

Date: January 24, 2012

VAOPGCPREC 1-2012

From: General Counsel (021)

Subj: Request for Opinion on SAH Escrows (VAIQ 7177957)

To: Director, Loan Guaranty Service (26)

Question Presented:

What is the Secretary's responsibility for managing and distributing funds held in escrow for a Specially Adapted Housing (SAH) construction case if a Veteran decides not to complete the purchase of the property after grant funds have been deposited into an escrow account?

Held:

When a Veteran decides not to complete the purchase of a property after SAH grant funds have been disbursed, the Secretary must determine whether the contractor has both performed his obligations under the construction contract and satisfied the SAH guidelines. If the contractor has done so, VA should release the funds to the contractor in accordance with 38 C.F.R. § 36.4410 and the escrow agreement. If the contractor has not, the funds should remain in the escrow account pending civil litigation.

Discussion:

1. In discussions with your office, it is our understanding that a recipient of SAH assistance entered into a contract on July 18, 2008, to construct and purchase a specially adapted residence. Pursuant to 38 C.F.R. § 36.4406 and VA's normal practice, the VA Regional Office directed that an escrow be established for the grant and other funds. An escrow agreement was executed by the Veteran and the building contractor on December 29, 2008, naming the Regions Bank as the Escrowee.

2. The escrow agreement provided in part:

Out of [the escrowed] funds the Escrowee agrees to make disbursements, all subject to the written authorization of the VA Representative, as follows:

a. to pay obligations of the Veteran for or relating to his/her acquisition of the construction site . . . (and only on the written request of the Veteran as to each such payment);

2.

Director, Loan Guaranty Service (26)

b. to the contractor such sums as are otherwise due and payable under the terms of the construction agreement . . . ;

c. to pay other expenses determined by the VA Representative to be costs or obligations incurred by the Veteran for the acquisition of suitable housing (and only on the written request of the Veteran as to each such payment).

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3. The funds herewith deposited with the Escrowee are subject to disbursement by the Escrowee to effect completion of the construction and payment of related obligations as provided in this Agreement regardless of the death or incompetency of the Veteran, default of the Contractor, or the happening of any other event In the event . . . of the default of the Contractor the Escrowee shall disburse the funds herewith deposited with it to contractors, sub-contractors, material workers, laborers, sureties or other persons furnishing labor, materials, equipment or services in connection with the construction as directed by the lender and approved by the Veteran and the VA Representative

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6. The Veteran and Contractor respectively acknowledge that no agency or other legal relationship exists or is intended to be created between them and the VA representative . . . by this Agreement; and respectively acknowledge that the VA Representative . . . when acting in pursuance of this Agreement, is acting solely for and in behalf of [VA] in administering Chapter 21, Title 38, U.S.C.

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9. In the event any question arises relative to the subject matter of this Agreement . . . and not settled by agreement among the parties . . . the question will be submitted to the Chief Benefits Director . . . whose decision thereon shall be final.

10. The Veteran agrees that for purposes of this Agreement the VA Representative is authorized to consent on his/her behalf to disbursements of escrowed funds by the Escrowee to such payees, in such amounts and at such times as the VA Representative considers proper to fulfill the purposes and conditions of this Agreement.

3.

Director, Loan Guaranty Service (26)

3. Construction of the residence proceeded. After VA disbursed approximately \$30,000 to the contractor for work that had been completed, the Veteran decided, unilaterally, that he no longer wanted to purchase the home. VA made repeated attempts to encourage the Veteran to follow through with his contractual obligations, including a letter dated August 27, 2009, in which VA advised the Veteran that the "SAH grant funds of \$60,000 are at risk of forfeiture." Now, the Veteran and the contractor are at an impasse, approximately \$30,000 of the Veteran's SAH funds remain in an escrow account, and your office has requested our opinion as to how to best address this situation under the law.

4. The first step the Secretary must take is to determine whether the contractor has performed his obligations under the contract and in accordance with SAH guidelines. Chapter 13 of VA Manual M26-12 explains that, before consenting to the disbursement of funds, VA must receive a satisfactory compliance inspection report. "VA can release grant funds only after a proper inspection has been conducted by a VA-assigned Compliance Inspector, all non-compliant items on *VA Form 26-1839 (Compliance Inspection Report)* are resolved, and *VA Form 26-1839* has been reviewed and approved by the Regional Loan Center." See M26-12, Chapter 13, Section D, p.13D-2. Assuming there are no construction deficiencies and the Secretary determines the contractor has performed, the Secretary should proceed under the guidelines for Escrow Fund Release. See M26-12, Chapter 13, Section E.

5. We believe there is ample authority for VA to disburse funds pursuant to the Manual provisions even if the Veteran has not consented. Although none of the M26-12's guidelines on Handling and Resolving Issues addresses the situation presented here, 38 C.F.R. § 36.4410 authorizes the Secretary to "take such action as may be necessary or appropriate to relieve undue prejudice to an eligible individual or a third party contracting or dealing with such eligible individual which might otherwise result." In this instance, the contractor is a third party who is dealing with the SAH recipient. When the Veteran, the contractor, and the Escrowee entered into the escrow agreement, they all agreed that the purpose of the deposited funds was "to effect completion of the construction and payment of related obligations...regardless of the death or incompetency of the Veteran, default of the Contractor, or the happening of any other event." Furthermore, paragraph 10 of the escrow agreement states that, "the VA Representative is authorized to consent on his/her behalf to disbursements of escrowed funds by the Escrowee to such payees, in such amounts and at such times as the VA Representative considers proper to fulfill the purposes and conditions of this Agreement." Therefore, if the Secretary determines the contractor has fulfilled his obligations, and the only reason the contractor has not been paid is that the Veteran has refused to complete the transaction, the Secretary should exercise the authority found in the regulations, escrow agreement, and M26-12 for disbursing the remaining funds to the contractor.

4.

Director, Loan Guaranty Service (26)

6. If the Secretary determines the contractor has not fulfilled his obligations, the Secretary should not consent to the release of additional funds. The account should remain on hold until either the contractor or the Veteran pursues legal remedies to determine who is entitled to the remainder.

7. It might be argued that, since the Veteran is not following through with the statutory purpose of acquiring an adapted home, the Veteran has received a benefits payment to which he was not entitled; therefore, the remaining funds should be returned to the Treasury. Although both statute (38 U.S.C. § 2102) and regulation (38 C.F.R. § 36.4402) provide that VA is not authorized to pay to the Veteran any more than the cost of acquiring the adapted home, we have not found any legal support for VA laying claim to the escrowed funds while the Veteran remains involved in a dispute with a creditor, particularly when the creditor is the contractor who is a party to the escrow agreement. In fact, such a claim may run counter to other SAH policies. The grant check was issued in the Veteran's name, not VA's. The M26-12 states that the funds should be deposited timely into an interest-bearing escrow account so that "the Veteran receives the highest benefit from the proceeds...and in the event of a Veteran's death...the Veteran's estate may continue with the project or have the property returned to the same condition it was prior to grant approval." See M26-12, Chapter 13, Section A, p.13-A-4. The manual further states that, "Any interest on the grant funds is outside the scope of the escrow agreement. The Veteran chooses how to handle the earned interest upon completion of the escrow agreement." See M26-12, Chapter 13, Section A, p.14-A-4. In short, although the escrow agreement allows VA to exercise oversight and to consent or withhold consent for disbursements, we cannot point to any law, regulation, administrative guidance, or even any term in the escrow agreement itself that would bind the Escrowee into returning the funds to VA until after any claims of creditors are resolved. If any funds are left over after the resolution, VA may direct the escrow agent to disburse them to the Treasury rather than to the Veteran.

8. It might also be argued that, because the Veteran has not complied with the statutory purpose for receiving SAH assistance, any funds granted to the Veteran should be considered an overpayment for which the Veteran should be personally liable to the Secretary. Had chapter 21 of title 38, United States Code, included a clear requirement for collecting such overpayments, similar to the one found in the Education program (see 38 U.S.C. § 3685), we would have agreed that the Secretary should pursue a debt collection action under these circumstances. We also would have agreed a debt collection action would be appropriate if VA had promulgated regulations setting forth the liability assumed by a grant recipient. Since we cannot find any clear standard regarding what constitutes an overpayment in the SAH program, however, we must advise that the authority for establishing a debt would be legally questionable under the facts presented.

5.

Director, Loan Guaranty Service (26)

9. A debt collection action under these circumstances might fail to satisfy the principles of due process. Without advance notice to the Veteran, it is difficult to show that he should have known about the possible liability to the Secretary; he could have reasonably believed his only financial responsibility to VA would have been a reduction in SAH entitlement available, not in the creation of a debt. Had he known otherwise, he may have attempted to negotiate a reduction in what he owed to the contractor, thereby reducing the amount of the debt he would owe to the Secretary as a result. The knowledge might have changed whether he opted to apply for the SAH assistance in the first place, or whether he contracted for this particular home with this particular contractor. This is not to say that, for the process to be fair to the Veteran, he must certify that he understands all financial implications at the time of application. However, the absence of advance notice to the Veteran of his obligations in the event of his deciding not to complete the purchase of a property that is the subject of an SAH grant may be viewed as a lack of due process necessary to establish a debt owed by the Veteran to the Secretary.

10. We recommend the Secretary promulgate regulations and revise the SAH escrow agreement so that, if a situation like this should present itself in the future, the Secretary may point to clear standards for addressing the various issues we have raised. Our office will be pleased to work with the program office in drafting any necessary changes.

A handwritten signature in black ink, appearing to read "Will A. Gunn", with a long horizontal flourish extending to the right.

Will A. Gunn