

No. 96063-1

Court of Appeal No. 76510-8-I

King County Superior Court No. 15-2-12454-4 SEA

IN THE COURT OF APPEALS  
OF THE STATE OF WASHINGTON  
DIVISION I

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WASHINGTON STATE HOUSING FINANCE COMMISSION, a public  
body corporate and politic of the State of Washington,

Respondent,

v.

NATIONAL HOMEBUYERS FUND, INC., f/k/a Homebuyers Fund,  
Incorporated, a California nonprofit corporation; GOLDEN STATE  
FINANCE AUTHORITY, f/k/a California Home Finance Authority, f/k/a  
California Rural Home Mortgage Finance Authority, a California joint  
powers authority; RURAL COUNTY REPRESENTATIVES OF  
CALIFORNIA, f/k/a Regional Council of Rural Counties, f/k/a Mountain  
Counties Water Resources Association, a California nonprofit corporation,

Appellants.

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**APPELLANTS' REPLY BRIEF**

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## I. INTRODUCTION

WSHFC ignores the fundamental issues presented by this appeal: WSHFC's lack of injury (and thus lack of standing), and the absence of any Washington or California law prohibiting Homebuyers Fund from giving money to low and moderate income Washington homebuyers to help fund their down payments.

Unable to show either that it has been injured or that the challenged gifts are unlawful, WSHFC attempts to drag the Court into novel interpretations of the National Housing Act ("NHA") and HUD guidelines related to federal mortgage insurance. Courts have repeatedly held, however, that there is no private right of action to enforce the NHA, its implementing regulations, or HUD policy. Moreover, enforcement relating to federal mortgage insurance is a task for HUD, not state courts. Nor does HUD's "prohibited source" rule—on which WSHFC heavily relies—have any application here.

Rather than confront Homebuyers Fund's key arguments, WSHFC instead casts ad hominem aspersions that have nothing to do with the issues presented on appeal. The Court should not be distracted by WSHFC's hyperbole—which has no basis in reality. WSHFC has no standing to challenge transactions it has no part in, and even if it did,

neither California nor Washington law prohibits Homebuyers Fund from giving away money in Washington. The judgment should be reversed.

## II. REPLY RESTATEMENT OF THE CASE

WSHFC has no standing to challenge Homebuyers Fund's activities in Washington, and has no private right of action to enforce HUD policy. Because the law does not support it, WSHFC recites page after page of allegations that are either immaterial, misleading, or both. For example, it cites decade-old communications with HUD in an attempt to show that HUD disapproves of Homebuyers Fund's *gift* assistance. *See* Resp. Br. 9-11 (citing CP 442, 553, 560-578, 581-602). But these communications related to the provision of *secondary financing*, which Homebuyers Fund no longer provides. Moreover, they preceded 2008 amendments to the NHA, which significantly altered the legal landscape. *See id.* Whether HUD thought in the early 2000s that Homebuyers Fund could offer *secondary financing* outside California has no bearing on whether Homebuyers Fund may now provide *gifts*, with no **obligation or** expectation of repayment, to homebuyers in Washington—something it did not begin doing until 2014. CP 5.

WSHFC also asserts that Homebuyers' Fund somehow concealed its gift program from HUD. But HUD does not approve, or even regulate,

providers of gift assistance. Thus, there was nothing for Homebuyers Fund to have concealed from HUD, and WSHFC's accusation rings hollow.

To receive mortgage insurance from the Federal Housing Administration ("FHA"), the homebuyer must make a down payment consisting either of the buyer's own funds or approved secondary financing. Gifts are considered the borrower's own funds. *See* HUD Handbook<sup>1</sup> at 230 ("Gifts refer to the contributions of cash or equity with no expectation of repayment."). HUD's underwriting policy provides that gifts may come from a variety of sources, including family members, friends, employers, labor unions, charitable organizations, governmental agencies, or public entities.<sup>2</sup> *Id.* at 230.

The lender—e.g., the bank that originates a first mortgage—is solely responsible for ensuring that funds used for a down payment represent a true gift from an acceptable source. HUD does not "approve," screen, or otherwise evaluate gift donors. There is no geographic or "jurisdictional" limitation on gift funds. A Washington homebuyer may

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<sup>1</sup> Citations to "HUD Handbook" refer to the current FHA Single Family Housing Policy Handbook 4000.1, *available at* <https://portal.hud.gov/hudportal/documents/huddoc?id=40001HSGH.pdf>.

<sup>2</sup> WSHFC cites to Mortgagee Letter 06-13 to argue that the list of permissible sources of gifts is exhaustive. While that point is not material to the issues on appeal, it is noteworthy that the Mortgagee Letter WSHFC cites has been fully superseded. *See* Mortgagee Letters Superseded by HUD Handbook 4000.1, *at* [https://portal.hud.gov/hudportal/HUD?src=/program\\_offices/administration/hudclips/sfhs/uperseded/mltrs\\_full](https://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/sfhs/uperseded/mltrs_full) (last visited Sept. 21, 2017).

receive a gift from her grandmother in Indiana, her employer in New York, or a charitable organization in Texas.

Secondary financing, on the other hand, refers to “any financing other than the first Mortgage that creates a lien against the Property.” HUD Handbook at 235. Unlike gifts, secondary financing—which puts the homebuyer further in debt—may only be provided by nonprofit and governmental entities. *See id.* at 235-38. Nonprofit entities must obtain prior HUD approval before they can provide secondary financing and must request approval for a specific geographic area.<sup>3</sup> *See id.* at 86, 237. Thus, there *is* a “jurisdictional” element to secondary financing. WSHFC provides secondary financing. Homebuyers Fund provides gifts. This distinction, which WSHFC intentionally obscures, is critical to understanding this case.

### **III. ARGUMENT**

#### **A. WSHFC Lacks Standing to Bring This Action**

##### **1. WSHFC Ignores the Bulk of Homebuyers Fund’s Standing Arguments**

While acknowledging that lack of standing is Homebuyers Fund’s “primary argument on appeal,” WSHFC buries its response at the end of

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<sup>3</sup> This rule does not apply where the entity is exempted from federal income taxation under “Section 115” of the Internal Revenue Code. 26 U.S.C. § 115; *see also* Mortgagee Letter 2012-24.

its brief. WSHFC then simply ignores several of Homebuyers Fund’s key arguments. This failure to respond speaks volumes.

For example, WSHFC does not respond to the argument that it has suffered no injury as a result of Homebuyers Fund’s conduct. *See* App. Br. at 14-18. It makes no attempt to show either “that injury has occurred to a legally protected right” or the “distinct and personal interest in the outcome of the case” required to create standing. *See Pac. Marine Ins. Co. v. State ex rel. Dep’t of Revenue*, 181 Wn. App. 730, 740, 329 P.3d 101 (2014). WSHFC admits, however, that it has no right to be free from competition and has no exclusive rights in Washington. Resp. Br. at 43.

Nor does WSHFC respond to the argument that it has no governmental standing to enforce the law, except to implicitly concede it by claiming that “the Commission need not be a regulatory agency to enforce its rights in court.” Resp. Br. at 45; App. Br. at 18-21.

WSHFC also ignores all six of the cases Homebuyers Fund cites concerning the legal standard for standing. *See* App. Br. at 13-14. Indeed, WSHFC fails to discuss *any* of the authorities discussed in Homebuyers Fund’s standing argument, App. Br. at 13-18, with the exception of a

cursory and unsuccessful attempt<sup>4</sup> to distinguish *Hardin v. Ky. Util. Co.*, 390 U.S. 1, 88 S. Ct. 651, 19 L. Ed. 2d 787 (1968). Resp. Br. at 44.<sup>5</sup> Unable to rebut Homebuyers Fund’s legal arguments, WSHFC simply ignores them.

## 2. WSHFC’s “Zone of Interest” Arguments Are Baseless

Because it cannot demonstrate any injury to itself, WSHFC attempts to reframe the standing question in terms of “zones of interest.” Ignoring the law cited by Homebuyers Fund, WSHFC relies on *State v. Johnson*, 179 Wn.2d 534, 552, 315 P.3d 1090 (2014), for the proposition that “an injured party has standing to sue when it falls within the ‘zone of interests’ of a law it invokes.” Resp. Br. at 40. But *Johnson* set forth a *two-part* test, requiring the plaintiff to first show “a *personal injury* fairly traceable to the challenged conduct and likely to be redressed by the requested relief.” *Johnson*, 179 Wn.2d at 552 (emphasis added). Only once injury is established does the “zone of interests” test come into play.

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<sup>4</sup> WSHFC repeats its assertion that *Hardin* distinguished “lawful and unlawful competition” but ignores Homebuyers Fund’s arguments and authorities about what that means. Compare App. Br. 17-18 and Resp. Br. 44. WSHFC also quotes, but ignores, *Hardin*’s limitation of competitor standing to circumstances where “the particular statutory provision involved does reflect a legislative purpose to protect a competitive interest.” *Hardin*, 390 U.S. at 6. WSHFC does not identify any specific statutory provision with a legislative purpose to protect WSHFC’s competitive interest.

<sup>5</sup> WSHFC also cites, with no discussion, *Alexander v. Sandoval*, 532 U.S. 275, 121 S. Ct. 1151, 149 L. Ed. 2d 517 (2001). Resp. Br. at 42. Otherwise WSHFC does not refer in any manner to the numerous authorities cited by Homebuyers Fund.

*See id.* Nowhere in its brief does WSHFC even acknowledge the injury requirement in *Johnson*, much less show that it was met.

WSHFC also cites *Five Corners Fam. Farmers v. State*, 173 Wn.2d 296, 303, 268 P.3d 892 (2011), which addressed the “relaxed” standing requirements for procedural injuries. But even under this relaxed standard, the plaintiff still must specify a particular statutory or constitutional provision that has been violated, and show a concrete invaded interest protected by the violated provision. *Id.* WSHFC has failed to do this. More importantly, the relaxed test applies only to procedural rights litigants have against their own government, and is completely inapplicable here. Under both *Johnson* and *Five Corners*, WSHFC lacks standing.

### **3. WSHFC Has No Standing Under Washington Law**

WSHFC argues that it “falls within the zone of interest” of its originating statutes, RCW 43.180.010 and RCW 43.180.050. Neither of those statutes regulates or prohibits anything. They are inapposite.

RCW 43.180.010 is merely a statement of public policy recognizing that the state housing finance commission is “**a**” (not “the”) financial conduit to participate in various programs. RCW 43.180.050 merely sets forth WSHFC’s powers, which do not include policing other providers of down payment assistance. Neither of these statutes, nor any

other Washington statute, regulates in any respect who may provide down payment gift assistance—or any of the other conduct Homebuyers Fund is accused of engaging in. Because nothing in the record demonstrates that Homebuyers Fund has violated these statutes, they do not create standing.

WSHFC next argues, in a complete non-sequitur, that “the allocation of state and local governmental authority in Washington” is an issue of concern to the state’s courts. Resp. Br. at 41. The only case WSHFC cites for this argument has nothing to do with standing.<sup>6</sup> In any event, Homebuyers Fund does not purport to exercise any state or local governmental authority in Washington, let alone disrupt any allocation of such authority between governing bodies.<sup>7</sup> Nor does WSHFC demonstrate

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<sup>6</sup> WSHFC cites *City of Tacoma v. Taxpayers of Tacoma*, 49 Wn.2d 781, 307 P.2d 567 (1957), *rev’d on other grounds*, 355 U.S. 888. That case had nothing to do with standing; it concerned whether a city had the power to condemn state land previously committed to public use (it did not; *see* 49 Wn.2d at 798-99) and if not, whether a federal statute could give it that power (it could not; *see id.* at 800).

<sup>7</sup> Nor is FHA mortgage insurance a system of “cooperative federalism,” as WSHFC contends. Down payment assistance can be (and is in fact) provided by both private and public entities in Washington. CP 835-36. Such providers are expressly contemplated by HUD’s underwriting manual. *See* HUD Handbook at 230. To argue otherwise, WSHFC relies on inapt cases discussing housing programs that have nothing to do with the origination of FHA-insured mortgages. *See* Resp. Br. at 26 (citing *Resident Action Council v. Seattle Housing Auth.*, 177 Wn.2d 417, 327 P.3d 600 (2013)).

Indeed, to the extent this case poses a federalism concern, it is one of preemption. By now focusing its arguments on novel interpretation of federal regulations, WSHFC is asking this Court to make national housing policy. Congress did not intend for the disparate state courts to reach novel questions of federal housing policy, brought by strangers to the transactions involved. *See infra* Part III.A.4.

that any such question arises from an injury to it, or that Homebuyers Fund is violating a Washington law designed to protect WSHFC.

#### **4. WSHFC Has No Standing Under Federal Law**

WSHFC next argues, still without also showing any individualized injury, that it is “within the zone of interest” of federal law. WSHFC contends that, because it is an “authorized state entity” under HUD regulations, it has an “implied” right to challenge any other provider of down payment assistance that is “unauthorized.” Here too, the cases WSHFC cites do not support its arguments.

Courts evaluating this issue across the United States have consistently recognized that there is *no* private right of action to enforce either the NHA or the HUD regulations implementing it. *See, e.g., Three Rivers Ctr. for Indep. Living, Inc. v. Hous. Auth.*, 382 F.3d 412, 431 (3d Cir. 2004) (HUD accessibility regulations do not provide a private right of action); *Talton v. BAC Home Loans Servicing LP*, 839 F. Supp. 2d 896, 911 (E.D. Mich. 2012) (holding there is “no private right of action for breach of HUD’s mortgage servicing policies”); *Hayes v. M & T Mortg. Corp.*, 389 Ill. App. 3d 388 329 Ill. Dec. 440, 906 N.E.2d 638, 642 (2009) (HUD mortgage regulations do not create a private right of action); *Wells Fargo Home Mortg., Inc. v. Neal*, 398 Md. 705 922 A.2d 538, 544 (2007)

(FHA and HUD regulations do not create private right of action; citing 12 more cases).

In the face of such overwhelming authority, WSHFC resorts to citing irrelevant case law and non-binding secondary sources in an attempt to establish a private right of action where none exists.

First, WSHFC argues that 12 U.S.C. § 1735f-6 gives it an implied private right of action to sue Homebuyers Fund. While the question of whether a private right of action exists depends on congressional intent, WSHFC fails to demonstrate any such intent.<sup>8</sup> Indeed, there is no indication that HUD regulates gift-givers at all, much less gives other persons or entities enforcement power over them. HUD does not “approve” or “disapprove” providers of gift assistance.<sup>9</sup> Instead, Congress granted HUD’s Mortgagee Review Board authority to enforce HUD/FHA policy. *See* 12 U.S.C. § 1708(c). It is the Board that has authority over the lenders who are approved to offer mortgage loans insured by FHA

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<sup>8</sup> *Alexander v. Sandoval* held that there is no private right of action to enforce federal regulations implementing Title VI of the Civil Rights Act of 1964. 532 U.S. at 293. The Supreme Court’s narrow recognition of a private right of action to enforce federal regulations is entirely inconsistent with WSHFC’s arguments in this case.

<sup>9</sup> *See, e.g.*, HUD Handbook at 234, 308; HUD OIG, NOVA Financial & Investment Corporation, Tucson, AZ, 2015-LA-1005, at 3 (July 9, 2015) (“Although the U.S. Department of Housing and Urban Development (HUD) does not approve downpayment assistance programs, such programs and the lenders using the programs must ensure that funds provided comply with HUD FHA rules and regulations.”), available at <https://www.hudoig.gov/sites/default/files/documents/2015-LA-1005.pdf>.

consistent with FHA guidelines. *See id.*; 24 C.F.R. § 203.5(c). If such a lender originates a mortgage loan with FHA insurance that fails to comply with HUD’s underwriting criteria—including criteria relating to down payments or gifts—the Board may seek penalties, including reprimands, suspension of authority, monetary penalties, indemnification of loans, and withdrawal of the lender’s FHA approval. HUD may also refer offending lenders to the Department of Justice. *See* 31 U.S.C. § 3803.

This robust administrative enforcement system shows not only that Congress did not intend a private right of action,<sup>10</sup> but also that any private action is preempted by the HUD enforcement system, which fully occupies the field and with which this state court action actually conflicts.

Finally, WSHFC argues that “an authorized entity may challenge an unauthorized entity exercising competing governmental authority in the same jurisdiction” and, more broadly, that “any specially authorized enterprise in a restricted market has standing to challenge an unauthorized participant in that same market.” Resp. Br. at 43-44. None of the cases WSHFC cites support these broad contentions, which are inconsistent with

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<sup>10</sup> WSHFC also cites a law review article concerning whether federal courts should have the power to create private rights of action where Congress has been silent. The political views of that article concerning what the law should be are not authority for anything. Seth Davis, *Implied Public Rights of Action*, 114 COLUM. L. REV. 1 (2014).

the general rule that neither statutes nor regulations automatically create a private right of action absent legislative intent that they do so.

*Skagit County* concerned the authority of a rural hospital district to provide care outside of its statutory geographic boundaries and did not touch on standing. *Skagit Cnty. Pub. Hosp. Dist. No. 304 v. Skagit Cnty. Pub. Hosp. Dist. No. 1*, 177 Wn.2d 718, 305 P.3d 1079 (2013). The Court “closely examine[d] the statutes conferring authority on the [Public Hospital Districts (‘PHDs’)]” and determined that the Legislature did not mean to “allow one rural PHD to raid the territory of another.” *Id.* at 726. This analysis of the statutes governing rural public hospital districts does not support the broad standing rule WSHFC tries to place on it.

Similarly, *Alderwood Water Dist. v. Pope & Talbot, Inc.*, 62 Wn.2d 319, 382 P.2d 639 (1963) did not address any principles of standing. *Alderwood* considered “whether a municipal water district of this state can directly furnish water to the inhabitants of an area located outside the boundaries of such district but within the boundaries of another water district.” *Id.* at 320. The Court’s analysis was based on “closely examining in toto statutory provisions conferring authority upon the potentially competing municipal corporations” and determining what the statutes allowed. *Id.* at 321-22. The Court held that the “statutory prohibition against the geographical overlapping of water districts obviously carries

with it an implication that one water district should not infringe upon the territorial jurisdiction of another water district[.]” *Id.* at 322. No statutory geographic restrictions or express prohibitions are at issue here.

In *Day v. Inland Empire Optical, Inc.*, 76 Wn.2d 407, 456 P.2d 1011 (1969), the Court held that licensed ophthalmologists and opticians have standing under Washington law to challenge competition from unlicensed persons. *Id.* at 416-17. The Court described this special standing rule as resting on the “precise grounds” that “[a]s licensed members of a profession, calling or trade which is subject to reasonable regulation by the state and without which license no one of them could lawfully practice or carry on the profession, trade or calling, each plaintiff could properly resort to the courts to require others so licensed to abide by the laws and regulations governing the practice or carrying on of the licensed profession, calling or trade.” *Id.* at 416. *Puget Sound Traction, Light & Power. Co. v. Grassmeyer*, 102 Wash. 482, 173 P. 504 (1918), is much the same. The Court held that the holder of a state issued franchise to run street railways had standing to sue and enforce a prohibition on jitney (i.e. privately operated) buses which risked injury to the licensed street cars. The Court reasoned that the jitney buses’ unlawful presence on the streets made them a “nuisance per se” and thus they could be enjoined “by any one suffering a special injury thereby.” *Id.* at 490.

*Day* and *Grassmeyer* provide narrow standing exceptions for highly regulated professions and public franchises (so-called “license” or “franchise” cases); they do not support the broad general rule of standing argued by WSHFC. The fact that WSHFC is *allowed* under Washington law to provide down payment assistance in connection with HUD-insured mortgages does not provide standing for WSHFC to sue anyone else for doing so. *See* App. Br. at 14-18. WSHFC has no such standing.

#### **5. WSHFC Has No Standing Under California Law**

Finally, WSHFC claims that it has standing to enforce “the territorial limits that California places on its counties” As “a matter of comity.” Resp. Br. 44-45. It cites no case law supporting this “comity” standing argument,<sup>11</sup> which it appears to have created out of whole cloth. As WSHFC argues earlier in its brief, “a party can enforce not only Washington law, but also the law of other jurisdictions, *so long as it has standing to do so.*” Resp. Br. at 40 (emphasis added).<sup>12</sup> WSHFC has no

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<sup>11</sup> WSHFC cites California Government Code § 6502, as well as the Washington Interlocal Cooperation Act, which concern creation of a joint powers authority by several public entities, and have no relevance to WSHFC’s standing arguments. Neither of these statutory schemes provide WSHFC standing to bring its claims here.

<sup>12</sup> WSHFC cites for this proposition *Richardson v. Pac. Power & Light Co.*, 11 Wn.2d 288, 118 P.2d 985 (1941), a wrongful death action arising from the electrocution of the plaintiff’s husband. The case has nothing to do with standing, but rather with whether Washington would enforce the law of the place where the death occurred (Oregon). WSHFC also cites RCW 5.24.010, concerning judicial notice of foreign law. Neither citation supports WSHFC’s insistence that it has standing to sue Homebuyers Fund to enforce WSHFC’s understanding of California law.

standing here.

**B. Homebuyers Fund’s Conduct Is Lawful**

**1. Homebuyers Fund Is Not Exercising Sovereign Authority in Washington**

All of WSHFC’s merits arguments are rooted in the notion that Homebuyers Fund is somehow trying to act like part of the government of Washington State. Thus, WSHFC cites cases concerning territory disputes between two political subdivisions, and argues that WSHFC, rather than Homebuyers Fund, has been delegated authority by the Legislature.<sup>13</sup>

WSHFC’s argument is a straw man. These cases concern the Legislature’s allocation of the sovereign power to govern among various entities it created. Homebuyers Fund does not claim it has any power to *govern* in Washington, or that it is a creature of the Washington Legislature.

WSHFC misleadingly argues that Homebuyers Fund is trying to “shed its skin” and that the Court should be “wary” of how Homebuyers Fund’s status is described.<sup>14</sup> WSHFC resorts to ad hominem arguments

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<sup>13</sup> As discussed in connection with the standing argument, both *Alderwood Water Dist.* and *Skagit County* concerned disputes between two statutorily-created subdivisions of state government regarding the meaning of geographic restrictions explicitly set forth in the relevant statutes.

<sup>14</sup> E.g., WSHFC cites to communications in which Homebuyers Fund contract employees display differing understandings about the entity’s nonprofit status. The casual

because it has no reasoned response, supported by case law, to Homebuyers Fund’s clear showing that *being* a governmental entity for purpose of HUD underwriting criteria is not the same thing as *acting* in a governmental capacity as a sovereign. App. Br. at 33-36.

Moreover, as Homebuyers Fund has explained, “an entity can be an ‘agency’ or instrumentality’ of government for one purpose but not another.” *Guardian Indus. Corp. v. Comm’r*, 143 T.C. 1, 14 (2014). WSHFC simply ignores this and most of the other authority cited at pages 34 and 35 of the Appellants’ brief.<sup>15</sup> But there is nothing inconsistent in the fact that Homebuyers Fund qualifies as a “governmental agency” for HUD purposes, a “Section 115” entity under IRS provisions, *see* 26 U.S.C. § 115, and a nonprofit public benefit corporation under California law, *see* CAL. CORP. CODE § 5140.<sup>16</sup>

WSHFC cites no authority for its insistence that Homebuyers Fund’s status as a “governmental agency” under HUD’s underwriting criteria means that Homebuyers Fund is attempting to govern anything in

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email communications of low-level employees lacking a deep grasp of corporation and municipal law are irrelevant to the legal questions presented here.

<sup>15</sup> The only authority from this section of the Appellants’ Brief that WSHFC responds to are two federal cases dealing with the ability of political jurisdictions to act in their proprietary capacity outside of their jurisdictions. That topic is addressed below at pages 18-19.

<sup>16</sup> Under 26 U.S.C. § 115, certain governmental entities—which, like Homebuyers Fund, may also be nonprofit corporations—are exempt from federal taxation. CP 995-99; *see also* App. Br. at 34 n.10.

the State of Washington. Case law concerning how to resolve disputes between two competing subdivisions of Washington government simply has no bearing on this dispute.

**2. Homebuyers Fund Is Authorized to Conduct Business Outside of California**

WSHFC also argues that California law prohibits Homebuyers Fund from operating outside of California. California law, however, expressly gives Homebuyers Fund the right to act outside California. As a nonprofit public benefit corporation, Homebuyers Fund has “all of the powers of a natural person” including the power “to conduct its activities in any other state, territory, dependency, or foreign country.” CAL. CORP. CODE § 5140. Homebuyers Fund has a separate corporate existence and is not limited by the restrictions placed on the counties that comprise the membership of GSFA. App. Br. at 27-31.<sup>17</sup>

WSHFC is wrong in arguing Homebuyers Fund is not governed by the California Corporations Code and instead must adhere to the restrictions placed on local governments in California. But even if WSHFC were correct on this point, WSHFC’s argument fails to recognize

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<sup>17</sup> WSHFC also continues to rely heavily on *Cabrillo Cmty. College Distr. v. Cal. Junior College, Assn.*, 44 Cal. App. 3d 367, 372, 118 Cal. Rptr. 708 (1975), and the Bilaver opinion letter. Resp. Br. at 32-33. WSHFC ignores Homebuyers Funds’ arguments concerning this “authority,” simply repeating arguments to which Homebuyers Fund has already responded.

that a county has *no* geographic limitation on actions undertaken in a proprietary capacity unless the law explicitly provides otherwise.<sup>18</sup> As the Washington Supreme Court explained long ago:

The suggestion that, to allow a city of this state to acquire property of the nature here in question in another state would, in effect, be an assumption of extra-territorial jurisdiction, we think, is wholly without force, in view of the fact that the city's ownership of such property situated outside its own territorial limits, whether within or without this state, is only the ownership and control over such property in the city's proprietary capacity. Such ownership does not, to our minds, suggest an assumption of extra-territorial governmental jurisdiction, either on the part of the state of Washington or of its cities, over property, situated in another state.

*Langdon v. City of Walla Walla*, 112 Wash. 446, 452, 193 P. 1, 3 (1920).

And the California Supreme Court recently reaffirmed that “the state ordinarily has the same freedom of action as a private entity” when acting as a market participant. *Friends of the Eel River v. N. Coast R.R. Auth.*, 5 Cal. 5th 677, 220 Cal. Rptr. 3d 812, 399 P.3d 37, 52 (2017). “In this proprietary capacity they generally should have the same freedom as private actors in the market, just as they must ordinarily carry the same burdens.” *Id.* at 72-73; *see also* 62 C.J.S. *Mun. Corp.* § 147.

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<sup>18</sup> WSHFC argues that Homebuyers Fund's activities insufficiently benefit the residents of the underlying counties. This argument merely highlights WSHFC's lack of standing: whether or not WSHFC is correct, and it is not, has no effect whatsoever on WSHFC.

In short, the geographic limitation WSHFC invokes does not exist. “[I]n contrast to the exercise of governmental authority outside of its territorial limits, a municipality may, in its business or proprietary capacity, exercise extraterritorial powers, such as the power to contract.” *Orland Hills v. Citizens Utils. Co.*, 347 Ill. App. 3d 504, 282 Ill. Dec. 966, 807 N.E.2d 590, 603 (2004).

### **3. WSHFC Misapplies Federal Law and HUD Guidelines**

Because WSHFC lacks a private right of action under the National Housing Act, its arguments regarding HUD rules are irrelevant. They are also wrong on the merits. Federal law does not preclude Homebuyers Fund from giving cash gifts to homebuyers because Homebuyers Fund is not a “financially interested” party under the NHA’s “prohibited source” rule. *See* 12 U.S.C. § 1709(b)(9)(C). Homebuyers Fund is not a party to the underlying sale of residential real estate, and does not financially benefit from that transaction.

To understand the prohibited source rule, it is helpful to understand the mischief at which it was aimed. The early 2000s saw a real estate boom during which seller concessions, including seller-financed down payment assistance, became common. *FHA: Prohibited Sources of Minimum Cash Inv. Under the NHA—Interpretive Rule*, 77 Fed. Reg. 72,219 (Dec. 5, 2012). Although sellers were banned from *directly*

financing down payment assistance, there was no ban on sellers *indirectly* providing such assistance. *Id.* at 72,221.

Some nonprofit entities used this loophole to “partner” with sellers under an arrangement whereby the nonprofit would provide down payment assistance to the homebuyer. *Id.* Then, “after the funds were provided by the nonprofit entity to the homebuyer, the seller made a donation to the nonprofit entity of the amount of the assistance plus a fee.” *Id.* This practice artificially inflated sale prices and appraised values, which played a role in the subprime mortgage crisis. *Id.*

In the wake of this crisis, Congress amended the NHA to prohibit down payment assistance from parties who “financially benefit” from the property sale. *See* 12 U.S.C. § 1709(b)(9)(C). This provision is known as the “prohibited source” rule. Specifically, § 1709(b)(9)(C) provides (emphasis is added):

In no case shall the funds required by subparagraph (A) [the provision requiring the borrower to have a down payment] consist, in whole or in part, of funds provided by any of the following parties before, during, or after closing of the property sale:

- (i) The seller or any other person or entity that **financially benefits from the transaction.**
- (ii) Any third party or entity that is reimbursed, directly or indirectly, by any of the parties described in clause (i).

WSHFC claims this provision applies to Homebuyers Fund because it “financially benefits from the transaction.”<sup>19</sup>

As HUD itself has acknowledged, only parties who “financially benefit” from the real property sale itself fall within the reach of the prohibited source rule. Homebuyers Fund does not financially benefit from the property sale and is not party to the property sale. Instead it, like WSHFC, generates revenue (to make future down payment gifts) from the sale of mortgage-backed securities on the secondary market. As HUD explained in a recent legal opinion on this precise issue, the prohibited source rule is “directed towards parties that financially benefit from the property sales transaction and the primary mortgage transaction, **not transactions that occur in the secondary mortgage market.**” Memo from Nani Coloretti, Dep. Sec. of HUD (May 25, 2016), at 3 (“Coloretti Memo”) (emphasis added).

WSHFC claims certain deposition testimony “proves” that Homebuyers Fund “financially benefits” from the underlying transactions. Resp. Br. at 25. But testimony from a non-lawyer at Homebuyers Fund that it “benefits” from the fact that an underlying property sale took place

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<sup>19</sup> WSHFC does not argue that Homebuyers Fund falls within the second prong of the prohibited source rule, nor could it, as Homebuyers Fund is not reimbursed by any entity that financially benefits from the transaction.

does not answer the legal question of whether downstream indirect benefits in the secondary mortgage market fall within the prohibited source rule. For example, a moving company may also claim that it “benefits” from property sales (after all, people need movers when they purchase or sell their homes). But this does not mean that such activities fall within the reach of the prohibited source rule. HUD itself—the agency charged with implementing the NHA—has determined that its rule does not reach benefits realized from selling mortgage-backed securities. *See Coloretti Memo.*

**C. WSHFC’s Cursory Alter Ego Claims Are Baseless**

Finally, WSHFC argues that it has shown Homebuyers Fund, RCRC, and GSFA are alter egos merely because they share an address, have overlapping directors and officers, and transact business with each other. WSHFC’s arguments are insufficient as a matter of law to create jurisdiction in this Court over RCRC and GSFA, which WSHFC admits do not themselves have any contacts with Washington.

WSHFC makes no attempt to rebut Defendants’ showing that (1) Homebuyers Fund is presumed to have a separate corporate existence, and (2) Homebuyers Fund has complied with all potentially relevant corporate formalities. It has its own articles of incorporation and bylaws. CP 859, 950. Its board of directors holds regular meetings. *See, e.g., CP 877 (pp.*

130:12–131:13), 953. It is also capitalized, and has its own distinct obligations from GSFA and RCRC. *See, e.g.*, CP 950–62, 1047–66. The IRS has issued a private letter ruling to Homebuyers Fund as a separate entity, CP 995–99, and Homebuyers Fund issues its own, audited financial statements on an annual basis, CP 1047–66.

WSHFC argues both that Washington law governs this issue and that Washington and California law are the same. But neither RCRC nor GSFA has ever done business in Washington. Plus, attacks on corporate form are governed by the law of the state of incorporation. *See App. Br.* at 38.

WSHFC, moreover, ignores the language of the very cases it cites. In order to apply the alter ego doctrine, Washington law requires WSHFC to show “two essential factors. First, the corporate form must be intentionally used to violate or evade a duty; second, disregard must be ‘necessary and required to prevent unjustified loss to the injured party.’” *Meisel v. M & N Modern Hydraulic Press Co.*, 97 Wn.2d 403, 410, 645 P.2d 689 (1982).<sup>20</sup> WSHFC does not attempt to show either here. Indeed, there is no argument whatsoever by WSHFC that the presence of RCRC or

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<sup>20</sup> Although WSHFC cites *Meisel* as applying Washington law to pierce a New Jersey corporate veil, in fact that case does not discuss choice of law at all.

GSFA as parties adds anything to this suit, much less that it is “necessary and required to prevent unjustified loss to the injured party.”<sup>21</sup>

Nor do WSHFC’s control arguments demonstrate an abuse of the corporate form. *Rider v. City of San Diego*, 18 Cal. 4th 1035, 77 Cal. Rptr. 2d 189, 959 P.2d 347, 352 (1998) (“Because the Financing Authority has a genuine separate existence from the City it does not matter whether or not the City ‘essentially controls’ the Financing Authority.”) (internal citation omitted); *City of Cerritos v. Cerritos Taxpayers Ass’n*, 183 Cal. App. 4th 1417, 1442, 108 Cal. Rptr. 3d 386 (2010) (“We are not at liberty to ignore the [nonprofit public benefit] corporation’s status; it has a ‘genuine separate existence’ from the City and Agency, so ‘it does not matter whether or not the City ‘essentially controls’ Cuesta Villas.”). WSHFC offers no cogent rebuttal to this authority.

WSHFC argues that this case is similar to *FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc.*, 180 Wn.2d 954, 331 P.3d 29 (2014), and *In re Rapid Settlements, Ltd.*, 166 Wn. App. 683, 271 P.3d 925 (2012). It is not. *FutureSelect* was not a veil piercing or alter ego case,

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<sup>21</sup> California law similarly requires an abuse of the corporate form that injures the plaintiff. “The alter ego doctrine arises when a plaintiff comes into court claiming that an opposing party is using the corporate form unjustly and in derogation of the plaintiff’s interests. . . . Thus the corporate form will be disregarded only in narrowly defined circumstances and only when the ends of justice so require.” *Mesler v. Bragg Mgmt. Co.*, 39 Cal. 3d 290, 216 Cal. Rptr. 443, 702 P.2d 601, 606-07 (1985).

but instead was an agency case holding that a foreign defendant could be subject to personal jurisdiction for acts undertaken by its agent, the effects of which were felt in Washington. *FutureSelect*, 180 Wn.2d at 966. *FutureSelect* thus has no bearing whatsoever on the alter ego question presented here.

As for *Rapid Settlements*, that case involved two entity defendants sharing common control and ownership, where one claimed to have “ceased doing business several years ago.” *Rapid Settlements*, 166 Wn. App. at 689. Piercing the corporate veil was thus necessary to avoid injustice to the plaintiff. Here, by contrast, there is no allegation—much less evidence—of any abuse of the corporate form.

Neither RCRC nor GSFA have any contacts with Washington that subject them to personal jurisdiction. Their close business ties to Homebuyers Fund, a validly created and adequately capitalized separate entity, do not, as a matter of law, create “alter ego” jurisdiction over these entities. RCRC and GSFA should be dismissed from this action for lack of personal jurisdiction.

#### **IV. CONCLUSION**

For the reasons set forth above and in the initial brief on appeal, the trial court’s decision should be vacated, and the case should be remanded for entry of judgment in favor of Defendants.

Respectfully submitted this 22nd day of September, 2017.

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Court of Appeal No. 76510-8-I

King County Superior Court No. 15-2-12454-4 SEA

IN THE COURT OF APPEALS  
OF THE STATE OF WASHINGTON  
DIVISION I

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WASHINGTON STATE HOUSING FINANCE COMMISSION, a public  
body corporate and politic of the State of Washington,

Respondent,

v.

NATIONAL HOMEBUYERS FUND, INC., f/k/a Homebuyers Fund,  
Incorporated, a California nonprofit corporation; GOLDEN STATE  
FINANCE AUTHORITY, f/k/a California Home Finance Authority, f/k/a  
California Rural Home Mortgage Finance Authority, a California joint  
powers authority; RURAL COUNTY REPRESENTATIVES OF  
CALIFORNIA, f/k/a Regional Council of Rural Counties, f/k/a Mountain  
Counties Water Resources Association, a California nonprofit corporation,

Appellants.

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APPENDIX TO APPELLANTS' REPLY BRIEF

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**INDEX TO APPENDIX**

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REPLY APP. 4-12	FHA Single Family Housing Policy Handbook 4000.1 (selected pages)
REPLY APP. 13-20	Memo from Nani Coloretti, Dep. Sec. of HUD (May 25, 2016)



# U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

**Date:** November 21, 2012

**To:** All FHA-Approved Mortgagees

## Mortgagee Letter 2012-24

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**Subject** Secondary Financing Eligibility Requirements for Internal Revenue Code (IRC) Section 115 Entities

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**Purpose** The purpose of this Mortgagee Letter (ML) is to clarify that HUD deems Section 115 entities to be “instrumentalities of government” for the purpose of providing secondary financing under single family FHA programs. Entities providing proof of Section 115 status, as described below, need not meet the instrumentality of government test otherwise required by ML 1994-02, and need not be included on HUD’s Nonprofit Organization Roster, as originally provided in ML 2009-38, which was later superseded by ML 2011-38.

This ML supersedes guidance on Section 115 entities stated in ML 2011-38, except for the waiver of the voluntary board requirements as described in the ML, which waiver remains in place.

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**Effective Date** All provisions of this ML are effective immediately.

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*Continued on next page*

## Mortgagee Letter 2012-24, Continued

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### **Instrumentality of Government Status for Section 115 Entities**

Given the requirements imposed on entities to qualify under Section 115 of the Internal Revenue Code, HUD has determined that Section 115 entities should be treated as instrumentalities of government for purposes of FHA's secondary financing program. Furthermore, HUD also considers entities with the dual distinction of 501(c)(3) **and** Section 115 status to be instrumentalities of government. As such, Section 115 entities must follow all FHA guidance in HUD handbooks, regulations, Mortgagee Letters, and Housing Notices, to which instrumentalities of government are subject regarding the operations of secondary financing programs.

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### **Section 115 Entities – Secondary Financing Programs**

As instrumentalities of government, Section 115 entities are not required to have HUD approval or placement on HUD's Nonprofit Organization Roster to operate a secondary financing program. Section 115 entities implementing secondary financing programs are held to the same program eligibility standards applicable to all other government agencies and instrumentalities of government operating secondary financing programs as described in 24 CFR §203.32(b).

However, Section 115 entities are not considered instrumentalities of government for participation in other FHA programs. Therefore, they must meet eligibility and participation requirements for those FHA programs. If participation in other FHA programs requires approval and placement on HUD's Nonprofit Organization Roster, Section 115 entities must remain on HUD's Nonprofit Organization Roster. In such cases, Section 115 entities will still be considered to be instrumentalities of government for purposes of secondary financing, even though they are also on HUD's Nonprofit Organization Roster.

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### **Documentation Requirements for Section 115 Status**

When operating a secondary financing program, organizations claiming Section 115 status must present proof of that status as requested by the lender:

- 1) a letter from the organization's auditor; or
  - 2) a written statement from the organization's General Counsel, as an official of the organization; or
  - 3) a Letter Ruling issued by the Internal Revenue Service; or
  - 4) an equivalent document evidencing Section 115 status.
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*Continued on next page*

## Mortgagee Letter 2012-24, Continued

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**Documentation  
Requirements  
for Section 115  
Status**  
(continued)

The document used as evidence of Section 115 status must state that the organization's income is excluded from federal taxation through Section 115 of the Internal Revenue Code. Documentation evidencing Section 115 status must be placed on the right side of the case binder directly after "Request for Late Endorsement" in the attached, FHA Case Binder – Documentation Order.

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**Paperwork  
Reduction Act**

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0540. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

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**Questions**

If you have any questions regarding this Mortgagee Letter, please call the FHA Resource Center at 1-800-CALLFHA (1-800-225-5342). Persons with hearing or speech impairments may reach this number via TTY by calling the Federal Information Relay Service at 1-800-877-8339.

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**Signature**

Carol J. Galante  
Acting Assistant Secretary for Housing-  
Federal Housing Commissioner

---

[Attachment](#)



**U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**  
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

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**Special Attention of:**

All FHA Approved Mortgagees  
All Direct Endorsement Underwriters  
All FHA Roster Appraisers  
All FHA Roster Inspectors  
All FHA Approved 203(k) Consultants  
All HUD Approved Housing Counselors  
All HUD Approved Nonprofit Organizations  
All Governmental Entity Participants  
All Real Estate Brokers  
All Closing Agents

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**Transmittal:** Handbook 4000.1

**Issued:** December 30, 2016

**Effective Date:** Multiple; See Below

**1. This Transmits:**

The incorporation of previously published updates to Handbook 4000.1, FHA Single Family Housing Policy Handbook.

**2. Explanation of Materials Transmitted:**

This revision to the FHA Single Family Housing Policy Handbook, or Handbook 4000.1 (Handbook), is being published to update existing sections.

**I. DOING BUSINESS WITH FHA**  
**B. Other Participants**  
**4. Nonprofits and Governmental Entities**

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**(ii) Standard**

A nonprofit must adhere to its AHPP during its entire approval period. Any activity undertaken by a nonprofit that requires the use of their FHA nonprofit approval must be in accordance with the approved AHPP.

Unlike the application for approval, a separate AHPP must be submitted to every Jurisdictional HOC for the geographic areas in which the nonprofit agency wishes to do business.

If, at some point in the future, a nonprofit wants to engage in activities outside the scope of its approved AHPP, it must submit a revised AHPP to the Jurisdictional HOC(s) for approval prior to implementation.

**Conflicts of Interest**

No person who is an employee, officer, or elected or appointed official of the nonprofit agency, or who is in a position to participate in a decision making process pursuant to the AHPP or gain inside information with regard to the lease or purchase of the Property pursuant to the AHPP may obtain a personal or financial interest or benefit from the purchase of the Property, or have an interest in any contract, subcontract, or agreement with respect thereto, or the proceeds thereunder, either for themselves, or for those with whom they have family or business ties, during their tenure or for one year thereafter.

**(iii) Required Documentation**

**Copy of the AHPP**

The nonprofit must submit a copy of the AHPP for each local area in which the nonprofit agency intends to be active. If the nonprofit wants to expand its approval area, the Jurisdictional HOC may require additional information.

The AHPP must address the following:

- the areas, including state, city, county and zip code, in which the nonprofit plans to administer the program(s). The program must be operated within a 200-mile radius of the nonprofit's office;
- how Low- to Moderate-Income persons will benefit from participation in the program;
- how the nonprofit will transition families and individuals into homeownership;
- how the nonprofit's savings will be passed along to program recipients;

## II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

### A. Title II Insured Housing Programs Forward Mortgages

#### 4. Underwriting the Borrower Using the TOTAL Mortgage Scorecard (TOTAL)

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##### (2) Standard

The Mortgagee may consider Private Savings Club funds that are distributed to and received by the Borrower as an acceptable source of funds.

The Mortgagee must verify and document the establishment and duration of the club, and the Borrower's receipt of funds from the club. The Mortgagee must also determine that the received funds were reasonably accumulated, and not borrowed.

##### (3) Required Documentation

The Mortgagee must obtain the club's account ledgers and receipts, and a verification from the club treasurer that the club is still active.

#### (F) Gifts (Personal and Equity) (TOTAL)

##### (1) Definition

Gifts refer to the contributions of cash or equity with no expectation of repayment.

##### (2) Standards for Gifts

###### (a) Acceptable Sources of Gifts Funds

Gifts may be provided by:

- the Borrower's Family Member;
- the Borrower's employer or labor union;
- a close friend with a clearly defined and documented interest in the Borrower;
- a charitable organization;
- a governmental agency or public Entity that has a program providing homeownership assistance to:
  - low or moderate income families; or
  - first-time homebuyers.

Any gift of the Borrower's MRI must also comply with the additional requirements set forth in [Source Requirements for the Borrower's MRI](#).

###### (b) Donor's Source of Funds

Cash on Hand is not an acceptable source of donor gift funds.

## II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

### A. Title II Insured Housing Programs Forward Mortgages

#### 4. Underwriting the Borrower Using the TOTAL Mortgage Scorecard (TOTAL)

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##### (2) Sales Commission (TOTAL)

An inducement to purchase exists when the seller and/or Interested Party agrees to pay any portion of the Borrower's sales commission on the sale of the Borrower's present residence.

An inducement to purchase also exists when a Borrower is not paying a real estate commission on the sale of their present residence, and the same real estate broker or agent is involved in both transactions, and the seller is paying a real estate commission on the Property being purchased by the Borrower that exceeds what is typical for the area.

##### (3) Rent Below Fair Market (TOTAL)

Rent may be an inducement to purchase when the sales agreement reveals that the Borrower has been living in the Property rent-free or has an agreement to occupy the Property at a rental amount considerably below fair market rent.

Rent below fair market is not considered an inducement to purchase when a builder fails to deliver a Property at an agreed-upon time, and permits the Borrower to occupy an existing or other unit for less than market rent until construction is complete.

##### (I) Downpayment Assistance Programs (TOTAL)

FHA does not "approve" downpayment assistance programs administered by charitable organizations, such as nonprofits. FHA also does not allow nonprofit entities to provide gifts to pay off:

- Installment Loans
- credit cards
- collections
- Judgments
- liens
- similar debts

The Mortgagee must ensure that a gift provided by a charitable organization meets the appropriate FHA requirements, and that the transfer of funds is properly documented.

##### (1) Gifts from Charitable Organizations that Lose or Give Up Their Federal Tax-Exempt Status

If a charitable organization makes a gift that is to be used for all, or part, of a Borrower's downpayment, and the organization providing the gift loses or gives up its federal tax-exempt status, FHA will recognize the gift as an acceptable source of the downpayment provided that:

## II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

### A. Title II Insured Housing Programs Forward Mortgages

#### 4. Underwriting the Borrower Using the TOTAL Mortgage Scorecard (TOTAL)

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- the gift is made to the Borrower;
- the gift is properly documented; and
- the Borrower has entered into a contract of sale (including any amendments to purchase price) on or before the date the IRS officially announces that the charitable organization's tax-exempt status is terminated.

#### (2) Mortgagee Responsibility for Ensuring that Downpayment Assistance Provider is a Charitable Organization

The Mortgagee is responsible for ensuring that an Entity providing downpayment assistance is a charitable organization as defined by Section 501(a) of the Internal Revenue Code (IRC) of 1986 pursuant to Section 501(c) (3) of the IRC.

One resource for this information is the [IRS Exempt Organization Select Check](#), which contains a list of organizations eligible to receive tax-deductible charitable contributions.

#### (J) Secondary Financing (TOTAL)

Secondary Financing is any financing other than the first Mortgage that creates a lien against the Property. Any such financing that does create a lien against the Property is not considered a gift or a grant even if it does not require regular payments or has other features forgiving the debt.

#### (1) Secondary Financing Provided by Governmental Entities and HOPE Grantees (TOTAL)

##### (a) Definitions

A Governmental Entity refers to any federal, state, or local government agency or instrumentality.

To be considered an Instrumentality of Government, the Entity must be established by a governmental body or with governmental approval or under special law to serve a particular public purpose or designated by law (statute or court opinion) and does not have 501(c)(3) status. HUD deems Section 115 Entities to be Instrumentalities of Government for the purpose of providing secondary financing.

Homeownership and Opportunity for People Everywhere (HOPE) Grantee refers to an Entity designated in the homeownership plan submitted by an applicant for an implementation grant under the HOPE program.

## II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

### A. Title II Insured Housing Programs Forward Mortgages

#### 4. Underwriting the Borrower Using the TOTAL Mortgage Scorecard (TOTAL)

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##### (b) Standard

FHA will insure a first Mortgage on a Property that has a second Mortgage or lien made or held by a Governmental Entity, provided that:

- the secondary financing is disclosed at the time of application;
- no costs associated with the secondary financing are financed into the FHA-insured first Mortgage;
- the insured first Mortgage does not exceed the FHA [Nationwide Mortgage Limit](#) for the area in which the Property is located;
- the secondary financing payments are included in the total Mortgage Payment;
- any secondary financing of the Borrower's MRI fully complies with the additional requirements set forth in [Source Requirements for the Borrower's MRI](#);
- the secondary financing does not result in cash back to the Borrower except for refund of earnest money deposit or other Borrower costs paid outside of closing; and
- the second lien does not provide for a balloon payment within 10 years from the date of execution.

Nonprofits assisting a Governmental Entity in the operation of its secondary financing programs must have HUD approval and placement on the Nonprofit Organization Roster unless there is a documented agreement that:

- the functions performed are limited to the Governmental Entity's secondary financing program; and
- the secondary financing legal documents (Note and Deed of Trust) name the Governmental Entity as the Mortgagee.

Secondary financing that will close in the name of the nonprofit and be held by a Governmental Entity must be made by a HUD-approved Nonprofit.

The Mortgagee must enter information on HUD-approved Nonprofits into [FHA Connection \(FHAC\)](#), as applicable.

Secondary financing provided by Governmental Entities or HOPE grantees may be used to meet the Borrower's MRI. Any loan of the Borrower's MRI must also comply with the additional requirements set forth in [Source Requirements for the Borrower's MRI](#).

There is no maximum Combined Loan-to-Value (CLTV) for secondary financing loans provided by Governmental Entities or HOPE grantees.

Any secondary financing meeting this standard is deemed to have prior approval in accordance with [24 CFR § 203.32](#).

## II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

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#### 4. Underwriting the Borrower Using the TOTAL Mortgage Scorecard (TOTAL)

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##### (c) Required Documentation

The Mortgagee must obtain from the provider of any secondary financing:

- documentation showing the amount of funds provided to the Borrower for each transaction;
- copies of the loan instruments; and
- a letter from the Governmental Entity on their letterhead evidencing the relationship between them and the nonprofit for each FHA-insured Mortgage, signed by an authorized official and containing the following information:
  - the FHA case number for the first Mortgage;
  - the complete property address;
  - the name, address and Tax ID for the nonprofit;
  - the name of the Borrower(s) to whom the nonprofit is providing secondary financing;
  - the amount and purpose for the secondary financing provided to the Borrower; and
  - a statement indicating whether the secondary financing:
    - will close in the name of the Governmental Entity; or
    - will be closed in the name of the nonprofit and held by the Governmental Entity.

Where a nonprofit assisting a Governmental Entity with its secondary financing programs is not a HUD-approved Nonprofit, a documented agreement must be provided that:

- the functions performed by the nonprofit are limited to the Governmental Entity's secondary financing program; and
- the secondary financing legal documents (Note and Deed of Trust) name the Governmental Entity as the Mortgagee.

##### (2) Secondary Financing Provided by HUD-Approved Nonprofits (TOTAL)

###### (a) Definition

A HUD-approved Nonprofit is a nonprofit agency approved by HUD to act as a mortgagor using FHA mortgage insurance, purchase the Department's Real Estate Owned (REO) Properties (HUD Homes) at a discount, and provide secondary financing.

HUD-approved Nonprofits appear on the [HUD Nonprofit Roster](#).

###### (b) Standard

FHA will insure a first Mortgage on a Property that has a second Mortgage or lien held by a HUD-approved Nonprofit, provided that:

- the secondary financing is disclosed at the time of application;

## II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

### A. Title II Insured Housing Programs Forward Mortgages

#### 4. Underwriting the Borrower Using the TOTAL Mortgage Scorecard (TOTAL)

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- no costs associated with the secondary financing are financed into the FHA-insured first Mortgage;
- the secondary financing payments must be included in the total Mortgage Payment;
- the secondary financing must not result in cash back to the Borrower except for refund of earnest money deposit or other Borrower costs paid outside of closing;
- the secondary financing may not be used to meet the Borrower's MRI;
- there is no maximum CLTV for secondary financing loans provided by HUD-approved Nonprofits; and
- the second lien may not provide for a balloon payment within 10 years from the date of execution.

Secondary financing provided by Section 115 Entities must follow the guidance in [Secondary Financing Provided by Governmental Entities and HOPE Grantees](#).

Any secondary financing meeting this standard is deemed to have prior approval in accordance with [24 CFR § 203.32](#).

#### (c) Required Documentation

The Mortgagee must obtain from the provider of any secondary financing:

- documentation showing the amount of funds provided to the Borrower for each transaction; and
- copies of the loan instruments.

The Mortgagee must enter information into [FHAC](#) on the nonprofit and the Governmental Entity as applicable. If there is more than one nonprofit, enter information on all nonprofits.

### (3) Family Members (TOTAL)

#### (a) Standard

FHA will insure a first Mortgage on a Property that has a second Mortgage or lien held by a Family Member, provided that:

- the secondary financing is disclosed at the time of application;
- no costs associated with the secondary financing are financed into the FHA-insured first Mortgage;
- the secondary financing payments must be included in the total Mortgage Payment;
- the secondary financing must not result in cash back to the Borrower except for refund of earnest money deposit or other Borrower costs paid outside of closing;
- the secondary financing may be used to meet the Borrower's MRI;

## II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

### A. Title II Insured Housing Programs Forward Mortgages

#### 5. Manual Underwriting of the Borrower

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and no cash allowance is given to the Borrower. The inclusion of the items below in the sales agreement is also not considered an inducement to purchase if inclusion of the item is customary for the area:

- range
- refrigerator
- dishwasher
- washer
- dryer
- carpeting
- window treatment
- other items determined appropriate by the HOC

#### (2) Sales Commission (Manual)

An inducement to purchase exists when the seller and/or Interested Party agrees to pay any portion of the Borrower's sales commission on the sale of the Borrower's present residence.

An inducement to purchase also exists when a Borrower is not paying a real estate commission on the sale of their present residence, and the same real estate broker or agent is involved in both transactions, and the seller is paying a real estate commission on the Property being purchased by the Borrower that exceeds what is typical for the area.

#### (3) Rent Below Fair Market (Manual)

Rent may be an inducement to purchase when the sales agreement reveals that the Borrower has been living in the Property rent-free or has an agreement to occupy the Property at a rental amount considerably below fair market rent.

Rent below fair market is not considered an inducement to purchase when a builder fails to deliver a Property at an agreed-upon time, and permits the Borrower to occupy an existing or other unit for less than market rent until construction is complete.

#### (I) Downpayment Assistance Programs (Manual)

FHA does not "approve" downpayment assistance programs administered by charitable organizations, such as nonprofits. FHA also does not allow nonprofit entities to provide gifts to pay off:

- Installment Loans
- credit cards
- collections
- Judgments
- liens
- similar debts



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
OFFICE OF THE DEPUTY SECRETARY  
WASHINGTON, D.C. 20410-0050

May 25, 2016

**MEMORANDUM FOR:** David Montoya, HUD Inspector General  
Edward Golding, Principal Deputy Assistant Secretary,  
HUD Office of Housing

**FROM:** Nani Coloretti, Deputy Secretary *Nani Coloretti*

**SUBJECT:** Decision: Office of Inspector General Audit of NOVA Financial &  
Investment Corporation's FHA-Insured Loans with Downpayment  
Assistance, Report 2015-LA-0010

Consistent with section 5-5 of the Department's Audit Management System Handbook 2000.06 REV-4, this decision memorandum represents management's decision and resolves the present disagreement between the Office of Inspector General (OIG) and the Office of Housing-Federal Housing Administration (FHA) arising out of OIG's audit of NOVA Financial & Investment Corporation (NOVA) and its origination of FHA-insured single family mortgages for borrowers using downpayment assistance provided by various housing finance agencies.

### BACKGROUND INFORMATION

Despite several attempts to resolve their differences of opinion, OIG and FHA continue to disagree as to whether the downpayment assistance programs being operated by the governmental entities and utilized by borrowers in connection with FHA-insured financing originated by NOVA violated FHA's requirements. OIG and Housing disagree on six recommendations made in the NOVA Audit, and OIG referred these disagreements to me for resolution. Specifically, OIG recommended that NOVA do the following:

1. OIG Recommendation 1B: "stop originating FHA loans with ineligible gifts as part of downpayment assistance programs ...."
2. OIG Recommendation 1C: "indemnify HUD for 405 FHA loans that were originated with the ineligible gift as part of the downpayment assistance programs ...."
3. OIG Recommendation 1D: "indemnify HUD for the additional 304 loans originated under the Home in Five, Pima Tucson, and similar downpayment programs that may contain ineligible downpayment assistance .... HUD must review the 304 loans to determine whether they were insurable without the ineligible downpayment assistance."

4. OIG Recommendation 1F: “collaborate with loan servicers to reduce the interest rates for FHA borrowers who received downpayment assistance, were charged a premium interest rate, and have not refinanced or terminated their original FHA loan”
5. OIG Recommendation 1G: “reimburse FHA borrowers for overpaid interest as a result of the premium interest rate for those who received downpayment assistance, were charged a premium interest rate, and have refinanced or terminated their original FHA loan”
6. OIG Recommendation 1H: “update all internal control checklists to include specific HUD FHA rules and regulations governing downpayment assistance, premium interest rates, and allowable fees”

The resolution of these six recommendations primarily depends upon the determination of three issues:

1. What is the interpretation and application of the National Housing Act “Prohibited Sources” provisions to the downpayment assistance provided by a governmental entity?
2. Whether the specific practices of the governmental entities providing downpayment assistance in the particular instances referenced in the NOVA Audit violate these “Prohibited Sources” provisions as they were interpreted and applied at the time of the audit.
3. Whether the specific practices of the governmental entities at issue in the NOVA Audit violate any other applicable FHA requirements concerning premium pricing or gift funds.

After meeting with OIG, FHA and the Office of General Counsel (OGC) on these issues, I charged OIG and OGC with conferring further to see if there was any common ground with respect to the relevant legal issues underscoring the Audit’s determinations. The two offices conferred, and OIG also provided documentation that previously was not available to FHA or OGC. I understand that, pursuant to those discussions, the three offices – OIG, Housing, and OGC – agree that the *Federal Housing Administration: Prohibited Sources of Minimum Cash Investment Under the National Housing Act – Interpretive Rule* (“2012 Interpretive Rule”) permits governmental entities to provide downpayment assistance that may represent a borrower’s minimum cash investment. Docket No. FR-5679-N-01. However, neither office has changed its underlying view of the legal issues surrounding the NOVA FHA-insured single mortgages at issue in the audit and continue to disagree as to the manner in which a governmental entity may raise funds for its downpayment assistance program and the manner in which a governmental entity may provide downpayment assistance to perspective borrowers. Both OIG and OGC provided me with their position on these legal issues, and this memorandum sets forth my final determination.

## **1) The “Prohibited Sources” Provisions and Treatment of Governmental Entities**

The 2012 Interpretive Rule is the Department’s legal interpretation and application of the National Housing Act’s “Prohibited Sources” provisions, which restrict certain persons and entities from funding the borrower’s minimum required downpayment. The Interpretive Rule specifically excludes governmental entities from the “Prohibited Sources” provisions and places no restrictions or prohibitions on how governmental entities raise funds for their downpayment assistance programs. In addition, the Department’s General Counsel has opined by memorandum dated August 11, 2015 (“General Counsel’s opinion”) and attached hereto as Attachment A, that governmental entities generate their funds for downpayment assistance programs through a variety of mechanisms (which could include the sale of mortgages on the secondary market) and, once the funds legally belong to the governmental entity, that control is sufficient to render them eligible for use as downpayment assistance and a proper source for the borrower’s minimum cash investment. Neither the Interpretive Rule nor the subsequent Mortgagee Letter 2013-14, titled “Minimum Cash Investment and Secondary Financing Requirements – Acceptable Documentation for Funds Provided by Federal, State, or Local Governments, their Agencies or Instrumentalities,” placed restrictions on the manner in which governmental entities raised funds. Additionally and as the General Counsel has noted, the “Prohibited Sources” provisions of the National Housing Act, captured at section 203(b)(9)(C) of the Act, are directed towards parties that financially benefit from the property sales transaction and the primary mortgage transaction, not transactions that occur in the secondary mortgage market. As such, I have determined that the governmental entities involved in the NOVA Audit represented a permissible source for borrowers’ minimum cash investment.

## **2) “Prohibited Sources” Provisions as Interpreted and Applied at the Time of the NOVA Audit**

The 2012 Interpretive Rule and Mortgagee Letter 2013-14 were in effect and applicable during the time of OIG’s audit. In fact, OIG’s analysis in the audit acknowledged and recognized the applicability of the 2012 Interpretive Rule and Mortgagee Letter 2013-14. The audit determinations, however, rely upon a finding that certain provisions of the FHA Handbook (“Handbook”) still apply to governmental entities. Specifically, OIG asserts that the lender is obligated to ensure compliance with 4155.1 5.B.4.a, which requires that there is no expected or implied repayment of gift funds by the borrower, and 4155.1 5.A.2.i, which places a restriction on the use of premium pricing that results in a credit to the borrower such that the credit cannot exceed the borrower’s closing costs and/or prepaid items. In light of the Interpretive Rule and Mortgagee Letter 2013-14, which post-date and supersede the cited Handbook provisions, and the subsequent General Counsel’s opinion regarding the applicability of these authorities, I conclude that OIG has not established in its audit a violation of any applicable requirements governing these downpayment assistance programs.

### 3) Gift Funds and Premium Pricing

#### a. Gift Funds

I also conclude, contrary to OIG's allegations, that the funds used for the downpayment assistance were consistent with the FHA rules governing gift funds, as determined by Handbook 4155.1. Based on the information provided by OIG, it appears that the borrowers received grant funds from the governmental entities and were not, in fact, required to repay these grants. Indeed, OIG takes issue with an apparent arrangement between certain governmental entities and lenders participating in the secondary mortgage market, in which the lenders reportedly provided funds to support the downpayment assistance program (financial support that, according to OIG, was borrower-funded); but documents memorializing the arrangement expressly provide that the "[d]own payment assistance is a grant and is not directly repayable by the borrower ..."<sup>1</sup> In addition, according to the record information provided by OIG, the borrowers did not execute any additional note or security instrument to document the creation of a debt obligation securing the repayment of the downpayment assistance amount.<sup>2</sup> The sales contract was not artificially inflated and the original principal balance of the mortgage was not increased to cover the cost of the downpayment assistance. There was no prepayment penalty imposed upon the borrower if the borrower prepaid the mortgage such that the full value of any increased interest rate was not fully realized. As such, I conclude that there was no expectation of repayment of the downpayment assistance as alleged by OIG. Thus, I conclude that the downpayment assistance at issue in OIG's audit is permitted under current FHA rules.

#### b. Premium Pricing

I also conclude that FHA's policies addressing "premium pricing" in Handbook 4155.1 were not applicable in the circumstances as alleged by OIG. FHA's requirements related to "premium pricing" are only applicable where the interest rate negotiated between the borrower and lender results in a credit from the lender that then is reflected on line 802 of the HUD-1 Form.<sup>3</sup> OIG specifically has found that no credit was generated in these cases. *See* Appendix D (indicating that no credit was found in the HUD-1 for the reviewed loans). Consequently, there cannot be a violation of FHA's premium pricing policies where there is no corresponding credit to the borrower, because FHA's restrictions on premium pricing do not apply.

### DECISION

The "Prohibited Sources" provisions of section 203(b)(9)(C) of the National Housing Act do not mandate the conclusion that governmental entities are prohibited sources of downpayment

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<sup>1</sup>As previously determined, there are no restrictions placed on governmental entities in how they elect to raise funds for their respective downpayment assistance programs. The subsequent sale of the mortgage on the secondary market is a permissible source of funds for a governmental entity's downpayment assistance program. Additionally, FHA does not have the legal authority to regulate interest rates.

<sup>2</sup>Memorandum of Jeremy Kirkland, Counsel to the Inspector General, to Tanya E. Schulze, Regional Inspector General For Audit (hereinafter "Kirkland Memorandum"), dated June 17, 2015, concerning the NOVA Audit, page 2, (noting borrowers had gift letters stating that the downpayment assistance was not required to be repaid.)

<sup>3</sup>In the section of the HUD-1 Form setting out items payable in connection with the loan, line 802 requires the mortgagee to provide the "credit or charge (points) for the specific interest rate chosen" by the borrower.

assistance in connection with FHA-insured mortgages, regardless of how such entities generate their funds. Based on the facts presented by OIG in the NOVA Audit, it does not appear that the legal position of the Department and the policies of FHA with respect to governmental downpayment assistance in place at the time of the audit were violated by the lender. Moreover, the policies of FHA with respect to premium pricing and gifts also do not appear to have been violated by the lender, based on the facts that OIG has presented.

The NOVA Audit makes neither allegations nor any determinations that the then applicable FHA requirements found in Mortgagee Letter 2013-14 were violated. The NOVA Audit also does not support a determination that the 2012 Interpretive Rule was violated. As such, I find no basis in the NOVA Audit to support Recommendations 1B, 1C, 1D, 1F and 1G and therefore will not require any further action by FHA with respect to these recommendations. With respect to Recommendation 1H, I concur with OIG's recommendation and direct FHA to review and, where appropriate, update its guidance, including any internal control checklists, to include FHA rules and regulations governing downpayment assistance, premium interest rates and allowable fees, consistent with this memorandum. Additionally, while the Department believes the downpayment assistance program as described in OIG's audit is permissible under law and that OIG has not established a violation of any FHA rules and regulations applicable at the time of the audit, I am directing FHA, in concert with the Government National Mortgage Association ("Ginnie Mae"), to review prospectively, and provide to the Deputy Secretary within 90 days any policy recommendations relating to, (1) the role of secondary mortgage market participants in providing financial assistance to governmental entities that in turn use those funds, including funds generated through prior mortgage transactions, to support downpayment assistance programs; and (2) any advisable parameters governing such arrangements. In addition, I am directing FHA to evaluate the appropriate risk-related factors with respect to loans that include downpayment assistance, including any potential additional risk to consumers and/or to the Mutual Mortgage Insurance Fund, and determine whether steps can be taken to mitigate that risk and ensure that the risks are within FHA's risk tolerance. FHA should report the results of its evaluation to the Deputy Secretary within 30 days.

# **ATTACHMENT A**



OFFICE OF HOUSING

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

AUG 11 2015

MEMORANDUM FOR: Edward L. Golding, Principal Deputy Assistant Secretary for Housing, H

FROM: Helen Kanovsky, General Counsel, C *Helen Kanovsky*

SUBJECT: Permissible Source of Funds for Governmental Entities Downpayment Assistance Programs.

You have advised that the audit of NOVA Financial & Investment Corporation by the U.S. Department of Housing and Urban Development's (HUD) Office of Inspector General (OIG) has created concerns about the propriety of certain Downpayment Assistance (DPA) programs being operated by various governmental entities, including Housing Finance Agencies. Specifically, you requested guidance concerning whether a governmental entity's use of FHA mortgages with arguably higher than market interest rates in its DPA program represents "premium pricing" as defined by Federal Housing Administration (FHA) requirements. Additionally, you asked whether a practice of raising funds in this manner by governmental entities to provide DPA is permissible under FHA requirements.

First, FHA's Interpretative Rule, Docket No. FR-5679-N-01, published on December 5, 2012 and Mortgagee Letter 2013-14, published on May 9, 2013 superseded previous FHA guidance in regards to governmental entities DPA programs. Second, neither the Interpretative Rule nor the Mortgagee Letter placed restrictions on how a governmental entity may fund its DPA programs. Finally, the use of funds derived from the sale of mortgages with higher than market interest rates does not constitute premium pricing as defined by FHA, nor does it violate any other requirement placed on DPA provided by governmental entities.

Permissible Source of Funds for Downpayment Assistance Programs

Governmental entities are a permissible source of funds for a borrower's Minimum Cash Investment. FHA's interpretation of section 203(b)(9)(C) of the National Housing Act provides that FHA is not prohibited from insuring mortgages originated as part of a governmental entities DPA programs when the entity directly provides funds toward the required Minimum Cash Investment. This interpretive rule placed no restrictions on how governmental entities acquired the funds used for their respective DPA programs. In fact, the interpretive rule specifically mentioned and recognized various ways governmental entities currently raise funds for their respective DPA programs – such as public funds, tax revenue, taxable and tax exempt general obligation bonds, and housing bonds. Further, the interpretive rule did not prohibit nor preclude governmental entities from raising funds through other means such as the sale of mortgages on the secondary market.

Subsequent to the interpretive rule, FHA issued Mortgagee Letter 2013-14, which provided additional guidance to mortgagees on how to document the funds used for DPA provided as well as guidance on secondary financing by a Federal, State, or local governments or their agencies or

instrumentalities. This Mortgagee Letter did not place any restrictions or prohibitions on how a governmental entity could raise funds to fund its DPA program.

FHA's determination not to place restrictions or prohibitions on how a governmental entity raises funds to support its DPA programs through either the Interpretive Rule or the Mortgagee Letter is in keeping with FHA's previous guidance. FHA's Handbook 4155.1.5. B.4.b concerning the source of funds for a gift specifically states that "FHA is not concerned with how a donor obtains gift funds, provided that the funds are not derived in any manner from a party to the sales transaction." Further, as the Interpretive Rule and the Mortgagee Letter are the later enacted, they supersede any previous guidance that arguably may conflict. FHA does not place restrictions or prohibitions on how a governmental entity elects to raise funds to support its DPA program and governmental entities may directly provide funds for a borrower's Minimum Cash Investment.

#### Premium Pricing

Section 203(b)(5) of the National Housing Act provides that the interest rate on an FHA insured mortgage is to be agreed upon by the borrower and the lender. Regulation 24 C.F.R. §203.20 similarly provides that the borrower and the lender are to agree upon the mortgage interest rate. FHA does not regulate interest rates and cannot regulate interest rates.

FHA's current guidance does not prohibit premium pricing. FHA guidance does, however, restrict how a credit to the borrower, as a result of premium pricing, may be used. FHA permits the credit to be applied towards a borrower's closing costs or other prepaid items, but does not permit the credit to be used towards the borrower's downpayment. If the resulting credit exceeds the amount of actual closing costs or prepaid items, HUD requires the lender to reduce the principal balance of the mortgage.

There is no violation of FHA restrictions on premium pricing where the rates agreed upon by borrower and lender are generally the rates available to homebuyers participating in DPA programs. Similarly, there is also no violation of FHA restrictions on premium pricing where any apparent increased interest rate did not result in a corresponding credit to the borrower.

#### NOVA Audit

Based on the above legal analysis, we do not see any basis to challenge the legality of NOVA's DPA programs. Because the practices engaged in by NOVA do not represent premium pricing as defined by FHA requirements, and because FHA does not restrict the source of the funds used for the DPA provided by governmental entities, we cannot support the OIG's conclusion that NOVA violated FHA requirements concerning premium pricing or the provision of gifts. Please let me know if you have any further questions concerning this matter.

**DECLARATION OF SERVICE**

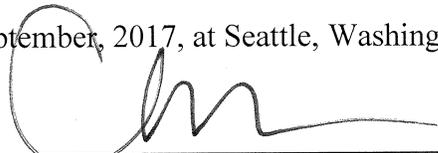
The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on September 22, 2017, I caused to be served a true and correct copy of the foregoing document upon counsel of record, at the address stated below, via the method of service indicated:

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dawn.taylor@pacificalawgroup.com (asst.)		
<i>Attorneys for Respondent</i>		

DATED this 22nd day of September, 2017, at Seattle, Washington.

  
\_\_\_\_\_  
Thao Do, *Legal Assistant*

**MCNAUL EBEL NAWROT & HELGREN PLLC**

**September 22, 2017 - 3:33 PM**

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