 (Westlaw Apr. 23, 2012); Sugar Cane Growers Co-op. v. Veneman, 289 F.3d 89 (D.C. Cir. 2002).

[30]7 C.F.R. Part 1980, Subpart D (2009).

[31]*See* 31 C.F.R. § 285.11(e) (2010).

[32]*See id*. § 285.11(k) (2010); *In re* Christopher D. Pallente, AWG Docket No. 10-0061 (Feb. 4, 2010), *available at* http://www.dm.usda.gov/oaljdecisions/files/100204_AWG_10-0061DO.pdf.

[33]*See* 31 C.F.R. §§ 285, 900, 901, 902, 903 and 904 (2009); 7 C.F.R. Part 3 (2009).

[34]Handbook 2-3550, Chapter 7: Special Collections (May 27, 1998), *available at* http://www.rurdev.usda.gov/SupportDocuments/3550-2chapter07.pdf.

[35]*Id*. ¶ 7.8.

[36]7 C.F.R. § 3.60(b) (2009).

[37]§ 3.11.

[38]*See In re* [Redacted], Case No. 2011W000360 (July 15, 2011), *available at* http://usda-nad.entellitrak.com/etk-usda-nad-3.0.7.0.0-prod/page.request.do?page=page.highlightedFile&id=63058&query_text=&query_text2=.

[39]31 C.F.R. §§ 285.11(f)(4) and (f)(5) (2010).

phone. The borrower, in addition to challenging the basis or amount of the debt, can seek to postpone collection by claiming a hardship. A hardship finding may result in the reduction of the amount collected or total postponement. Typically, however, the postponement does not exceed two years, at which time the borrower again must institute an appeal.

If the borrower loses the hearing, Treasury may start the collection process through an administrative wage garnishment or offset of federal benefits or income tax refunds. If a wage garnishment is sought, Treasury may not garnish more than 15% of the borrower's income. The amount that may be offset varies depending on the source of the offset.[40] For example, no limitations exist with respect to offsets of tax refunds, while a 15% limitation exists with respect to Social Security and retirement benefits.[41]

Fortunately, debts owed to the United States from the RHS housing programs are dischargeable by a bankruptcy proceeding.

Conclusion

RHS' aggressive collection practices are inconsistent with its own mission and the practices of other federal agencies that administer homeownership programs. The Department of Housing and Urban Development, which operates a multibillion dollar home insurance program under the Federal Housing Administration (FHA), apparently has chosen not to pursue recovery of its losses from insured borrowers. This is particularly notable because the incomes of borrowers participating in the FHA program are much higher than those of borrowers participating in the RHS programs. It is not clear why RHS has chosen a different path in light of the purpose of its programs and the persons that it is serving.

Even more curious is the fact that as of this federal fiscal year, RHS has increased the amount that it charges guaranteed borrowers for the RHS guarantee and has begun to charge borrowers a monthly mortgage insurance premium. Both of these actions were taken to make the program self-sustaining and eliminate the need for federal support. In light of these fees, there is no reason for RHS to continue to pursue guaranteed loan borrowers for its losses.

Given the purpose of the RHS housing programs, the incomes of the persons that it serves and the ongoing economic crisis, there is no reason why RHS should pursue borrowers who have defaulted on their direct or guaranteed loans, particularly if the reasons for the default are beyond their control. Borrowers who have failed in good faith to achieve the American dream of homeownership should not be pursued for losses incurred by the government under these programs and have the nightmare of wage garnishment and federal offsets following them for the rest of their lives. ■

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[40] http://www.fms.treas.gov/debt/regulations_quickref.html.
[41] *Id.*