12.1 INTRODUCTION

This chapter covers Agency procedures regarding account acceleration, foreclosure, and liquidation for projects in default.

Loan Servicers should offer all appropriate special servicing tools to help borrowers with financial problems bring the account current. However, if it is clear that a borrower cannot continue with the loan, the Loan Servicer should analyze the feasibility of liquidation options and recommend the option that is in the Government’s best interest, defined as the option that will result in the greatest net recovery.

Section 1 of this chapter describes how the Agency determines whether or not to liquidate, and if so, which of the available options would be least costly for the Government. This section provides a brief catalogue of liquidation options, a discussion of net recovery value and basic security loss, and an outline of how decisions to liquidate are ultimately made.

Section 2 of the chapter contains information on liquidation procedures for voluntary liquidation and foreclosure. A discussion about the acquisition of chattel property is also included. Section 3 discusses debt settlement.

SECTION 1: MAKING THE DECISION TO LIQUIDATE

12.2 AN OVERVIEW OF LIQUIDATION OPTIONS

When the Agency determines that liquidation is appropriate, it may accelerate the loan. The borrower must pay the full account balance and meet the other terms of the loan within the prescribed time frame, or the Agency may initiate foreclosure proceedings. Once the loan has been accelerated, the Agency will not accept partial payment unless required to do so by State law.

A. Voluntary Liquidation

1. Voluntary Sale

Sale of the security property is generally the most desirable option for both the Agency and a borrower who is unable to continue the loan. For the Agency, a sale to another party avoids the costs of foreclosure, as well as the costs related to owning and disposing of a property. For the borrower, it offers the best opportunity for being released from the debt without a major credit history blemish. A borrower may sell the property to a third party even after the account is accelerated.

If the borrower sells or transfers title of a security property on which the loan has been accelerated, the Agency requires payment in full to release any Agency liens or to
stop foreclosure action. However, to facilitate a sale after acceleration, the Agency may agree to release Agency liens in return for payment of the estimated net recovery value.

2. Deed in Lieu of Foreclosure

After the account has been accelerated, the borrower can offer to convey the security property to the Agency. The Agency will accept the deed in lieu of foreclosure only if the Agency will realize a greater net recovery value than would be obtained if foreclosure proceedings continued.

3. Assignment to Junior Lien Holder

The Agency may assign the note and mortgage to a junior lien holder, if such a lien holder makes an offer for the property in the amount of at least the net recovery value, and all appeal rights have expired.

B. Foreclosure

1. Agency Foreclosure

When all reasonable efforts have failed to encourage the borrower to voluntarily liquidate the loan through sale of the property, deed in lieu of foreclosure, or by entering into an accelerated repayment agreement, the Agency may initiate foreclosure proceedings.

2. Foreclosure by a Another Lien Holder

If there is a prior lien holder, the Agency must determine if the prior lien holder should have the opportunity to foreclose. Foreclosure by a prior lien holder may be a less costly alternative to Agency foreclosure. If the Agency intends to foreclose in cases in which there is a prior lien, the Agency must decide either to settle the lien or foreclose subject to the lien.

C. Acquisition of Chattel Property

The Agency will make determinations regarding disposition of chattel property that are in the best interest of the government. The Agency will make every effort to avoid acquiring chattel property by having the borrower or Field Office Staff liquidate the property.

12.3 NET RECOVERY VALUE

Estimated net recovery value represents the amount that the Agency could expect to recover from a property if it was liquidated after considering all costs associated with liquidating, holding, and selling the property. Attachment 12-A contains a net recovery value worksheet to aid in this calculation. Actual net recovery value is the amount the Agency does in fact recover from the sale of a property, after accounting for all costs.
The following sections provide guidance in estimating net recovery value.

A. Establishing Market Value

The market value of the property is the fundamental basis for establishing the estimated net recovery value. All calculations undertaken on the net recovery value worksheet provide additions or deductions from market value.

Depending upon the likely method of liquidation and at what point in the process the calculation is being made, market value may be based on an estimated value, on an appraisal or on the actual sale price. Early in the process of determining which liquidation method should be followed, the Loan Servicer may need to make a rough estimate of the market value based on any available information.

B. Environmental Considerations

The Loan Servicer’s estimate of market value must take into consideration potential environmental hazards that may pose a liability issue for the Agency, and the presence of environmental resources for which the Agency will have an affirmative responsibility to take protective measures once it owns the property. Exhibit 12-1 provides a partial list of environmental factors for consideration.

To minimize Agency liability, the Agency must ensure, prior to acquiring property through foreclosure, that the property has been examined for potential contamination from hazardous substances, hazardous wastes, and petroleum products, including underground storage tanks. This should be accomplished by requesting that Field Office Staff complete the ASTM Standard E-1528 Transaction Screen Questionnaire, (TSQ). If the completed form raises any concerns it should be submitted to the State Environmental Coordinator for further evaluation and guidance.

The Agency also should examine the property prior to acquisition and consider any costs associated with environmental resources the Agency might be required to protect.

For additional information, see RD Instruction 1940-G.
Exhibit 12-1
Environmental Considerations

Environmental Factors
- Traffic or noise;
- Hazardous materials or waste;
- Radon, asbestos, or urea formaldehyde; and
- Lead-based paint or other lead contaminants.

Environmental Resources
- Aquifer recharge areas;
- Coastal barrier resources;
- Coastal zone management areas;
- Endangered/threatened species or critical habitat;
- Floodplains, wetlands, or flood hazard areas;
- Historical or archaeological sites;
- Important farmland, prime forestland, or prime rangeland;
- National landmarks;
- Wild and scenic rivers; and
- Wilderness areas.

C. Ordering an Appraisal

Guidance about ordering appraisals is presented in Chapter 4 of HB-1-3560. The point at which a formal appraisal is actually conducted will vary.

1. Valueless Lien

If the Loan Servicer’s estimate suggests that the lien may be valueless, an appraisal should be obtained immediately. If the appraisal indicates that the lien is in fact valueless, it should be released without incurring servicing costs.

2. Deed in Lieu of Foreclosure

If, after acceleration, the borrower offers a deed in lieu of foreclosure, an appraisal should be obtained immediately so the Loan Servicer can determine whether it is in the government’s interest to accept the deed.

3. Foreclosure

If the property will be going to foreclosure, no appraisal should be obtained until shortly before the sale is scheduled to take place. In areas where the foreclosure process can be lengthy, the value of the property could change before the sale if the appraisal is conducted too far in advance.
D. Holding Period

Nearly all costs and income used in the net recovery value calculation are affected by the holding period. For estimated net recovery value, the length of the holding period is estimated differently, depending on the likely method of disposition. The holding period should be estimated as the time between the date the net recovery worksheet is being filled out and the anticipated date for:

- Filing of the deed and the expiration of redemption rights (foreclosure);
- Filing the warranty deed (deed in lieu of foreclosure);
- Filing the release (release of valueless lien); or
- Payoff and release (debt settlement offer subsequent to acceleration).

The time for marketing and disposition, if the property is acquired, should also be considered when estimating the holding period.

E. Deductions from Market Value

Numerous costs associated with liquidation must be considered when determining the net recovery value, including the following costs.

- **Prior liens to be paid by the Agency.** In a case where a prior lien is involved, the amount required to repay the prior lien holder must be included in the calculation;

- **Junior liens to be paid by the Agency.** If the Agency pursues foreclosure, junior liens are not paid. However, in the case of a deed in lieu of foreclosure, it may be to the Agency’s advantage to pay off a junior lien holder. The agency should conduct a title search to identify the position and the amount of each lien against the property;

- **Selling expenses to be paid by the Agency.** All transaction costs involved in selling the property, including advertising, commissions for selling agents, required seller certifications, surveys, points, and closing costs paid by the Agency, whether on behalf of the borrower in a voluntary liquidation, or as an Agency expense for a real estate owned (REO) sale;

- **Holding costs.** During the time that the Agency owns the property, the monthly interest accrued is multiplied by the number of months in the holding period;

- **Depreciation during the holding period.** The property may depreciate in value while it is being held by the Agency;

- **Administrative costs.** The administrative burden associated with holding a property includes the cost of liquidation, such as attorney fees, filing, recordation, advertising, and document service fees, that are customarily incurred in a foreclosure action; and
• **Management costs.** During the period the Agency holds the property it will accrue costs related to cleaning, securing, and maintaining the property such as utilities and real estate taxes.

**F. Additions to Market Value**

Although most of the adjustments to market value involve deductions to reduce the recovery amount, there are a few factors that can increase the market value.

• **Appreciation during the holding period.** In markets that are strong, the property may appreciate while it is being held by the Agency; and

• **Income during the holding period.** In general, the Agency does not lease properties. However, REO properties may be leased in limited circumstances, such as a property located in an area where keeping the property occupied could greatly reduce vandalism, or if there are tenants living in the property whom the Agency does not wish to displace.

### 12.4 BASIC SECURITY LOSS

The basic security loss is the difference between the property’s market value and the outstanding Agency debt on the property, including principal, and other recoverable costs.

It is important for the Loan Servicer to consider the basic security loss in determining how to work with the borrower. For example, the debt settlement arrangements the Agency agrees to might be more lenient in the case of a borrower with a property that lost value through no fault of the borrower. This information can be used for portfolio analysis to help the Agency originate loans more effectively in the future.

### 12.5 ACCOUNT LIQUIDATION

**A. Making the Decision to Liquidate**

In all liquidation cases, the State Director will be responsible for the final decision to liquidate the borrower’s account based on advice and counsel from the Office of General Counsel (OGC) and the following information supplied by the Loan Servicer:

• An opinion by the Loan Servicer about whether the borrower is forcing an acceleration to circumvent the prepayment process;

• The specific recommendations of the Loan Servicer on the method of carrying out the liquidation;

• The case file and any other pertinent information developed in support of the accusations;

• A summary of Agency efforts to work out an acceptable solution short of liquidation;
• A current appraisal of the security property will be completed by an Agency official authorized to make that particular type of appraisal and an estimate of the net amount that may be realized from the sale of the assets;

• The most recent balance sheet or financial statement from the borrower;

• A current statement of account from the St. Louis Office; and

• A problem case report.

• The Agency will handle liquidation, whether by voluntary liquidation or foreclosure, in accordance with the requirements at 7 CFR 3560.456(c) and (d).

In all liquidation cases, the State Director is responsible for the final decision to liquidate the account based on an opinion from OGC and relevant information supplied by the Field Office (e.g., case files, summary of efforts to work out an acceptable solution, appraisals of the property, borrower’s financial statements and balance sheets, specific recommendations). If the Agency determines that the borrower has taken action to bring about the acceleration in an effort to avoid the prepayment process, the Agency will consider alternatives to acceleration, such as suing for specific performance under the loan and management documents.

B. Possible Outcomes of Agency’s Decision to Liquidate

If the Agency decides to liquidate, there are several possible outcomes, which are as follows:

• The borrower may cure the default by developing and submit to the Agency for approval a workout agreement that proposes actions to be taken over a period of time to prevent or correct a default;

• The borrower can voluntarily convey the property to the Agency;

• Transfer (sale or transfer and assumption of mortgage);

• Foreclosure;

• Payoff with use restriction; or

• Debt settlement (cash only) for minimum bid or greater.
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SECTION 2: LIQUIDATION PROCEDURES

12.6 OVERVIEW

After the Loan Servicer exercises special servicing options and the borrower is still unable to continue with the loan, the Loan Servicer must determine the feasibility of liquidating the borrower's account. Any recommendation should result in the greatest net recovery to the Government.

The borrower may liquidate voluntarily, either through sale of the property or deed in lieu of foreclosure. If it determined that the borrower’s account must be liquidated, the Agency may recommend foreclosure and accelerate the loan.

12.7 VOLUNTARY CONVEYANCE

After acceleration, borrowers may voluntarily liquidate through deed in lieu of foreclosure or an offer by a junior lien holder. In the case of voluntary liquidation, the borrower is responsible for all expenses associated with liquidation and acquisition. The Agency will only consider acceptance of an offer of voluntary conveyance if it is likely to receive a recovery on its investment. The Agency will not accept a voluntary conveyance offer if it is not in the Government’s best interest to do so. The Agency should refuse the voluntary conveyance if the Agency lien has neither present nor prospective value or recovery of the value would be unlikely or uneconomical.

Voluntary sale of the security property may be the least onerous option for the borrower and the least costly option for the Government. If there is an interested buyer, procedures for property transfer that should be followed are described in Chapter 7 of this handbook.

A. Payment of Liens

If the Agency accepts a deed in lieu of foreclosure, it will pay prior liens if the Government’s investment and payment of the lien may be recovered. The Agency will accept conveyance subject to prior liens if the lien holder does not object. In this case, the Agency will make installment payments on the lien.

Junior liens must be paid by the borrower. If the borrower does not agree to pay these obligations, the Government will do so if it is in its best interest in the long run. The State Director determines whether the Agency will settle junior liens.

B. Required Components of an Offer of Voluntary Conveyance

An offer of voluntary conveyance will consist of the following documentation:

- Form RD 3560-22, Offer to Convey Security;

- Warranty Deed, which will be recorded only when the voluntary conveyance is accepted;
• A current financial statement, balance sheet, and information on present income and potential earning ability;

• For organization borrowers, a resolution by the Board of Directors that authorizes conveyance of the property; and

• Assignment of Housing Assistance Payments (HAP).

C. Appraisals

Prior to the Agency’s acceptance of an offer of a deed in lieu of foreclosure, the current market value of the property must be obtained through an appraisal by a qualified appraiser.

D. Decisions

The Loan Servicer will submit the case file of the borrower to the State Office. The State Office will review the file and make a decision, after having obtained advice from the OGC. When the market value of the property is less than the Agency debt, the Agency must consider the borrower’s current situation and future prospects for paying this debt.

Items to be included in the borrower’s case file are shown in Exhibit 12-2.

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**Exhibit 12-2**

**Liquidation Option - Borrower’s Case File**

- Report on Multi-family Housing Problem Case;
- Liquidation and management plan;
- Form RD 3560-22;
- Resolution authorizing conveyance, if applicable;
- Current title search;
- Environmental review;
- Form RD 3560-7;
- Form RD 3560-10;
- Current appraisal prepared by a qualified appraiser;
- Due diligence report;
- Balance of Rural Development account and other liens, if any;
- Assignment of HAP contracts, if applicable;
- Current statement of account from the St. Louis Office;
- Development plan with breakdown of costs, if applicable; and
- Form RD 402-2, Statement of Deposits and Withdrawals, if applicable.
E. Closing of Conveyance

Closing of conveyance will be complete when the recorded deed has been returned to the Agency with no outstanding encumbrances other than Agency liens and/or previously approved prior liens. Costs incurred prior to the completion of the transaction will be charged to the borrower as recoverable costs.

Upon closing of the transaction, if applicable, the Loan Servicer will release liens and inform the borrower of the release from liability. Borrowers must be notified whether or not they have been released from liability.

The State Director will cancel any interest credit and suspend any rental assistance. Tenants must be informed of the possible consequences of liquidation. If the property will no longer participate in the Section 515, 514/516, or 521 programs, the tenants must be given a minimum of 180 days’ written notice.

12.8 FORECLOSURE

State laws pertaining to acceleration and foreclosure will affect the procedures the Agency is required to follow. OGC should be consulted to ensure that appropriate procedures are followed.

A. Making the Acceleration Decision

The Agency must decide whether to accelerate the account and begin the foreclosure process. The decision to accelerate involves numerous considerations, many of which will vary case by case. The following issues should always be considered.

1. OGC Concurrence

Advice and counsel should be obtained from OGC before beginning the foreclosure process if:

• The foreclosure is based on a nonmonetary default; or

• The property also serves as security for a loan under another USDA program, such as the FSA, since this may trigger liquidation of the other loan.

2. Tribal Land

If the security property is on tribal-allotted or trust land, the acceleration may be approved only after the Agency has offered, in writing, to transfer the account to an eligible tribal member, the tribe, and the Indian Housing Authority serving the tribe or tribes.
3. Role of Other Lien Holders

Depending upon the status of other liens on the security property, the Agency may invite other lien holders to join in the foreclosure action, or join in a foreclosure action initiated by another lien holder.

B. Acceleration

1. Acceleration Notice

If the Agency determines that the appropriate approach to liquidation is foreclosure, the process begins with an acceleration notice (Guide Letter 1955-A-1, Notice of Acceleration to MFH Borrowers Liable for the Debt (Excludes Borrowers Who Were Discharged in Bankruptcy) or Guide Letter 1955-A-2, Notice of Acceleration to MFH Borrowers Discharged in Bankruptcy Who Have Not Reaffirmed the Debt). The acceleration notice demands full payment of the account, including unpaid principal and interest, advances, and subsidy subject to recapture. It notifies the borrower of: (1) the reason for the acceleration, (2) the amount due, (3) the method of payment, (4) the opportunity for an informal review with the decision maker to seek mediation or alternative dispute resolution or to request an administrative appeal hearing, (5) and prepayment restrictions. The notice gives the borrower 30 days to pay in full or request a hearing.

The acceleration notice must also include language regarding prepayment restrictions. If a borrower prepays an Agency loan made before December 21, 1979, the tenants must be given 180 days' notice that the project can be removed from the program. For information on these loans, see Chapter 15.

The notice must be sent to the borrower and any cosigners simultaneously by both regular mail and certified mail, return receipt requested. If the property address is different from the address of the borrower, the notice should be sent to the property address as well.

2. Payment Subsidy

If a borrower is receiving payment subsidy, the payment subsidy agreement will not be canceled when the debt is accelerated, but it will not be renewed unless the account is reinstated.

3. Offers to Pay

The decision to accelerate the account must not be made until the Loan Servicer has made all reasonable efforts to help the borrower become successful. Therefore, once the account has been accelerated, borrower efforts to cure the default will not be accepted unless required by state law. If state law requires that foreclosure actions be halted if an account is brought current, partial payment of the accelerated amount must be accepted. Otherwise, any payment for less than the full amount required to close the account should be returned to the borrower.
The borrower’s account may be paid off by cash, transfer and assumption, sale of the property, or voluntary conveyance. The Agency may grant the borrower additional time to voluntarily liquidate. If an offer is deemed unacceptable, the Agency’s denial is not appealable.

C. Review of the Acceleration Decision

Several remedies are available to borrowers who believe their accounts should not have been accelerated. These include an informal review, mediation or dispute resolution, and a formal appeal with the National Appeals Division (NAD) of the Department of Agriculture. Foreclosure actions will be held in abeyance while an appeal is pending.

D. Transfers and Subsequent Loans During Foreclosure

Properties can be transferred during the foreclosure process. However, the foreclosure process should not be stopped until the applicant is determined eligible and the transfer is determined to be feasible and in the best interest of the government. For a discussion of how the value of a property is determined, see Chapter 7, Section 7.26.

E. Foreclosure Notice

A foreclosure notice that includes the following must be published:

- Projected sale date and location;
- Fair market value of the property;
- The amount to be bid by the Agency;
- The amount of Agency debt against the property; and
- Use restriction provisions.

For judicial foreclosure states, notices are to comply with State laws.

Servicing Officials should take an aggressive approach to advertising foreclosure sales and marketing inventory properties. A list of potential buyers who would be interested in purchasing projects at foreclosure sale or inventory properties should be developed. Notices of scheduled foreclosure sales can then be sent to those interested
parties in addition to advertising in newspapers, notifying local real estate agents, and posting advertisements on the Agency’s Multi-Family Housing REO website at https://mfhreo.sc.egov.usda.gov.

F. Determining the Government’s Bid at Foreclosure Sale

The Government’s bid should equal the amount of the Agency’s net recovery value or the market value of the security, whichever is less.

The State Director will designate an individual to bid at foreclosure, unless prohibited by State law. If the Agency is the senior lien holder, it can only submit one bid. If the Agency is not the senior lien holder, the designated bidder may make incremental bids in competition with other bidders.

If a project that is subject to restrictive-use provisions is sold outside the program at the foreclosure sale, the Agency has no means to continue to enforce the restrictive-use provisions after the purchase.

G. After Foreclosure

1. Agency Reporting

After the property has been acquired, the Field Office must furnish the State Director with a report on the sale. Two forms must be filed: Form RD 3560-19, Status of REO Property, and, if applicable, Form RD 3560-55.

2. The Property

Upon acquisition, any existing leases must be transferred, and management agreements must either be extended or canceled.

3. The Borrower

If the property is acquired by the Agency, the Agency must credit the borrower’s account with the Government’s maximum bid. If the property is not acquired by the Agency, the borrower’s account must be handled in accordance with State law.

The Agency must make attempts to collect any unsatisfied balances. When deficiency judgments are sought, the State Director must prepare Form RD 1962-20, Notice of Judgment, which establishes how the account is to be handled by the Field Office.

12.9 ACQUISITION OF CHATTEL PROPERTY

The Agency will make every effort to avoid acquiring chattel property by having the borrower or Field Office Staff liquidate the property according to RD Instruction 1962-A, and applying the proceeds to the borrower’s accounts. Authorized methods of acquisition of chattel property include:
• **Sales**, including execution sales, Agency foreclosure sales, sale by trustee in bankruptcy, public sale by prior lien holder, and public sale conducted under voluntary liquidation.

• **Voluntary conveyance**, which is acceptable only when the borrower can convey ownership free of other liens and the borrower can be released from liability under the conditions set forth in 7 CFR 3560.457. Payment of other lien holders’ debts by the Agency in order to accept voluntary conveyance of chattels is not authorized. If the Agency declines an offer of voluntary conveyance of chattels, the Loan Servicer will provide a copy of the rejection to the borrower.

• **Attending sales**, which the Loan Servicer will attend unless it is deemed to be physically unsafe to do so or if attending the sale would cause unfavorable publicity. The Loan Servicer will attend a sale held by a prior lien holder if the market value of the chattel is significantly greater than the amount of the prior lien.

• **Appraising chattel property**, which is the Loan Servicer’s responsibility prior to the sale. An outside contractor in accordance with RD Instruction 2024-A may conduct an appraisal.

• **Abandonment of security interest**, should the chattel property have no market value and obtaining title would not be in the best interest of the Government. Such a situation might occur if costs of moving or rehabilitation are excessive.

• **Bidding at sale**, which the Loan Servicer might do if there are no other bids or if the property may be sold at an amount which is less than the Government’s authorized bid. The Loan Servicer may not bid if the chattel property under prior lien is significantly less than the amount owed to the prior lien holder or if the Agency debt has been satisfied. Loan Servicers may not bid at a sale held by a junior lien holder or at a private sale.

Unless costs are incurred after the government acquires title to the chattel property, the borrower will pay all costs related to acquisition of the property. The Loan Servicer will use *Form RD 3560-19, Status of REO Property*, to report acquisition of chattel property.
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SECTION 3: DEBT SETTLEMENT

Debt settlement is a process in which the Agency attempts to maximize repayment of outstanding debts that are not satisfied through voluntary or involuntary liquidation. There are four types of debt settlement: compromise, adjustment, charge-off, and cancellation. The Agency complies with the Debt Collection and Improvement Act of 1996 in pursuing outstanding debt. However, a majority of MFH loans are to non-recourse borrowers for which no additional recovery is possible after liquidation. Therefore, the Agency primarily uses debt settlement in conjunction with voluntary liquidation.

The State Director may approve or reject proposed debt settlements when the outstanding balance of the indebtedness amount in the offer is less than $1 million. The National Office must approve or reject any settlements totaling $1 million or more.

12.10 BORROWER ELIGIBILITY

A borrower may request debt settlement in conjunction with or after voluntary liquidation of security. The Agency may agree to settle a borrower’s debt if:

- All liable parties apply for debt settlement;
- The loan security is sold for cash or transferred to a third party;
- The borrower pays a compromise or adjustment offer of the current market value of the security, less prior liens, plus any additional amount the Agency determines the borrower can pay; and
- The initial payment, with a compromise or adjustment offer must be equal to or greater than the value of the security, less prior liens.

The Agency will not debt settle a borrower’s debt if:

- The borrower possesses another Agency loan for which he or she cannot or will not settle the debt;
- The Department of Justice has jurisdiction over the borrower’s loans or has a case pending against the borrower because of a suspected criminal violation in connection with the debt or security for the debt; or
- The Agency requests the Department of Justice to institute a civil action against the borrower to protect its interests.

12.11 APPLICATION REQUIREMENTS

The Agency considers a borrower’s financial status when evaluating the borrower’s request for debt settlement. A borrower must submit complete and accurate information from which the Agency can make a full determination of the borrower’s financial condition. This information must include the following items from all liable parties:
• A completed Form RD 3560-57, Application for Settlement of Indebtedness;
• A current financial statement and cash flow projections;
• Verification of income;
• Verification of assets for the past 12 months;
• Verification of debts greater than $1,000;
• Tax returns for the past three years; and
• Any other items requested by the Agency.

12.12 COMPROMISE AND ADJUSTMENT

A borrower is not required to dispose of security prior to application for debt settlement. However, if a borrower has disposed of security prior to applying for debt settlement, proceeds from the disposed security must first be applied to the borrower’s account. If the Agency approves a compromise or adjustment offer, the Agency will cancel any debt remaining after the compromise or adjustment offer is paid and applied to the debt.

A. Secured Debts

Secured debts may be compromised or adjusted as follows:

• The debt is fully matured under the terms of the note or other instrument, or has been accelerated by the Agency prior to the settlement application;

• A compromise offer must at least equal the net recovery value of the security as determined by the Agency, less prior liens, plus any additional amount the Agency determines the borrower is able to pay based on a current financial statement; and

• An adjustment offer must meet the requirements of a compromise offer, except the payments may be made over the shortest period the Agency determines is feasible, not to exceed five years

B. Unsecured Debts

Unsecured debts are most frequently account balances remaining after the borrower has voluntarily liquidated security property. The borrower’s compromise or adjustment offer must represent the maximum amount the Agency determines the borrower can pay based on a current financial statement and any other available information. An adjustment agreement may not exceed five years.
C. Handling Payments

All compromise or adjustment payments will be recorded. The St. Louis Office will hold payments in the Deposits Fund Account until notification is received from the State Office of the approval or rejection of the offer. For approved offers, payments will be applied in accordance with established policies, beginning with the oldest loan in the settlement. When the Agency accepts an adjustment offer, the St. Louis Office does not adjust the accounts involved until the borrower makes all the payments to the Agency.

D. Delinquent Adjustment Agreement

Adjustment payments that are more than 30 days past due are referred to the State Director. The State Director may:

- Void the agreement;
- Process a new debt settlement agreement; or
- Grant a time extension.

The borrower may appeal the cancellation of the adjustment agreement.

12.13 CHARGE-OFF

Charge-off is an administrative tool the Agency uses to write off nonperforming debt from the Agency’s portfolio. However, borrowers remain liable for charged-off debt, and the Government may continue to pursue collection. The Agency may charge off nonjudgment debt when:

- The principal balance is $2,000 or less, and efforts to collect the debt have been unsuccessful or would not be economical;
- OGC advises in writing that the Agency’s claim is legally without merit;
- Efforts to induce voluntary repayment are unsuccessful and OGC advises in writing that evidence to prove the Agency’s claim in court cannot be produced;
- The borrower is unable to pay any part of the debt and has no apparent future debt repayment ability; or
- There is no security for the debt.

12.14 CANCELLATION

When the Agency administratively extinguishes a debt owed to it, a cancellation occurs. Under these circumstances, the Agency releases the borrower from liability for the debt.
A. Cancellation with Application

When the borrower applies for debt settlement, the Agency may approve the request if the borrower’s application shows that the borrower cannot make any compromise or adjustment offer. The Loan Servicer must obtain documentation from the borrower that, due to unusual or extenuating circumstances, a compromise or adjustment offer is not feasible.

B. Cancellation without Application

The Loan Servicer may make a recommendation to cancel debt, without an application from the borrower in the following circumstances:

- All liable entities no longer exist;
- The 6-year statute of limitations of offset expires;
- The borrower has been discharged of the debt in bankruptcy;
- The debt, including a deficiency judgment, is otherwise legally without merit; or
- The account has been returned to the Agency after cross-servicing by the Department of Treasury.

C. Processing and Approving Cancellations

The Loan Servicer must execute the completed *Form RD 3560-57* and process the cancellation in accordance with the FMI.

The Loan Servicer must notify the borrower in writing of the debt settlement approval and the approximate amount that the Agency will report to the IRS. When the Agency cancels debt without application from the borrower, the Agency must send a letter regarding the debt cancellation to the borrower’s last known address.

The Agency must cancel any requests for offsets against the borrower after debt settlement approval.

12.15 REFERRAL TO THE DEPARTMENT OF TREASURY

Because most borrowers are nonrecourse borrowers, the Agency does not often refer accounts to the Department of Treasury for cross-servicing or offset as there are no liable parties for the debt. However, there may be times when it is appropriate to refer an account to the Department of Treasury for debt collection. The Agency should refer an account to the Department of Treasury when:

- The debt is 180 days past due;
- The security has been liquidated; and
The balance is due and payable.

The Agency should not refer an account to the Department of Treasury when:

- There are no liable entities to pursue;
- An internal offset is sufficient to collect the debt within three years after the debt becomes past due;
- The borrower is in compliance with an adjustment agreement;
- The debt is in litigation or bankruptcy action is pending; or
- The borrower is deceased.
# ATTACHMENT 12-A

## NET RECOVERY VALUE WORKSHEET

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<td>(3) Proposed Liquidation Option:</td>
</tr>
<tr>
<td>(5) Estimated Holding Period:¹</td>
</tr>
</tbody>
</table>

## II. CALCULATION OF NET RECOVERY VALUE

| (6) Market Value (use current appraisal) |
| (7) Deductions from Market Value |
| A. Liquidation costs | $________ |
| B. Acquisition cost | $________ |
| C. Settlement cost of prior liens | $________ |
| D. Estimated cost to operate during appraisal period² | $________ |
| E. Cost to correct health and safety violations | $________ |
| F. Cost to address environmental hazards (if different from E) | $________ |
| G. Selling costs | $________ |

| (8) Additions to Present Market Value |
| A. Appreciation during holding period | $________ |
| B. Income during holding period | $________ |
| C. Total Additions (sum of items 8A and 8B) | $________ |

| (9) NET RECOVERY VALUE (6 minus Item 7G plus Item 8C) |

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¹ The estimated inventory holding period prior to resale should be based upon previous experience in selling non-program property in the state and the availability of current funding for non-program inventory properties. If a state has not had experience in marketing non-program properties, the Multi-Family Housing Portfolio Management (MFHPM) Division in the National Office should be contacted.

² The cost to operate the project during the inventory holding period prior to resale should be based upon typical operating costs, excluding debt payments to the government, for similar projects in the servicing jurisdiction.