

No. 96063-1

No. 76510-8-I

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

NATIONAL HOMEBUYERS FUND, INC., et al.,

Appellants,

v.

WASHINGTON STATE HOUSING FINANCE COMMISSION,

Respondent.

BRIEF OF RESPONDENT
WASHINGTON STATE HOUSING FINANCE COMMISSION

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I. INTRODUCTION

Under the federal government's mortgage insurance program, mortgages to low-income borrowers are guaranteed against risk of loss, but the loans must be made on qualifying terms. Normally, that includes a minimum financial contribution from the borrower. Authorized state and local government entities, however, are permitted to fund the borrower's down-payment, because of their accountability to citizens and track record of providing supportive services for such borrowers. Respondent, the Washington State Housing Finance Commission (the "Commission"), is one such entity authorized in Washington. Due to prior abuses leading up to the 2008 financial crisis, non-profit corporations are no longer qualified to provide the same assistance under the federal program.

Since 2014, respondent National Homebuyers Fund, Inc., a California nonprofit corporation known as NHF,¹ has been posing as a government agency in Washington to offer federally insured mortgage loans with down-payment assistance for low-income borrowers. NHF bundles and sells these federally insured mortgages for profit, and then uses the money to fund unrelated lobbying efforts in California. But NHF

¹ In its opening brief, NHF refers to itself as "Homebuyers Fund," *see* Op. Br. at 1, but it no longer goes by that name, *see* CP 530, 544, 549 (reflecting formal name change). Instead, it has been referred to as "NHF" in its marketing materials, by its own officers and employees, in its communications with third parties, and throughout the record and prior briefing in this case. *See, e.g.*, CP 436 ("Q. Let's talk about NHF. Is it okay to use NHF? A. Yes. That's what we use as well."); *see also* CP 562, 585, 612, 630, 743. To avoid any confusion, this brief will refer to Appellant as NHF.

lacks the authority under either Washington or California law needed to originate these kinds of mortgages in Washington.

Moreover, NHF's suggestion that it is merely a non-profit corporation operating in a proprietary capacity is disingenuous and contradicted by the record. NHF has specifically and consistently asserted governmental authority to originate federally insured mortgages with down-payment assistance in this state, as it must. As the only entity in Washington that has been delegated government authority for that purpose statewide, the Commission has standing to challenge, in state court, NHF's unlawful invocation of such authority. The trial court was correct to declare that NHF's activities in Washington are prohibited by law. The Commission respectfully requests that this Court affirm that judgment.

II. STATEMENT OF THE CASE

A. The Federal Mortgage Insurance Program.

Ever since the Great Depression, the federal government has operated a number of programs in cooperation with state and local governments to improve housing conditions across the country. These programs range from public housing to community development grants. *See* 42 U.S.C. §§ 1437g, 5301. A key theme across these programs is the cooperative and active involvement of state and local governments, with a federal goal of vesting "maximum . . . responsibility and flexibility" in

state and local agencies while maintaining “appropriate accountability” to the public. 42 U.S.C. § 1437; *see, e.g., Resident Action Council v. Seattle Housing Auth.*, 177 Wn.2d 417, 429, 327 P.3d 600 (2013) (discussing “established framework of federal and state cooperation” in implementing housing programs).

This case concerns one particular federal housing program operated within that established framework: the mortgage insurance program. The program was created in the 1930s to address a failing housing industry, difficult mortgage market, and a lack of adequate homeownership among citizens. *See* HUD, *The Federal Housing Administration (FHA)*, HUD.GOV (2017).² Under the program, a part of the United States Department of Housing and Urban Development (“HUD”) known as the Federal Housing Administration (“FHA”) “provides mortgage insurance on loans made by FHA-approved lenders throughout the United States” *Id.*

Lenders provided with federal mortgage insurance are afforded “protection against losses” and thus “bear less risk,” but the “[l]oans must meet certain requirements established by FHA” *Id.*; *see also* 12 U.S.C. § 1709. One such requirement is that the homebuyer must pay a

² Available at https://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/fhahistory (last visited July 24, 2017).

moderate down-payment of at least 3.5 percent at the time of purchase. *See* 12 U.S.C. § 1709(b)(9)(A). This decreases the risk of default and promotes responsible lending.

To prevent circumvention of the down-payment requirement, restrictions are also placed on the financial assistance a borrower may receive in relation to the loan transaction. For one thing, a “person or entity that financially benefits from the transaction” is not allowed to fund any portion of the borrower’s required down-payment. 12 U.S.C. § 1709(b)(9)(C). More broadly, gifts of down-payment funds to the borrower are generally prohibited except from a specified list of acceptable sources. *See* HUD Handbook 4000.1 at 230 (2016) (“Handbook”).

Importantly, these restrictions on financial assistance do not apply to state or local government programs. State or local governments are allowed to subsidize the required portion of a borrower’s down-payment even as a financially interested party. *See FHA: Proh’d Sources of Min. Cash Inv. Under NHA—Interp. Rule*, 77 Fed. Reg. 72219 (Dec. 5, 2012) (“FHA Rule”); Handbook at 225-26. State and local governments are allowed this special privilege in large part because they have a track record of providing “various services to assist citizens within their jurisdictions in attaining affordable housing options.” FHA Rule, 77 Fed.

Reg. at 72220. Some nonprofit organizations were once allowed to provide such assistance, but it was eventually discovered that prior to the economic collapse of 2008, several nonprofits had been subsidizing down-payments in exchange for fee payments from sellers, artificially inflating prices and increasing default risk on the underlying loans. *Id.* at 72220-22. As a result, nonprofits are no longer afforded this special treatment.

HUD's handbook also lists government housing programs as acceptable sources for gifts of down-payment funds, along with family members, charitable organizations, and other specified parties. *See* Handbook at 230. HUD's prior guidance on this issue confirms that the list is exclusive. *See* HUD Mortgagee Letter 06-13 (May 25, 2006).

B. The Commission Operates as an Authorized State Government Entity in the Mortgage Insurance Program.

The Commission is a "public body" and "instrumentality of the state exercising essential government functions" in Washington. RCW 43.180.040(1). The Commission was created to assist in "making affordable and decent housing available throughout the state" thus contributing to the "general welfare" RCW 43.180.010. One of the Commission's primary purposes is to address problems in the mortgage market "that the private sector [cannot] correct," including common "high interest rates" that many citizens cannot afford. *Wash. State Housing Fin.*

Comm'n v. O'Brien, 100 Wn.2d 491, 496, 671 P.2d 247 (1983). The Commission thus focuses its efforts on special populations in need of governmental assistance, such as first-time low-income, disabled, and veteran borrowers. *See, e.g.*, CP 376-66.

The Commission is further authorized to “[p]articipate fully in federal . . . governmental programs . . . to secure to itself and the people of the state the benefits of those programs” RCW 43.180.050(1)(e); *see also* RCW 43.180.010 (authorizing the Commission to “participate in federal . . . housing programs” as part of “a recognized governmental function”). The Commission is thus an authorized government entity in Washington for the purpose of federal housing programs, including the mortgage insurance program.

One of the most important ways the Commission assists Washington residents with home financing is through its down-payment assistance programs. The Commission is specifically authorized to “[m]ake loans for down payment assistance to home buyers in conjunction with other commission programs.” RCW 43.180.050(1)(d).

As an authorized state entity, the Commission offers numerous specially tailored programs that help with the down-payment and closing costs of a home purchase in conjunction with federal mortgage insurance. *See, e.g.*, CP 376-77. These programs offer no-interest or low-interest

loans to eligible borrowers, with payment completely deferred until the primary mortgage is paid off or the home is sold or refinanced. CP 386-87. These secondary loans cover the borrower's minimum down-payment at the time of purchase. CP 384. The programs also include prescreening, borrower education and counseling, and caps on lender fees, among other services. *See* CP 374-75, 378-81. The benefit of these types of support services is part of HUD's rationale for allowing government entities to provide down-payment assistance as financially interested parties. FHA Rule, 77 Fed. Reg. at 72220.

The Commission is self-funded, designed and required to generate its revenues through its housing programs and bond issuances in order to fulfill its mission, rather than relying on state appropriations or state debt. *See* CP 407-08; RCW 43.180.010 (purpose of Commission is to "help provide housing throughout the state," through "housing programs" and issuance of "nonrecourse revenue bonds," without "using public funds or lending the credit of the state"). From its down-payment assistance program, the Commission generates revenues from the sale of the underlying primary mortgage loans as securities. *See* CP 404-06. Participating lenders originate the loans in conformance with program requirements; the loans are then delivered to the Commission through its service providers; the primary loans are pooled and sold as securities; and

all the loans are monitored and administered over time. *See* CP 382-85, 404-06, 412-14. The Commission recycles all the revenues generated from these efforts to support its programs, including the provision of new loans, additional down-payment assistance, homebuyer education for Washington households, and other Washington-based services. *See* CP 402-03, 409-11.

C. NHF Was Created to Offer Mortgage Financing Nationwide.

The Appellants in this case are overlapping instrumentalities of several rural counties in California that joined forces to promote their collective interests. In the 1950s, the counties created Appellant Rural County Representatives of California (“RCRC”), a nonprofit corporation that lobbies and otherwise advocates on behalf of its member counties. *See* CP 423-25. RCRC lobbies on issues of “unique” interest to the counties. CP 423. In 1993, the counties created Appellant Golden State Finance Authority (“GSFA”), a joint powers authority offering mortgage financing, including down-payment assistance for borrowers obtaining federally insured mortgages in California. CP 434-35, 480-81. GSFA’s operations have always been limited to California, based on the understanding that it has no authority to operate beyond the territorial limits of its underlying counties. CP 435-36, 480-81.

In 2002, the counties—acting through RCRC and GSFA—created NHF. CP 480-81, 541; *see also* CP 530-39. The purpose was to offer the same down-payment assistance products as GSFA, but in areas where GSFA itself could not operate. CP 443-47, 480-81. NHF was created as a nonprofit corporation, with the board members and officers of RCRC and GSFA designated the directors and officers of NHF. CP 530, 532, 535-36. NHF’s bylaws provide that any “excess revenues” NHF generates must be transferred to RCRC, and all of NHF’s assets inure to RCRC if NHF dissolves. CP 530, 544, 546. In 2003, NHF’s board of directors formally authorized the corporation to “do business in additional states to California,” including “Washington,” because the board deemed it to be “in the best interest of NHF” to do so. CP 549.

D. HUD Officials Rejected NHF’s Proposal to Operate Nationwide.

When NHF was created, it understood that in order to conduct its particular down-payment assistance operations nationwide, it would need to obtain approval from HUD or to partner with government entities in other states. CP 553. NHF hired a lobbyist to convince HUD to provide such approval, and sent multiple letters in 2002 and 2003 asking HUD to approve NHF’s activities nationwide as an instrumentality of government. *See* CP 442, 560-578.

As part of this effort to obtain approval, NHF made a proposal to HUD that would “require[] instrumentalities of government to maintain a primary focus on their own jurisdiction, with additional governmental control to ensure accountability.” CP 569. An entity like NHF seeking to operate outside its own jurisdiction would need to “honor any request from any governmental entity” in that jurisdiction to discontinue its operations there. CP 568. In the words of NHF’s president, the idea was to assure HUD that NHF would not “just . . . go crazy” in the absence of political accountability or oversight. CP 472-73.

In response, HUD sent a letter to NHF questioning whether HUD even had “the authority to allow NHF to do business outside the physical jurisdiction of the Governmental entities that created NHF” and indicating that it was conducting further research. CP 580. Ultimately, HUD did not agree to NHF’s proposal. CP 471.

In 2007, NHF made another attempt to obtain HUD’s approval for going national. *See* CP 581-602. NHF assured HUD that it is “a nonprofit with nationwide jurisdiction.” CP 589. Once again, HUD rejected NHF’s plan. HUD insisted it could not approve of NHF conducting business outside California and suggested that NHF try to partner with the housing finance agencies in each state. *See* CP 592, 594-95. NHF then reported back to HUD that it had “tabled” its effort to expand nationwide. CP 597.

In 2009, NHF again raised the possibility of expanding nationally with HUD. As reported by NHF's vice president to his colleagues at NHF, HUD responded by insisting that "the jurisdiction limitation absolutely stands." CP 514-15, 600.

E. NHF Expanded Covertly and Falsely Claimed Governmental Authority in Washington.

NHF came to realize that HUD has no procedures in place to adjudicate disputes over the allocation of governmental authority, which is a state law issue. CP 1425-27, 1431-34 ("Q. But in terms of [operating] outside the jurisdictional boundary of California? That's what you were asking for? A. At the time, we thought HUD actually gave approval for that But as I said, HUD doesn't have that in their procedure."). With this in mind, NHF determined to assert governmental authority to operate in other states without approval or oversight from HUD, while still obtaining federal insurance for its mortgages.

In particular, NHF learned that entities providing down-payment assistance through gifts, as opposed to secondary loans, do not need to be preapproved and placed on a HUD roster. *See* CP 437-38, 619, 626-27. When establishing this policy back in 2000, HUD made clear that "[m]ortgage lenders are responsible for assuring that the gift to the homebuyer" meets applicable legal requirements. HUD Mortgagee Letter

00-8 at 5 (Mar. 3, 2000). HUD further emphasized that approval letters for secondary financing are “not to be construed as approval of . . . [an] agency’s downpayment assistance gift programs.” *Id.* at 6. Instead, lenders are responsible to ensure full legal compliance whenever a gift is provided. *See also* HUD Mortgagee Letter 13-14 (May 3, 2013). Up to this point, NHF had offered only secondary loans and touted them as superior to gifts as a matter of policy. *See* CP 575. Now, NHF perceived that offering gifts would promote its own interests in avoiding HUD’s oversight.³

NHF proceeded with its plan for nationwide expansion, this time without asking questions or otherwise approaching HUD. *See* CP 486, 521-22. In 2014, NHF began offering down-payment assistance in a number of states outside California, including Washington. *See* CP 486-87, 496. This assistance was in the form of a gift, or what NHF called a

³ In 2012, HUD announced that entities exempted from federal taxation under § 115 of the Internal Revenue Code—an entity performing an essential governmental function and generating all of its revenues for a government—would be considered instrumentalities of government for purposes of providing secondary loans, without needing to obtain HUD’s formal preapproval and placement on a HUD roster. CP 605-06. This announcement did not purport to authorize such an entity to operate in a governmental capacity outside the jurisdiction of the underlying state or local government. *See id.* But it did suggest an initial way NHF might be able to avoid HUD’s oversight. In response, NHF’s vice president suggested to a lender interested in using NHF’s program in Texas that NHF would begin operating there. *See* CP 604 (“[NHF] is a Section 115 Instrumentality of Gvt. This means [NHF] in Texas”); *see also* CP 485, 518-20. The vice president clarified that he would be “looking into this a little more (without asking questions...).” CP 604. The issue ultimately became moot because NHF shifted to gifts instead of secondary loans.

“grant,” which covered the borrower’s minimum down-payment. *See* CP 485-87, 630.

NHF’s grant program relies on participating lenders to originate primary mortgage loans, obtain federal insurance for those loans, and then sell the loans to NHF’s servicer, the entity that will collect payments for the life of the loan. CP 453-54, 502-07, 516-17. Upon sale to the servicer, NHF reimburses the lender for all down-payment assistance funds used to complete the underlying mortgage transaction. CP 455-56, 516. The servicer then pools and sells the loans as securities to NHF, which in turn sells those securities for a profit on the open market. CP 453-54, 502-07, 516-17.

When lenders originally indicated on HUD forms that the down-payment assistance NHF provided came from a nonprofit, the mortgage loans were not approved for federal insurance. CP 613-18. Without federal insurance backing, NHF could not bundle and sell the mortgages for a substantial profit. *See* CP 469, 499-501, 510, 523. NHF began telling lenders to indicate that its funds come from an instrumentality of government. *See* CP 613-18.

To maintain the appearance of being governmental, NHF also actively marketed itself as governmental. NHF’s fliers announce that it is offering a “down payment assistance grant” as an “instrumentality of

government.” CP 630. As a result, lenders are more likely to trust NHF’s program and to report its funds as governmental, so that HUD approves without incident. *See* CP 613-18. Borrowers are also more likely to trust and participate in what appears to be a “government grant” program. *See* CP 1410-11, 1422.

NHF has gone further in hiding the details of its status and program from inquiring lenders and borrowers. As but one of numerous examples in the record of such an exchange:

Lender: “My specific question is what are your sources for the funds that you use for your downpayment programs?”

NHF Administrator: “NHF generates and uses its own funds for the program. . . . NHF is an instrumentality of government. If you have any other questions please let us know.”

Lender: “You say that NHF is an instrumentality of government – what government agency specifically? From where do you generate your ‘own funds’?”

NHF Administrator: “We are defined by IRS codes as an instrumentality of government, not part of any specific government agency (we are not a non-profit). NHF conducts various business ventures Our income is what is used to fund the programs. I hope that helps.”

CP 1439-41; *see also* CP 647, 650, 653-54, 1414-1418.

F. NHF's Program Is Designed to Maximize Revenues for Lobbying at the Expense of Borrowers.

NHF's program is designed solely to generate revenues. NHF's leadership and staff have backgrounds in finance and economics, not housing. *See* CP 1385-86, 1408-09. When NHF entered Washington, it made no effort to analyze the housing needs of this state. *See* CP 1375-76. Instead, it opted to minimize its involvement with borrowers and provides no supportive services for them. *See* CP 510-11, 1375, 1381-82. When asked whether or not the borrowers in its program are "savvy about . . . how the mortgage market works," NHF responded that it "wouldn't begin to address that" and "can't speak for those folks." CP 1381-82.

By design, NHF's program charges higher interest rates and fees on borrowers to generate profit. A higher rate means greater monthly payments for the life of the loan, which increases the value of NHF's securities. *See* CP 1321-22. More fees means lenders have an incentive to refer borrowers to NHF's program regardless of terms. CP 1326. It also means higher out-of-pocket expenses for borrowers at loan closing. CP 1317-19. Affordability—including out-of-pocket expense and amount of monthly payment—is of prime importance to most borrowers. *See* CP 1328-29. But borrowers have trouble evaluating or negotiating those aspects of the mortgage transaction. *See, e.g.,* Susan E. Woodward &

Robert E. Hall, *Consumer Confusion in the Mortgage Market*, 100 AM. ECON. REV. 511, 513 (2010); Fin. Crisis Inquiry Comm'n, THE FINANCIAL CRISIS INQUIRY REPORT 90-91 (2011) ("FCIR"). As a result, borrowers tend not to shop around and are subject to exploitation. *See, e.g.*, FCIR at 90-91.

NHF has actively concealed from lenders and borrowers that its "grant" program is intended to enrich NHF. Early on, NHF's program administrator asked management whether he should reveal the actual source of NHF's "grant" funds, i.e., that they are generated by setting higher interest rates on the underlying mortgage loans, so-called premium pricing:

I wasn't sure exactly how much we should be telling people who ask. I tried our normal [responses] . . . but she didn't like that. . . . I wasn't sure if you wanted us to tell lenders that we have a version of premium pricing, where we sell [] our loans on the market and receive compensation [] on each transaction that covers the grant and our operation cost.

CP 1443-46. In response, management clarified that "all lenders need to know is that funds will not run out and grants are provided by NHF funds." CP 1443. In short, management directed the administrator to hide that NHF's "gift" comes at a price. Thus, he has never disclosed NHF's "premium pricing" model to any inquirers. CP 1419. Instead, the administrator uses vague "preformed answers," and rephrases those

answers when pressed for more detail. CP -1416-1419; *see also, e.g.*, CP 647, 654.⁴

In 2014 and 2015, NHF sold thousands of loans originated in Washington, amounting to \$688,030,901 in total loan values, and millions of dollars in NHF revenues. CP 633. Washington has been “one of the higher volume states” for NHF’s operations. CP 698.

The profits that NHF generates in Washington are diverted to California for RCRC’s use and benefit. In its brief, NHF states that after providing its grants, covering its “costs,” and meeting “other obligations,” all “remaining revenue”—approximately 75 percent of its total revenue—is used to fund additional mortgages. Op. Br. at 6 n.3. But NHF fails to acknowledge that its costs and obligations include funneling substantial sums of money to RCRC.

As to program costs, NHF has no employees of its own and instead pays a service contract fee to RCRC to run NHF’s program, which

⁴ NHF insists it offers a “better deal” because the Commission’s contractor allegedly said so in an email. *See* Op. Br. at 9-10. But in that email, the contractor was speculating as to why “Guild,” a lender, might “switch” to NHF. CP 856. One reason he identified was that NHF offers a “gift not a second,” *id.*, consistent with his testimony that gifts involve less paperwork for lenders, *see* CP 1452-53. The email was written in March of 2014, when he had just learned about NHF’s entry into Washington. *See* CP 1449. At that time, he was commenting to coworkers in passing, “before NHF even did any production in the state” and before he had “any numbers” with which to evaluate its program in detail. CP 1454-57. As his email reflects, the contractor thought NHF would offer the “same ra[t]e” as the Commission—which is incorrect—and he did not take fees into account. CP 856. Elsewhere, the record indisputably establishes that NHF’s rates are consistently and substantially higher than the Commission’s. CP 389.

includes a 75 percent mark-up for RCRC. *See* CP 432-34, 436, 459-66, 692-95, 1511. And NHF's primary obligation, established in its bylaws, is to transfer any "excess revenues" beyond "the corporation's business operating needs" to RCRC "not less frequently than [on] an annual basis." CP 544. In other words, to whatever extent NHF recycles a portion of its revenues into additional mortgages, it does so only to obtain additional profits for RCRC.

During 2016 alone, NHF planned to transfer \$2,413,200 in service payments and \$3,056,000 in excess revenues (a "conservative" number intended to allow for NHF's continued growth) to RCRC. CP 704; *see also* CP 457-58. This represents over half of RCRC's budget—in stark contrast to member dues, which now represent only three percent. *See* CP 425-26, 458-59.

RCRC spends the funds it receives from NHF's program on local lobbying efforts and large officer salaries in California. RCRC is "a member services advocacy organization" with "five registered lobbyists on staff." CP 423. These lobbyists advocate on behalf of the member counties on "issues that are unique to smaller rural counties," and thus of special interest to the members. *Id.* RCRC also pays substantial salaries to its officers (who are also the officers of NHF), such as the president's salary of well over \$300,000 per year. *See* CP 427-29, 671-72. This was

supplemented with a bonus in 2014—the same year NHF substantially expanded its operations beyond California. *See* CP 429-30.

G. This Lawsuit.

After NHF began operating in Washington, the Commission began to receive inquiries from lenders who thought NHF was a Commission program. CP 388-89, 415. Other lenders contacted the Commission after being misled into believing NHF was a partner of the Commission. *Id.* It quickly became obvious to the Commission that NHF was pretending to be a government program and unlawfully undermining state policy. CP 1352-53.

As NHF notes, there are other providers of down-payment assistance in this state. *See* Op. Br. at 8-9, 17; CP 1336-38, 1359-6. The Commission has welcomed and sometimes even partnered with such providers. *See* CP 1336-39, 1359-60. Unlike any of those other providers, however, NHF was pretending to be a governmental program without the necessary authority. CP 1352-53. The Commission ultimately filed this lawsuit on May 21, 2015. CP 1.

In its Complaint, the Commission alleged that NHF was unlawfully invoking governmental authority in this state, and in doing so, interfering with the Commission's mission and programs. CP 1-2, 8-9. The Commission requested a declaration that NHF's activities in this state

are prohibited by law. CP 10-11. In response, NHF moved to dismiss the Complaint for failure to state a claim. CP 15-43. After hearing oral argument, the trial court denied the motion. CP 99-100

The parties proceeded to file cross-motions for summary judgment. CP 330-58, 733-86. After another hearing with oral argument, the trial court denied NHF's motion, finding that the Commission has standing to pursue its claim against NHF. CP 1254. The court denied the Commission's motion "in part," finding that "genuine issues of material fact" remained that precluded summary judgment. CP 1255.

The Commission moved for reconsideration, pointing out that all facts relevant to the Commission's claim were uncontroverted. CP 1258-62. This included that NHF is funding mandatory down-payments for federally insured mortgages at a profit, marketing and presenting itself as governmental to borrowers and lenders, and telling lenders to report its down-payment funds to HUD as governmental. CP 1258. These facts were proved using NHF's own testimony and documentation, and were undisputed in the parties' briefing. CP 1259. The trial court ordered responsive briefing on the reconsideration motion, CP 1265, ultimately agreed that no material factual disputes remained, and declared that NHF's housing activities in Washington are prohibited by law, CP 1287.

This appeal followed.

III. ARGUMENT

A. **NHF Lacks the Governmental Authority Necessary to Conduct Its Operations in Washington.**

NHF's participation in the federal mortgage insurance program in Washington depends on its status as a qualified government agency or instrumentality. A government agency or instrumentality that benefits financially from the underlying loan transaction can provide down-payment assistance and qualify the loan for federal insurance. A non-profit or private/proprietary entity that benefits from the underlying loan transaction cannot provide such assistance.

NHF argues, however, that it can offer its down payment assistance program in Washington as a non-profit or alternatively because it is acting in a proprietary capacity. But because NHF financially benefits from its down-payment assistance program, it cannot qualify for federal mortgage insurance as a non-profit or an entity (governmental or otherwise) operating in a proprietary capacity. NHF cannot argue on one hand that it is a government instrumentality in Washington—so that its down-payment assistance program qualifies for the mortgage insurance program—while arguing on the other that it is operating in Washington only in a non-profit or proprietary capacity. NHF knows this. In its briefing below, NHF admitted that it is relying “on its status as a governmental or public entity” in order to provide “assistance on FHA-

insured loans” in Washington. CP 776. Yet as demonstrated below, NHF does not have authority under Washington *or* California law to operate as a government agency or instrumentality providing down payment assistance for federally insured loans in Washington. Accordingly, NHF’s operations in this state are prohibited by law.

1. NHF Needs Governmental Authority to Fund Down-Payments as an Interested Party.

As a financially interested party, NHF requires governmental authority to fund the minimum down-payments on federally insured mortgage loans in this state. As noted above, one of the qualification requirements for federal mortgage insurance is that the homebuyer pay a down-payment of at least 3.5 percent at the time of purchase. *See* 12 U.S.C. § 1709(b)(9)(A). Federal law further provides that an “entity that financially benefits from the transaction” is not allowed to subsidize any portion of the required down-payment. *See* 12 U.S.C. § 1709(b)(9)(C).

An exception to this restriction exists for state or local government programs. In 2012, HUD issued its interpretive rule regarding the application of 12 U.S.C. § 1709(b)(9)(A) and (C) to governmental down-payment assistance. FHA Rule, 77 Fed. Reg. 72219. HUD noted that “[g]overnments—Federal, State, and local—and their agencies and instrumentalities have provided assistance toward the minimum [down-

payment] as part of homeownership programs from various public funds” Typically these public funds were appropriated for “specified public purposes.” 77 Fed. Reg. 72219, 72220. HUD further observed that “[a]nother key source of homeownership assistance programs . . . is provided by State and local governments, primarily through housing finance agencies (HFAs).” *Id.* The Commission is such an HFA. HUD lauded such state entities for providing “various services to assist citizens *within their jurisdictions* in attaining affordable housing options.” *Id.* (emphasis added).

Looking at the history of the restriction on down-payment assistance from financially interested parties, HUD recounted that nonprofit organizations were once allowed to provide such expanded assistance, but several had been subsidizing down-payments in exchange for fee payments from sellers, artificially inflating prices and default risk. *Id.* at 72220-22. These actions by non-profits lead to the broad prohibition against entities that financially benefit from the underlying loan transaction providing down-payment assistance.

HUD’s interpretive rule recognized the distinct role and benefit of government housing assistance to low-income purchasers, and that the revenues governments generate from loan transactions are devoted to assisting the very borrowers at issue, to whom they are politically

accountable, minimizing the potential for harm or abuse. In contrast, nonprofits are unaccountable to borrowers, often generate revenues for unrelated purposes, and at times have demonstrated a propensity for abusive or fraudulent conduct in this space. *See id.* at 72220-22.

In issuing its interpretation, HUD made clear that only true government entities qualify to provide down-payment assistance as financially interested parties. Specifically, HUD adopted the following definition of a government agency or instrumentality for this purpose:

the entity must have been established by a governmental body or with governmental approval or under special law to serve a particular public purpose or designated as an instrumentality by law (statute or court opinion) and the majority of governing board and/or principal officers named or approved by governmental body/officials, or the government body approves all major decisions and/or expenditures, or the government body provides funds through direct appropriations/grants/loans, with related controls applicable to all activities of entity.

Id. at 72222 n. 25. It is not clear that NHF could meet this definition of a government entity even in California. But it is clear that HUD was authorizing only government entities acting in a governmental capacity to provide down-payment assistance as financially interested parties. As HUD concluded in its rule:

Accordingly, HUD interprets NHA section 203(b)(9)'s "prohibited sources" provision in subsection (C) as not including funds provided directly by Federal, State, or local

governments, or their agencies and instrumentalities in connection with their respective homeownership programs.

Id. at 72223; *see also* Handbook at 226, 300-01 (confirming government entities may provide such assistance only “when acting *in their governmental capacity*” (emphasis added)).

NHF may argue that it does not “financially benefit” from its down-payment assistance program. But that argument is contrary to the record and the admissions of NHF. NHF admitted under oath that it “financially benefits from the underlying loan transaction” for each home purchase it subsidizes. CP 1377-1380 (“Yes, [NHF] would have to. If it didn’t, it would not be able to continue to do the services it does.”). NHF sets the loan terms, including the interest rate. *See* CP 713, 715. The “grant” acts as an incentive for the borrower to sign the loan. *See* CP 719. The lender then delivers the loan to NHF. *See* CP 453-54. NHF then sells the loan, bundled with other loans, as a mortgage-backed security. *See id.* NHF pre-sells each security (through a “forward contract”), so it knows what rate lenders must charge for NHF to make its profit. *See id.* All of NHF’s profits flow directly from the underlying home sale and the lender’s delivery of the mortgage to NHF. *See id.* As noted above, millions of dollars of NHF profits and highly marked-up administrative fees then go to RCRC. *See supra*, at 17-18. NHF cannot credibly argue

that it does not “financially benefit” from its down-payment assistance program in Washington.

In any case, NHF needs governmental authority to provide its down-payment gifts regardless of whether it benefits. HUD has clarified that such gifts “may be provided by” sources listed in its Handbook, including charitable organizations and government agencies. Handbook at 230. HUD’s prior guidance confirms that the list is exhaustive. *See* HUD Mortgagee Letter 06-13 (May 25, 2006). Indeed, it would make little sense to list charitable organizations if *any* organization could provide such gifts. NHF does not qualify as a charitable organization, given that it raises funds for lobbying. NHF can offer its gifts to Washington borrowers only if it has governmental authority to do so.

2. Washington Has Authorized the Commission and Local Authorities, not NHF, to Exercise Governmental Authority in the Federal Mortgage Insurance Program in Washington.

As explained above, the provision of governmental housing assistance, including mortgage financing, takes place in Washington and other states “within an established framework of federal and state cooperation.” *Resident Action Council*, 177 Wn.2d at 429 (discussing local housing authorities). In such a framework of “cooperative federalism,” the federal government offers states a special role within its

programs, and each state may designate the “authorized” entities that will participate on its behalf, “subject to [] federal regulations.” *Id.* at 429-30. Any such entity “remains subject to state law,” however, which “establishes [the entity] in the first place, defines [its] powers and obligations, and addresses various ancillary matters related to [its] operation.” *Id.* at 430.

Within this framework, Washington has delegated governmental authority to the Commission for purposes of the mortgage insurance program. *See* RCW 43.180.010, .050. Specifically, the Washington Legislature has authorized the Commission to provide its governmental homeownership financing services statewide in conjunction with federal programs. *See* RCW 43.180.050. The Legislature also authorized the Commission to coordinate with local authorities to the extent such local authorities are authorized to provide such services within their particular territories. *See* RCW 43.180.010(4). In contrast, NHF has no such authority in this state. NHF does not and cannot point to any authorization from the Washington Legislature for it or any other non-Washington entity—governmental, non-profit or otherwise—to provide down payment assistance in a governmental capacity as part of the federal mortgage insurance program in Washington.

In Washington, there is a strong presumption against duplication of government functions without express authorization, especially when “revenue is derived from the performance of services” and duplication “could result in a serious impairment of the ‘raided’ [governmental entity’s] financial position.” *Alderwood Water Dist. v. Pope & Talbot, Inc.*, 62 Wn.2d 319, 322, 382 P.2d 639 (1963); *see also Skagit Cnty. Pub. Hosp. Dist. No. 304 v. Skagit Cnty. Pub. Hosp. Dist. No. 1*, 177 Wn.2d 718, 723-27, 730-31, 305 P.3d 1079 (2013). These cases, in conjunction with the power granted to the Commission and local authorities to provide mortgage financing within federal programs, demonstrate that NHF is *not* authorized to assert status as a government entity to provide duplicative services in Washington.

NHF seeks to distinguish *Alderwood* and *Skagit County* on the basis that providing down-payment assistance is not an exclusive government function. But neither case involved an exclusive power. The two “functions” involved in *Alderwood* and *Skagit County* were providing water and operating hospitals, which private companies can do. The point of both cases was that where a particular government function—such as running a public water utility or public hospital—is legislatively delegated to specific government entities, other entities not authorized by the Legislature cannot perform the same government function. Here, the

Commission is the only statewide government entity legislatively authorized to provide down-payment assistance within the federal mortgage insurance program. NHF is prohibited from engaging in governmental competition within the Commission's territory.

NHF now suggests that it is not operating in a government capacity, *see* Op. Br. at 33-36, but the Court should be especially wary of NHF's representations on this point. The record shows that NHF describes its legal status in whatever way serves its interests at any given time. At the very same time NHF was telling the trial court that it operates merely as a nonprofit, *see, e.g.*, CP 94-95, its program administrator was telling lenders that NHF is "*not* a non-profit," but "a government entity [providing] grants," CP 653-54 (emphasis added). Beforehand, NHF's vice president had directed the removal of the designation "non-profit public benefit corporation" from NHF's website, leaving only "instrumentality of government" for lenders and borrowers to see. CP 656. When asked internally whether the change should be made "[a]cross all communication channels," the vice president's response summed up NHF's unprincipled approach to its status and authority: "Yes. I may ask you to change it back next month.. :)" *Id.* As but one of many more examples, in its answer to the complaint NHF denied that it has ever "directly reported to HUD that it is an instrumentality of government," CP

105, but documents produced in discovery then proved the opposite, *see* CP 597-98, 659.⁵

From the beginning, NHF was designed to exceed the territorial limits on its underlying counties *while at the same time* invoking their governmental status to provide mortgage products restricted to governments. CP 481, 553, 647, 649. NHF's initial business plan from 2002 confirms that this design was in place from the outset:

As a nonprofit corporation, [NHF] is exempt from many of the legal and regulatory restrictions imposed on government agencies such as [GSFA], yet because of its association with the RCRC and [GSFA], [NHF] may still qualify as an “instrumentality of government” . . . [which] would allow [NHF] to [] provide second loan financing with FHA loans for up to 100% of the homebuyer's cash to close . . . [and] qualify as a public entity with FannieMae and FHA/HUD.

CP 553. NHF has always purported to act as a government entity in Washington in order to qualify its loans for federal insurance. Recognizing that Washington law prohibits its acting here in a governmental capacity, NHF is now trying shed its skin but to no avail.

⁵ In its brief, NHF also argues that an entity may operate in a governmental capacity in one context while acting in a proprietary capacity in another context. *See* Op. Br. at 34. This argument is irrelevant—as are the cases that NHF cites in support of it—given that there is only *one* context at issue in this case: NHF's mortgage financing operations in Washington. NHF lacks the government authority needed to conduct those operations in this state.

3. California Has Not Authorized NHF to Exercise Governmental Authority Outside California.

As explained above, Washington law determines which entities in this state may exercise governmental authority for purposes of the federal mortgage insurance program, and NHF has been delegated no such authority here. That said, even if NHF's home state of California could authorize NHF to exercise governmental authority in this state, California has done nothing of the sort. To the contrary, California law prohibits counties or their instrumentalities from exercising government authority outside of California. Accordingly, NHF is doubly prohibited from invoking any governmental authority in Washington for purposes of offering its mortgage products in this state.

To begin with, California law prohibits the counties that underlie NHF from exercising government authority to conduct mortgage financing outside of their borders. The powers of counties in California are strictly construed, including specifically with regard to the territorial limits of any power granted. *See, e.g., Tax Factors v. Marin County*, 20 Cal. App. 2d 79, 87-88, 66 P.2d 666 (1937) (noting that any "reasonable doubt concerning the existence of [a] power" is "resolved . . . against the corporation, and the power is denied"); *Harden v. Super. Ct.*, 44 Cal.2d 630, 638-42, 284 P.2d 9 (1955) (noting that "power to act outside the

boundaries of the municipality” presumptively “does not exist” unless “specifically authorized”).

The counties underlying NHF have never been granted authority to offer any housing finance services outside of California. To the contrary, the one statute in California giving counties the authority to operate homeownership financing programs presumes that any such programs will be provided only within the boundaries of each participating county. *See* CAL. HEALTH & SAFETY CODE § 52020(a)(1) (authorizing such programs, allowing lenders doing “business *in the . . . county* the opportunity to participate,” and authorizing “adjacent counties” to join forces “*within the boundaries* of any one or more of the [counties]” (emphases added)). This ensures that counties remain focused on their own communities and prevents interference with the community-based programs of other states or counties.

Because the counties underlying NHF lack government authority to operate outside of California, they cannot delegate such authority to NHF. Government entities “can only delegate as much power as they themselves are given by the Legislature.” *Cabrillo Cmty. Coll. Dist. v. California Junior Coll. Assn.*, 44 Cal. App. 3d 367, 372, 118 Cal. Rptr. 708 (1975); *see also* Letter from Julia A. Bilaver, Deputy Att’y Gen. of Cal., to Victor J. James, Acting Gen. Counsel of Cal. Housing Fin. Auth.

(June 18, 2012) (“A local housing authority which lacks legal authority to operate statewide may not delegate authority it does not have to operate statewide to a corporation or other instrumentality.”) (citing *Cabrillo*).

In *Cabrillo*, the court held that an association created by public community colleges could not impose a residency requirement that the member colleges could not impose directly. 44 Cal. App. 3d at 372. Consistent with *Cabrillo*, California’s Nonprofit Corporation Law expressly contemplates that any corporation created by an “elected legislative body” will be created “in order to exercise authority that *may lawfully be delegated* by the elected governing body to a private corporation” CAL. CORP. CODE § 5120(e) (emphasis added).

NHF does not disagree with the basic principle that governments cannot delegate more authority than they have, nor does NHF attempt to argue that it derives government authority from any other source. *See Op. Br.* at 31, 32 (stating that “there is no *delegation* of power at issue here whatsoever” and that NHF does not “derive” authority from its underlying counties (emphasis in original)). Instead, NHF argues only that this principle is inapplicable because its activities are proprietary, not governmental. As explained above, NHF’s position is disingenuous and belied by the record. And NHF’s loans cannot qualify for the federal

mortgage insurance program if made in a proprietary rather than governmental capacity.

B. NHF Also Lacks Authority to Act in a Proprietary Capacity in Washington.

NHF focuses entirely upon arguing that California law authorizes it to operate in a proprietary capacity in Washington. As argued above, and as reflected in NHF's own prior conduct, governmental authority is required for NHF to originate its loans within the federal mortgage insurance program. Regardless, NHF lacks even proprietary authority to conduct mortgage financing in Washington. That is because the counties underlying NHF cannot operate extraterritorially even in a proprietary capacity, and NHF lacks independent authority to do so. Accordingly, NHF cannot operate in Washington in any capacity.

1. The Counties Underlying NHF Are Prohibited from Offering Mortgage Financing Outside of California Even in a Proprietary Capacity.

Under California law, even proprietary municipal activities require specific, underlying authorization. *See, e.g., Calkins v. Newton*, 36 Cal. App. 2d 262, 267 (1939) (noting legislature had not “empowered” county “to engage in . . . [any] business of a proprietary nature”). Further, any proprietary activity outside the municipality must be merely incidental to an authorized service being provided to its residents. *See, e.g., Durant v. City of Beverly Hills*, 39 Cal. App. 2d 133, 136-37, 102 P.2d 759 (1940)

(noting municipality authorized to provide water can “supply water to persons outside its limits” but only “to accomplish the main purpose of supplying water to those within” (internal quotations omitted)).

Here, NHF does not argue that its underlying counties are specifically authorized to offer mortgage products in Washington. They are not. *See* CAL. HEALTH & SAFETY CODE § 52020(a)(1). Moreover, NHF’s activities do not serve the interests of the counties’ residents, and are not incidental to any such service. CP 481 (“[NHF] was incorporated specifically to go outside of California” because “lenders were keen on being able to offer those programs outside of California.”).

NHF’s cited authority is inapposite. *See* Op. Br. at 35 n.11. Those authorities stand only for the limited proposition that a government may exercise proprietary authority over real property it owns, if the government’s conduct serves municipal purposes. *See S.D. Myers, Inc. v. City & Cnty. of San Francisco*, 253 F.3d 461, 474 (9th Cir. 2001) (city may require nondiscrimination provisions in contracts related to city-owned airport outside of city boundaries, where the requirements are “supported by the [City]’s interest in protecting its own consumers”); *Air Cal, Inc. v. City & Cty. of San Francisco*, 865 F.2d 1112, 1117 (9th Cir. 1989) (noting that “a municipality’s right to acquire or own property beyond its corporate limits for legitimate municipal purposes is well-

established”). NHF fails to acknowledge the related rule that “a municipality cannot acquire extraterritorial property *except for municipal purposes . . .*” *Baker v. City of Palo Alto*, 190 Cal. App. 2d 744, 754, 12 Cal. Rptr. 425 (1961) (emphasis added).

NHF points to no authority that permits a California county to exercise proprietary authority entirely unrelated to municipal services, and the Commission is aware of none. There is no basis upon which the counties underlying NHF can conduct mortgage financing outside California in a proprietary capacity. Accordingly, the counties cannot delegate any such authority to NHF.

2. The Counties Cannot Use the Corporate Form to Overcome the Territorial Limits on Their Authority to Offer Mortgage Financing.

The thrust of NHF’s argument is that California’s Nonprofit Corporations Laws permits government entities to create a nonprofit corporation to do anything, anywhere, regardless of whether the corporation’s conduct is related to municipal purposes. *See* Op. Br. at 26. That mischaracterizes California law. As noted above, counties possess only those powers that the legislature has granted them. *Cabrillo*, 44 Cal. App. 3d at 372. Counties have not been granted the power to create a nonprofit entity to exercise powers, or to further purposes, beyond those that the legislature has authorized. *See id.* at 371-72.

The authority cited by NHF is consistent with *Cabrillo* and irrelevant to the resolution of this dispute. *See* Op. Br. at 28-30. Those cases address only whether specific constitutional or statutory provisions that limit the manner in which a government may achieve a municipal purpose should also apply to a quasi-governmental or corporate entity created to achieve the same end. *See Rider v. City of San Diego*, 18 Cal. 4th 1035, 1039, 1044-45, 1055 (1998) (holding constitutional debt limit did not apply to joint powers agency created to finance expansion of city’s convention center because provision “by its terms” does not include joint powers agencies, and “financing arrangements . . . insulate[] the City in a real economic sense from prohibited ‘indebtedness’”); *City of Cerritos v. Cerritos Taxpayers Ass’n*, 183 Cal. App. 4th 1417, 1438 (2010) (voter approval requirement did not apply to nonprofit corporation created by city to operate tax-exempt low-income housing project within city); *Yoffie v. Marin Hospital Dist.*, 193 Cal. App. 3d 743, 746 (1987) (legislature had specifically permitted local hospital districts to transfer operation and maintenance of their assets to nonprofit public benefit corporations “for the benefit of the communities served by the district” and for the express purpose of permitting local hospital districts “to remain competitive”); *City of Bakersfield v. West Park Home Owners Assoc.*, 4 Cal. App. 5th 1199, 1211-12 (2016) (declining to apply same constitutional debt

limitation at issue in *Rider* to nonprofit public benefit corporation created by city to finance road improvements, where city was not responsible for the corporation's debt).

Most significantly, none of the cited cases authorizes a government entity to evade territorial limits on its activities. None of these cases authorizes activity outside of California. None of these cases authorizes activity that does not directly provide a service to the community served by the government entity. In short, these cases do not support NHF's position that California law permits counties to resort to the corporate form for any purpose, anywhere.

NHF was incorporated for the express purpose of selling mortgage products outside of California, to persons other than the underlying counties' residents, for the sole purpose of earning profits. NHF's logic has no bounds: under its interpretation of California law, the City of San Francisco could create an entity to run a hotel in Albuquerque or operate a power plant in New York. California's legislature did not contemplate, much less intend, such an absurd result. *See* CAL. CORP. CODE § 5140 (authorizing creation of nonprofit corporation "[s]ubject to . . . compliance with . . . applicable laws"). Simply put, California government entities do not have *carte blanche* to create a separate entity to engage in private,

proprietary ventures anywhere in the nation with the goal of making profits to send back to the underlying government entity.⁶

In sum, NHF's underlying counties lack even proprietary authority to engage in conduct outside of California and for purposes entirely unrelated to the interests of their residents. NHF provides no authority supporting the incredible proposition that counties can simply resort to the corporate form whenever they lack the authorization to act. Because NHF and its underlying counties have neither governmental nor proprietary authority to participate in Washington's housing market, the trial court properly held that NHF's conduct was prohibited by law. CP 1287.

C. The Commission Has Standing to Challenge NHF's Unlawful Mortgage Activities in Washington.

NHF's primary argument on appeal is that even if it lacks authority to offer its mortgage products to low-income borrowers in Washington, the Commission has no right to challenge those activities in court. *See* Op. Br. at 13-21. But that ignores the Commission's authorization to exercise state governmental authority within the federal mortgage insurance program to the exclusion of unauthorized entities like NHF. It likewise ignores the Commission's right to enforce the limits a sister state

⁶ In fact, California law generally prohibits the operation of a nonprofit corporation for the sole purpose of generating revenues for a third party or for a non-charitable purpose. *See, e.g.*, CAL. CORP. CODE § 5130 (prohibiting any nonprofit public benefit corporation from being "organized for the private gain of any person"). As noted, NHF's profits are transferred to RCRC principally to pay for lobbying activities.

has placed on its counties and their instrumentalities to avoid undue interference in other states. On either basis, the Commission has standing to challenge NHF's unlawful interference with the Commission's mission and programs.

1. The Commission Has Standing to Challenge NHF's Unlawful Participation in the Federal Mortgage Insurance Program.

In Washington courts, an injured party has standing to sue when it falls within the "zone of interests" of a law it invokes. *State v. Johnson*, 179 Wn.2d 534, 552, 315 P.3d 1090 (2014). A law's zone of interests can be inferred from the law's "operation" and "general purpose." *Five Corners Fam. Farmers v. State*, 173 Wn.2d 296, 304-05, 268 P.3d 892 (2011). And a party can enforce not only Washington law, but also the laws of other jurisdictions, so long as it has standing to do so. *See Richardson v. Pac. Pwr. & Light Co.*, 11 Wn.2d 288, 301-02, 118 P.2d 985 (1941) (noting the "strong public policy . . . in favor of recognizing and enforcing rights and duties validly created by a foreign law" (internal quotes omitted)); RCW 5.24.010. Here, the Commission falls within the zone of interests of both Washington and federal law as an authorized state entity within the federal mortgage insurance program.

First, the Commission falls within the zone of interests of Washington law, specifically the Legislature's delegation of state

authority to the Commission. As noted above, governmental mortgage financing is provided within a cooperative framework in which state law plays an important role. *See supra*, at 2-3, 27. The Washington Legislature has designated the Commission as the authorized statewide entity in this context, including for down-payment assistance. *See* RCW 43.180.010, .050(1)(d)-(e). The Legislature has also deemed the Commission to be exercising a “recognized governmental function” in conducting these activities. RCW 43.180.010.

The Commission falls squarely within the zone of interests of these state laws, which NHF is flouting. And the allocation of state and local governmental authority in Washington is an issue “peculiarly within the province of the courts of this state,” even when that authority intersects with a federal program. *City of Tacoma v. Taxpayers of Tacoma*, 49 Wn.2d 781, 791, 307 P.2d 567 (1957) (adjudicating municipality’s authority to condemn property in relation to federal permit authorizing such condemnation).⁷

⁷ The *City of Tacoma* decision was subsequently reversed due to res judicata: the plaintiff was challenging a particular federal project, the same dispute had been “finally determined” in “earlier litigation between the parties” in federal court, and Congress had designated such review “exclusive.” 357 U.S. 320, 334, 335-37, 339 (1958). None of these factors applies here. The Washington Supreme Court’s decision in *City of Tacoma* otherwise remains good law. *See, e.g., Pub. Util. Dist. No. 1 v. State*, 182 Wn.2d 519, 529-30 & n.5, 342 P.3d 308 (2015).

Second, the Commission also falls within the zone of interests of federal law. Consistent with the cooperative framework governing the mortgage insurance program, federal law provides the Commission with an implied right of action, as an authorized state entity, to challenge an unauthorized, pseudo-governmental competitor. Whether federal law confers such a right upon a given party depends on Congressional intent. *See Alexander v. Sandoval*, 532 U.S. 275, 286, 121 S. Ct. 1511, 149 L. Ed. 2d 517 (2001). The right may be “implied,” depending on the beneficiaries, intent, and purpose of the law being invoked. *E.g., Bennett v. Hardy*, 113 Wn.2d 912, 920-21, 784 P.2d 1258 (1990).

Here, the federal statutes governing the mortgage insurance program give special status and rights to authorized state entities—including an express right to provide secondary loans. *See* 12 U.S.C. § 1735f-6. Further, as explained above, there are no administrative procedures in place to adjudicate the allocation of state or local government authority for purposes of the program. *See supra*, at 11; *Mercer Isl. Sch. Dist. v. Office of the Superintendent of Pub. Instr.*, 186 Wn. App. 939, 969, 347 P.3d 924 (2015) (noting federal right of action implied when administrative procedures would “not provide an appropriate means” to resolve claim (internal quotations omitted)). This weighs heavily in favor of finding a cause of action under federal law,

given that “state agencies participat[ing] in cooperative federalism programs” have “special expertise in discerning and addressing enforcement gaps.” Seth Davis, *Implied Public Rights of Action*, 114 COLUM. L. REV. 1, 27-28, 61-62 (2014). Whether under state or federal law, the Commission has standing to challenge NHF’s unlawful conduct.

NHF objects that the Commission does not enjoy “protection from competition” or a “monopoly” over down-payment assistance. Op. Br. at 16. But the Commission has never suggested that it has (or wants) a monopoly. As noted above, the Commission acknowledges that there are other local Washington government entities offering down-payment assistance in Washington. *See supra*, at 19; RCW 35.82.020(9)(b), .200 (1). Family members and charitable organizations are also permitted to offer down-payment gifts. *See Handbook* at 230. But NHF is not one of those authorized parties.

An authorized entity may challenge an unauthorized entity exercising competing governmental authority in the same jurisdiction, as here. *See Skagit Cnty.*, 177 Wn.2d at 723-27, 730-31 (holding one public hospital district could be enjoined from “raid[ing] the territory of another”); *Alderwood*, 62 Wn.2d at 320-21, 322 (noting courts should analyze “closely” disputes over the authority of “potentially competing municipal corporations”). More broadly, any specially authorized

enterprise in a restricted market has standing to challenge an unauthorized participant in that same market. *See Day v. Inland Empire Optical, Inc.*, 76 Wn.2d 407, 416-17, 456 P.2d 1011 (1969); *Puget Sound Traction, Light & Pwr. Co. v. Grassmeyer*, 102 Wash. 482, 490-91, 173 P. 504 (1918). Because the Commission is an authorized state participant in the mortgage insurance program, it may challenge NHF as an unauthorized participant.

The cases that NHF cites do not hold otherwise. For example, NHF relies on *Hardin v. Ky. Util. Co.*, 390 U.S. 1, 88 S. Ct. 651, 19 L. Ed. 2d 787 (1968), *see* Op. Br. at 15, but fails to acknowledge the express distinction the Supreme Court drew in that case between lawful and unlawful competition:

This Court has, it is true, repeatedly held that the economic injury which results from lawful competition cannot, in and of itself, confer standing on the injured business to question the legality of any aspect of its competitor's operations. . . . In contrast, it has been the rule . . . that when the particular statutory provision invoked does reflect a legislative purpose to protect a competitive interest, the injured competitor has standing to require compliance with that provision.

390 U.S. at 5-6. In other words, the Commission has standing because it is legislatively authorized to exercise governmental authority in Washington for federal housing program purposes, whereas NHF is not. Indeed, NHF is prohibited by law from participating in the same program

in a governmental capacity. All the case law NHF relies upon involves lawful and intended competition, in contrast to NHF's activities here.

NHF also objects that the Commission has not been granted regulatory "enforcement powers." Op. Br. at 18-19. But again, the Commission has not claimed that it has such powers. The Commission is not attempting to oversee and regulate NHF, but to exclude it from a restricted program in which the Commission participates as an authorized entity. The Commission's standing is based on its delegated authority to participate in the mortgage insurance program as an official state entity. As explained above, that interest is sufficient to establish standing to sue under both state and federal law. *See supra*, at 41-43. Simply put, the Commission need not be a regulatory agency to enforce its rights in court. *See, e.g., Skagit Cnty.*, 177 Wn.2d at 723-27, 730-31.

2. The Commission Also Has Standing to Challenge NHF's Lack of Domicile Authority to Operate in Washington.

The Commission also falls within the zone of interests of California law, specifically the territorial limits that California places on its counties. California law restricts counties to their own territories, including with regard to home financing. *See supra*, at 31-33. Such limits, by their nature, are intended in part to protect other government entities from unwanted interference. This includes governments in other

states, as a matter of comity. That is why California law expressly authorizes its municipalities to operate “outside [the] state” if and only if “authorized” by a *consenting* foreign government entity. CAL. GOV’T CODE § 6502 (emphasis added). Washington imposes equivalent restrictions on its municipalities and other public bodies. *See, e.g.*, ch. 39.34 RCW.

NHF is an instrumentality of California counties that is interfering with the public policies and programs of the Commission without its consent. This is exactly the type of interference that California’s limits on extraterritorial activities are intended to prevent. The Commission thus falls within the zone of interests of California law.

D. RCRC, GSFA, and NHF Are Alter Egos of One Another.

Finally, NHF is acting fully in concert with RCRC and GSFA, as one consortium pursuing the interests of the underlying member counties. Accordingly, the trial court properly held that each entity is a proper defendant in this case, and that all of them are prohibited by law from operating in Washington. CP 1287.

Under the “alter ego” doctrine, where one entity “so dominates and controls a corporation that such corporation is [the entity’s] alter ego, a court is justified in piercing the veil of corporate entity and holding that the corporation” and the entity are “one and the same.” *In re Rapid*

Settlements, Ltd., 166 Wn. App. 683, 692, 271 P.3d 925 (2012) (internal quotations omitted). Courts will apply this doctrine where the corporate form has been abused, typically to perpetrate “fraud, misrepresentation, or some form of manipulation” *Meisel v. M & N Modern Hydraulic Press Co.*, 97 Wn.2d 403, 410, 645 P.2d 689 (1982).

NHF cites to inapplicable federal authority to argue that the law of the state of incorporation applies in veil-piercing cases. *See* Op. Br. at 38. That does not reflect Washington law, however, which applies the “most significant relationship rule” to resolve any choice of law issues. *E.g.*, *Pruczinski v. Ashby*, 185 Wn.2d 492, 503 n.7, 374 P.3d 102 (2016); *see also Meisel*, 97 Wn.2d at 403, 409-10 (applying Washington law to veil-piercing of New Jersey corporation); 1 Fletcher Cyc. Corp. § 43.72 (2016) (“[C]ourts have reached different conclusions about the proper law to apply when veil-piercing claims are brought against foreign corporations.”). In this case, Washington has the most significant relationship to NHF’s disputed activities. Regardless, the court need not reach this issue because NHF concedes that the result under either Washington or California law would be the same. *See* Op. Br. at 38 n.13.

Here, RCRC, GSFA, and NHF share an “identity of control and ownership” such that they are “one and the same.” *Rapid Settlements*, 166 Wn. App. at 693-94. For starters, these three entities share the same

address and have overlapping directors and officers. *See* CP 103, 427, 532, 535-36. Neither NHF nor GSFA has any employees: instead, individuals are employed and compensated by RCRC to perform all of NHF and GSFA's work. CP 427-28, 436. These entities are so interconnected that RCRC's own employees struggle to distinguish them. *See* CP 612 ("I'm not completely aware of the relationship between RCRC, GSFA, [] and NHF.").

Funds also flow freely between the three entities. NHF's excess revenues are transferred to RCRC on a regular basis, without any specific criteria or process. *See* CP 489-94. The officers discuss and decide all three budgets together. *See* CP 431-33. While the president testified that RCRC employees estimate and allocate the time spent on each separate entity each year, *see* CP 431-32, 693-94, NHF's program administrator testified he had never made such an estimate or allocation, CP 624, and that the time sheets he submits make no distinction between work on one entity versus another, *id.* RCRC also charges an exorbitant mark-up of 75 percent for administering NHF's programs, beyond overhead and other costs. *See* CP 1511.

Finally, RCRC, GSFA, and NHF even have a consolidated business plan. *See* CP 722-30. The plan covers all three entities and identifies an "overall objective" for the consortium to "develop and

manage programs that benefit RCRC member counties and other CA constituents.” CP 723. It even sets a goal of identifying “what *the organization* should look like in 3-5 years.” CP 724 (emphasis added).

Similar circumstances have supported veil-piercing in prior cases. *See FutureSelect Portfolio Mgmt., Inc. v. Tremont Grp. Holdings, Inc.*, 180 Wn.2d 954, 964-65, 331 P.3d 29 (2014) (parent company “owned, directed, influenced management, and provided support services”); *Rapid Settlements*, 166 Wn. App. at 693 (parent shared address and employees and “ownership of both entities [had] been held out to third parties as identical”). The only authority upon which NHF relies does not relate to, much less apply or interpret, the “alter ego” doctrine. Instead, those cases simply address whether certain constitutional approval requirements apply to the conduct of government-created entities. *See Rider*, 18 Cal. 4th at 1044; *Cerritos*, 183 Cal. App. 4th at 1442-43. They did not involve issues of liability or personal jurisdiction at all.

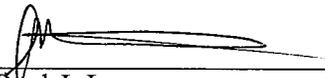
IV. CONCLUSION

Since it began operating in this state, NHF has been representing to lenders that it has authority to operate in a governmental capacity within the federal mortgage insurance program. Now that its conduct has been challenged, NHF attempts to defend itself as merely a private and proprietary actor. But NHF cannot have it both ways. As the record

shows, it has been knowingly engaging in mortgage transactions that require governmental authority in order to generate millions of dollars in revenues for its own purposes. Because NHF lacks any governmental authority in this state, its operations in Washington are prohibited by law. Regardless, NHF lacks authority under California law to run a federal mortgage loan business outside of California either in a propriety capacity or as a non-profit. The Commission respectfully requests that the Court affirm the trial court's declaration to that effect.

RESPECTFULLY SUBMITTED this 26th day of July, 2017.

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No. 76510-8-I

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

NATIONAL HOMEBUYERS FUND, INC., et al.,

Appellants,

v.

WASHINGTON STATE HOUSING FINANCE COMMISSION,

Respondent.

**APPENDIX TO BRIEF OF RESPONDENT
WASHINGTON STATE HOUSING FINANCE COMMISSION**

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List of Subjects in 16 CFR Part 1107

Business and industry, Children, Consumer protection, Imports, Product testing and certification, Records, Record retention, Toys.

Accordingly, the Commission amends 16 CFR part 1107 as follows:

PART 1107—TESTING AND LABELING PERTAINING TO PRODUCT CERTIFICATION

1. The authority citation for part 1107 continues to read as follows:

Authority: 15 U.S.C. 2063, Sec. 3, 102 Pub. L. 110-314, 122 Stat. 3016, 3017, 3022.

Subpart C—Certification of Children's Products

2. Add paragraph (f) to § 1107.21 to read as follows:

§ 1107.21 Periodic testing.

* * * * *

(f) A manufacturer must select representative product samples to be submitted to the third party conformity assessment body for periodic testing. The procedure used to select representative product samples for periodic testing must provide a basis for inferring compliance about the population of untested products produced during the applicable periodic testing interval. The number of samples selected for the sampling procedure must be sufficient to ensure continuing compliance with all applicable children's product safety rules. The manufacturer must document the procedure used to select the product samples for periodic testing and the basis for inferring the compliance of the product manufactured during the periodic testing interval from the results of the tested samples.

* * * * *

3. Add paragraph (a)(4) to § 1107.26 to read as follows:

§ 1107.26 Recordkeeping.

(a) * * *

(4) Records documenting the testing of representative samples, as set forth in § 1107.21(f), including the number of representative samples selected and the procedure used to select representative samples. Records also must include the basis for inferring compliance of the product manufactured during the periodic testing interval from the results of the tested samples;

* * * * *

Dated November 29, 2012.

Todd A. Stevenson, Secretary, Consumer Product Safety Commission.

[FR Doc. 2012-29204 Filed 12-4-12; 8:45 am]

BILLING CODE 6355-01-P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 203

[Docket No. FR-5679-N-01]

Federal Housing Administration: Prohibited Sources of Minimum Cash Investment Under the National Housing Act—Interpretive Rule

AGENCY: Office of the General Counsel, HUD.

ACTION: Interpretive rule.

SUMMARY: HUD is issuing this interpretive rule to clarify the scope of the provision in the National Housing Act that prohibits certain sources of a homebuyer's funds for the required minimum cash investment for single family mortgages to be insured by the Federal Housing Administration (FHA). Uncertainty has arisen as to the effect of this provision on State and local governments and their agencies' and instrumentalities' homeownership programs that provide funds for the minimum cash investment. This rule provides HUD's interpretation that this statutory provision does not remove the availability of FHA insurance for use in conjunction with State and local government programs that provide funds toward the required minimum cash investment. Although interpretive rules are exempt from public comment under the Administrative Procedure Act, HUD nevertheless invites public comment on the interpretation provided in this rule.

DATES: Effective Date: November 29, 2012. Comment Due Date: January 4, 2013.

ADDRESSES: Interested persons are invited to submit comments regarding this rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street SW., Room 10276, Washington, DC 20410-0500. Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. Submission of Comments by Mail. Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of

Housing and Urban Development, 451 7th Street SW., Room 10276, Washington, DC 20410-0500.

2. Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at www.regulations.gov. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the www.regulations.gov Web site can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

No Facsimile Comments. Facsimile (FAX) comments are not acceptable.

Public Inspection of Public Comments. All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an appointment to review the public comments must be scheduled in advance by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Relay Service at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at www.regulations.gov.

FOR FURTHER INFORMATION CONTACT: Millicent Potts, Associate General Counsel for Insured Housing, Office of General Counsel, U.S. Department of Housing and Urban Development Room 9226, 202-708-2212. Hearing or speech impaired individuals may access these numbers via TTY by calling the toll free Federal Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION:

I. Background

A. The National Housing Act Prohibition on Certain Sources of Cash Investment

To qualify a mortgage for FHA mortgage insurance, section 203(b)(9)(A) of the National Housing Act (12 U.S.C. 1709(b)(9)) requires the homebuyer to

pay “in cash or equivalent on account of the property an amount equal to not less than 3.5 percent of the appraised value of the property.” Some homebuyers obtain this minimum amount from sources other than their own earnings or savings; for example, a relative may give or loan them this money or some part of it. However, section 203(b)(9)(C) of the National Housing Act provides that no part of this required minimum investment may consist of funds provided by the seller of the property or any other person or entity who benefits financially from the sale of the property, or any person who is reimbursed by any such person or entity.

B. Federally Funded Homeownership Programs

Governments—Federal, State, and local—and their agencies and instrumentalities have provided assistance toward the minimum cash investment as part of homeownership programs from various public funds, including appropriated funds, operating tax revenues, taxable and tax-exempt general obligation bonds, and surplus revenues (for example, excess reserves). Federal homeownership assistance programs that have a cash investment component include HUD’s Neighborhood Stabilization Program, Community Development Block Grant (CDBG) program, and HOME Investment Partnerships program, as well as the Department of Veterans Affairs Home Loan Guaranty Service and U.S. Department of Agriculture’s Rural Development Housing and Community Facilities program. These Federal homeownership assistance programs have specified public purposes, such as revitalizing communities affected by foreclosures and vacancy, increasing the homeownership rate in particular geographies, making homeownership affordable to underserved populations and in high-cost markets.

For these Federal assistance programs, Congress has authorized funds to be distributed from the Treasury, often through State and local governments or their instrumentalities, for purposes of supporting homeownership programs. At the same time, section 203(b)(9)(C) of the National Housing Act raises the question whether the distribution of these same Federal funds would cause the mortgages originated on the basis of support from such funds not to qualify for FHA insurance. Reading the prohibition in section 203(b)(9)(C) to include other Federal agencies, State and local governments, or their instrumentalities disbursing government funds in accordance with the

requirements of government assistance programs would place these governments and instrumentalities in an untenable position of having governmental authority to provide assistance toward the minimum cash investment on the one hand, but being unable to use FHA-insured mortgage financing on the other. To do so would also frustrate the statutory purpose of these programs and of the FHA to encourage and support homeownership.¹

C. Other Government Funded Homeownership Assistance Programs

Another key source of homeownership assistance programs, such as assistance with closing costs, or rehabilitation, is provided by State and local governments, primarily through housing finance agencies (HFAs). According to the National Council of State Housing Finance Agencies, HFAs are generally State-chartered authorities established by State governments to help meet the affordable housing needs of State residents.² Although HFAs vary widely in characteristics such as their relationship to State government, most are independent entities that operate under the direction of a board of directors appointed by their respective State governors. They administer a wide range of affordable housing and community development programs.³ Using housing bonds, low-income housing tax credits, HOME program funds, and other Federal and State resources, HFAs have crafted hundreds of housing programs, including homeownership, rental, and all types of special-needs housing. HFAs have provided affordable mortgages to 2.6 million families to buy their first homes through mortgage revenue bond programs.⁴

A recent study of HFAs found that 100 percent of the 51 HFAs surveyed said that part of their mission is “to assist low- and moderate-income residents to purchase homes and be

successful homeowners.”⁵ A majority of those programs—in 2011, 88 percent (45 of 51) of State HFAs—include minimum cash investment as a part of advancing their mission.⁶ Federally backed mortgage insurance is also a critical part of the HFAs’ strategy. Of HFA loan production in 2011, 86 percent involved FHA, Veterans Administration (VA), or Rural Housing Service loan or loan insurance programs.

Many HFAs administer other State and Federal housing assistance programs such as homeless assistance, CDBG, and State housing trust funds. Local housing finance agencies operate similarly but at the county, city, or other municipal-entity level. In many cases, a local agency may be the local government itself. HFAs provide various services to assist citizens within their jurisdictions in attaining affordable housing options. These services include providing access to affordable mortgage loans for purchasing a home, counseling, money and other resources for closing costs, and assistance for any required investment in the mortgaged property. Such funds come from numerous sources. Program beneficiaries are usually low- and moderate-income individuals and families who have gone through homeownership counseling through which they receive training on money management, use of credit, and home maintenance.

D. FHA and Minimum Cash Investment Requirements

Since its enactment, the National Housing Act (NHA) has required the mortgagor to have a minimum investment in the property being purchased. For many years, the required minimum investment was 3 percent of the cost of acquisition, and is currently 3.5 percent of the home’s appraised value. Prior to 2008, the statute and regulations regarding the required investment were silent, with minor exceptions, as to permissible sources of the mortgagor’s required investment. However, FHA’s single family mortgage credit handbook, Handbook 4155.1,⁷ provided administrative guidance to approved mortgagees as to permissible sources of the funds that a homebuyer could use for the required minimum investment. HUD’s policy under the handbook provisions was to permit the minimum cash investment to be financed by sources including a family

¹ In providing an overview of the Housing and Economic Recovery Act of 2008 (HERA), the Congressional Research Service in an August 19, 2008 report for Congress on HERA [RL34623] notes that HERA authorizes \$4 billion for state and local governments to purchase and rehabilitate abandoned and foreclosed housing and that this housing would be sold or rented to low- and moderate-income individuals and families. See http://assets.opencrs.com/rpts/RL34623_20080819.pdf.

² See http://answers.usa.gov/system/self-service.controller?CONFIGURATION=1000&PARTITION_ID=1&CMD=VIEW_ARTICLE&USERTYPE=1&LANGUAGE=en&COUNTRY=US&ARTICLE_ID=10182.

³ See <http://www.ncsha.org/about-hfas/hfa-programs>.

⁴ See <http://www.ncsha.org/about-hfas>.

⁵ See http://www.chfainfo.com/documents/HFA_HEC_Report_March2012.pdf at 1.

⁶ *Id.* at 1.

⁷ See <http://www.hud.gov/offices/adm/hudclips/handbooks/hshg/4155.1/41551HSGH.pdf>.

member, the borrower's employer or labor union, a governmental entity, a charitable organization, or a close friend with a clearly defined and documented interest in the borrower. HUD's policies have always expressly prohibited the seller from financing or providing a gift of the required investment.

In the 1990s, several nonprofit entities developed an approach to funding homebuyers' cash investments that circumvented the handbook prohibition. These entities obtained charitable status from the Internal Revenue Service, and then encouraged home sellers to use their services and provided homebuyers with all or part of the required cash investment amount. 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. The donated funds were directed to subsequent homebuyers for the cash investment on their homes. The nonprofit does not conduct broad-based fundraising but instead relies on sellers and other businesses in real estate for financial support. In effect, sellers and other donors were indirectly funding the homebuyer's required minimum investment by reimbursing the nonprofit entity for each transaction.⁸

As the prevalence of channeling funds from sellers through nonprofit entities increased, FHA became concerned that this practice as applied to homebuyers with FHA-insured mortgages could result in FHA insuring riskier loans. In response, FHA published a proposed rule in 1999 to prohibit this source of the minimum cash investment.⁹ Under the proposed rule, a gift of the buyer's required minimum cash investment would disqualify the loan from FHA insurance if the entity providing the gift received funds directly or indirectly from the seller of the property. However, the proposed rule expressly included funds provided by a "State or local government agency or instrumentality" in the category of permissible sources of funds that the homebuyer can apply toward the minimum investment requirement.¹⁰ HUD withdrew the rule in January 2001 in light of widespread opposition to the rule as proposed.¹¹

The direct and indirect financing of homebuyers' minimum cash investment

by sellers continued to be a source of concern following the withdrawal of the proposed rule. In 2005, the Government Accountability Office (GAO) published a report on the risks raised by the reimbursement of nonprofit entities by sellers.¹² The GAO findings noted that sales prices were increased commensurately to cover the cost incurred by the seller, and thus resulted in homeowners having less actual equity in the newly acquired home.¹³ The GAO report also found that the default and claim rate for homes purchased with charitable gifts where the nonprofit entity was reimbursed by the seller was much higher than in those cases where the homebuyer provided his or her own money for the required investment.¹⁴

Moreover, the IRS found that organizations claiming to be charities were being used to funnel money from sellers to buyers through self-serving, circular-financing arrangements, and that in a typical scheme, there is a direct correlation between the amount of the funds provided to the buyer and the payment received from the seller.¹⁵ On May 4, 2006, the IRS issued Revenue Ruling 2006-27, which determined that organizations that indirectly provide cash investments funded by sellers to homebuyers do not qualify as tax-exempt charities.¹⁶ In the press announcement accompanying the ruling, the IRS stated that the ruling makes clear that organizations operating seller-funded programs are not charities because they do not meet the requirements of section 501(c)(3) of the Internal Revenue Code.¹⁷ The IRS also found that the seller pays the organization only if the sale closes, and the organization usually charges an additional fee for its services.¹⁸

On May 11, 2007, HUD again published a proposed rule that prohibited funds provided by the seller as a source for the minimum cash investment.¹⁹ This provision, entitled "Restrictions on Seller Funding,"

proposed to prohibit cash investment amounts that consists, in whole or in part, of funds provided by any of the following parties before, during or after closing of the property sale: "(1) The seller, or any other person or entity that financially benefits from the transaction; or (2) any third party or entity * * * that is reimbursed directly or indirectly by any of the parties listed in clause (1)." ²⁰ Once again, the May 2007 proposed rule expressly exempted funds from "a federal, state, or local government agency or instrumentality" from the category of prohibited sources for funds toward the required minimum investment.²¹ HUD published its final rule on October 1, 2007.²² On the effective date of the rule, a lawsuit challenging the rule was filed against HUD in the U.S. district court for the Eastern District of California, and in February 2008 the court set aside the final rule.²³

The 2005 GAO report, the 2006 IRS Ruling, and the judicial invalidation of HUD's final rule eventually led to congressional action on the issue in 2008. Section 2113 of the Housing and Economic Recovery Act of 2008 (HERA), signed into law on July 30, 2008, amended the NHA with language that is identical in relevant part to the language in HUD's 2007 final rule. Section 2113 of HERA amended section 203(b)(9) of the NHA to provide that mortgages eligible for FHA insurance must "[b]e executed by a mortgagor who shall have paid in cash or its equivalent, on account of the property an amount equal to not less than 3.5 percent of the appraised value of the property or such larger amount as the Secretary may determine." Section 203(b)(9) was also amended to include a new subparagraph (9)(C), which specifies prohibited sources for a mortgagor's minimum investment. Section 203(b)(9)(C) of the NHA states:

PROHIBITED SOURCES.—In no case shall the funds required by subparagraph (A) 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).

Since HERA's enactment, FHA has not replaced the regulation that was

⁸ See IRS Ruling 2006-27, available at <http://www.irs.gov/pub/irs-drop/rr-06-27.pdf>.

⁹ See Sources of Homeowner Downpayment, 64 FR 49956 (proposed Sept. 14, 1999).

¹⁰ See *id.* at 49958.

¹¹ See Withdrawal of Proposed Rule on Sources of Homeowner Downpayment Pursuant to Section 203 of the National Housing Act, 66 FR 2851 (January 12, 2001).

¹² See United States Government Accountability Office, "Mortgage Finance—Additional Action Needed to Manage Risk of FHA-Insured Loans with Down Payment Assistance," (Nov. 2005) available at <http://www.gao.gov/new.items/d0624.pdf>.

¹³ See *id.* at 25.

¹⁴ See *id.* at 3-4.

¹⁵ See <http://www.irs.gov/Charities-&-Non-Profits/Seller-Funded-Down-Payment-Assistance-Programs-Are-Not-Tax-Exempt>.

¹⁶ See <http://www.irs.gov/pub/irs-drop/rr-06-27.pdf>.

¹⁷ See <http://www.irs.gov/uac/IRS-Targets-Down-Payment-Assistance-Scams;-Seller-Funded-Programs-Do-Not-Qualify-As-Tax-Exempt>.

¹⁸ *Id.*

¹⁹ See Standards for Mortgagor's Investment in Mortgaged Property, 72 FR. 27048 (proposed May 11, 2007).

²⁰ See *id.* at 27049.

²¹ See *id.* at 27051.

²² See Standards for Mortgagor's Investment in Mortgaged Property, 72 FR 56002 (final Oct. 1, 2007).

²³ See *Nehemiah Corp. of America v. Jackson*, 546 F. Supp. 2d 830, 848 (E.D. Cal. 2008).

vacated by the district court in February 2008. However, Mortgagee Letter 2008–23 provides notification of the statutory revisions to the cash investment requirements imposed by HERA.²⁴ Instead of 3 percent of the cost of acquisition, the required investment was changed by HERA to 3.5 percent of the appraised value of the property. Aside from the statement that closing costs (*i.e.*, the present allowed seller incentive of 6 percent) could not be used to meet the 3.5 percent appraised value minimum investment requirement, the Mortgagee Letter is silent regarding the source of the required cash investment by the mortgagor.

II. This Interpretive Issue

A. Conjunction of Government Housing Assistance Programs and FHA-Insured Mortgages

It is HUD's interpretation that section 203(b)(9)(C) of the NHA does not prohibit FHA from insuring mortgages originated as part of the homeownership programs of Federal, State, or local governments or their agencies or instrumentalities when such agencies or instrumentalities also directly provide funds toward the required minimum cash investment.²⁵ The addition of a statutory provision on prohibited sources of cash investment funds, as part of the amendments to section 203(b)(9) of the NHA enacted in HERA, was intended to preclude the abuse of the program where a seller (or other interested or related party) funded the homebuyer's cash investment after the closing by reimbursing third-party entities and added the cost of this reimbursement to the sales price of the home, thus inflating the price of the home beyond its market value. It is HUD's interpretation that the amended section 203(b)(9) does not exclude as a permissible source of cash investment, funds provided directly by Federal,

²⁴ See Mortgagee Letter 2008–23, available at http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_19737.pdf.

²⁵ In Mortgagee Letter 94–2, FHA defined a government agency or instrumentality for purposes of section 528 of the NHA. See http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_16755.txt. This definition applies here. That definition provides that the entity must have been established by a governmental body or with governmental approval or under special law to serve a particular public purpose or designated as an instrumentality by law (statute or court opinion) and the majority of governing board and/or principal officers named or approved by governmental body/officials, or the government body approves all major decisions and/or expenditures, or the government body provides funds through direct appropriations/grants/loans, with related controls applicable to all activities of entity.

State, or local governments, or their agencies or instrumentalities as part of their respective homeownership programs.

HUD finds support for this interpretation in the surrounding provisions in HERA and in the legislative history of the amendment to section 203(b)(9). First, HERA itself authorized government home ownership programs that include a cash investment component, and interpreting section 203(b)(9)(C) to deny FHA insurance to mortgages resulting from such programs would frustrate their statutory purpose. In section 2301 of HERA, Congress authorized the first increment of funding for the Neighborhood Stabilization Program (NSP). NSP provides funds to low- and moderate-income homebuyers for the cash investment on purchasing lender-foreclosed single family properties when the property will be the buyer's primary residence and is located in an eligible target area. NSP funds are distributed through State and local government agencies and instrumentalities. NSP funds are also used to purchase vacant or distressed properties, which may then be resold by the purchasing agency or instrumentality to low- or moderate-income buyers with funds toward the minimum cash investment. Access to FHA mortgage insurance is often essential to making such programs work.²⁶ Thus, an interpretation of section 203(b)(9)(C) that precludes governments and their agencies and instrumentalities government agencies from providing funding toward the minimum cash investment for an FHA-insured mortgage would undercut a central purpose of NSP and similar Federal, State, and local government programs.²⁷

²⁶ HERA was enacted in 2008. FHA data shows that in that year, there was a dramatic increase in FHA's market share. From 2005 through 2007, FHA's market share ranged from 2.6 to 3.9% of the national mortgage market. In 2008, it rose to almost 20% of the market share. See "FHA-Insured Single Family Mortgage Originations and Market Share Report, 2009–Q4, http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_16681.pdf (last visited 7–3–2012). See also FHA's Annual Report to Congress on the Fiscal Year 2012 Financial Status of the FHA Mutual Mortgage Insurance Fund, issued November 16, 2012, which has updated information on FHA's market share, at http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2012/HUDNo.12-171.

²⁷ See *United Savings Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988) (statutory provisions should be interpreted to avoid interpreting inconsistencies between provisions); see also *Babitt v. Sweet Home Chapter of Communities for a Great Oregon*, 515 U.S. 687 (1995); *Gade v. Nat'l Solid Waste Management Ass'n*, 505 U.S. 88, 100–01 (1992).

Second, the legislative history of the amendment to section 203(b)(9)(C) also supports HUD's interpretation that it does not exclude State and local government home ownership programs from FHA insurance eligibility. In a statement supporting the amendment to section 203(b)(9)(C), Senator Dodd explained that "this bill eliminates the seller-funded downpayment assistance program."²⁸ There is no indication that State and local governments or their agencies or instrumentalities were to be within the scope of the amendment. The Senate Committee Report accompanying a 2007 bill containing statutory language²⁹ identical to what was eventually enacted in HERA further support this interpretation. The report explained that the "section also prohibits seller-funded downpayment entities from providing any of this required cash investment."³⁰ It noted that "[s]ince this legislation was passed by the Committee, HUD has promulgated a regulation that also prohibits *these entities* from providing downpayment assistance funds."³¹ As discussed above, the 2007 HUD rule to which the Senate Report refers expressly excluded State and local government agencies and instrumentalities from the category prohibited sources for the minimum cash investment. The report's identification of "seller-funded downpayment entities" as the targets of both HUD's proposed rule *and* of the bill indicates that the provision, which is identical to what was enacted in HERA, does not include State and local governments or their agencies or instrumentalities.

B. Scope of Interpretive Rule

Under section 203(b)(9)(A) of the NHA, the homebuyer's investment in the property must be at least 3.5 percent of its appraised value. So long as the homebuyer makes this minimum required investment from his or her own (or other approved) funds, any person, even one associated with the transaction, may contribute additional funds towards the borrower's costs without violating section 203(b)(9)(C). This interpretive rule only applies to funds that constitute all or part of the

²⁸ See 154 Cong. Rec. S6354–S6356 (July 7, 2008) available at <http://www.gpo.gov/fdsys/pkg/CREC-2008-07-07/html/CREC-2008-07-07-pt1-PgS6354-2.htm>.

²⁹ See FHA Modernization Act of 2007, S. 2338, (2007) § 103.

³⁰ S. Rep. No. 110–227, at 6 (Nov. 13, 2007), available at <http://www.gpo.gov/fdsys/pkg/CRPT-110srpt227/pdf/CRPT-110srpt227.pdf>.

³¹ *Id.* (emphasis added).

3.5 percent minimum investment requirement.

C. Conclusion

Accordingly, HUD interprets NHA section 203(b)(9)'s "prohibited sources" provision in subsection (C) as not including funds provided directly by Federal, State, or local governments, or their agencies and instrumentalities in connection with their respective homeownership programs.

D. Solicitation of Comment

This interpretive rule represents HUD's interpretation of section 203(b)(9)(C) and is exempt from the notice and comment requirements of the Administrative Procedure Act. *See* 5 U.S.C. 553(b)(3)(A). Nevertheless, HUD is interested in receiving feedback from the public on this interpretation, specifically with respect to clarity and scope.

Dated: November 29, 2012.

Helen R. Kanovsky,
General Counsel.

[FR Doc. 2012-29361 Filed 12-4-12; 8:45 am]

BILLING CODE 4210-67-P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 180

[EPA-HQ-OPP-2012-0202; FRL-9371-6]

Clodinafop-Propargyl; Pesticide Tolerance

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: This regulation reduces the established tolerance for residues of clodinafop-propargyl in or on wheat, grain. Syngenta Crop Protection, LLC requested this tolerance change under the Federal Food, Drug, and Cosmetic Act (FFDCA).

DATES: This regulation is effective December 5, 2012. Objections and requests for hearings must be received on or before February 4, 2013 and must be filed in accordance with the instructions provided in 40 CFR part 178 (see also Unit I.C. of the **SUPPLEMENTARY INFORMATION**).

ADDRESSES: The docket for this action, identified by docket identification (ID) number EPA-HQ-OPP-2012-0202, is available at <http://www.regulations.gov> or at the Office of Pesticide Programs Regulatory Public Docket (OPP Docket) in the Environmental Protection Agency Docket Center (EPA/DC), EPA West Bldg., Rm. 3334, 1301 Constitution Ave.

NW., Washington, DC 20460-0001. The Public Reading Room is open from 8:30 a.m. to 4:30 p.m., Monday through Friday, excluding legal holidays. The telephone number for the Public Reading Room is (202) 566-1744, and the telephone number for the OPP Docket is (703) 305-5805. Please review the visitor instructions and additional information about the docket available at <http://www.epa.gov/dockets>.

FOR FURTHER INFORMATION CONTACT: Mindy Ondish, Registration Division (7505P), Office of Pesticide Programs, Environmental Protection Agency, 1200 Pennsylvania Ave. NW., Washington, DC 20460-0001; telephone number: (703) 605-0723; email address: ondish.mindy@epa.gov.

SUPPLEMENTARY INFORMATION:

I. General Information

A. Does this action apply to me?

You may be potentially affected by this action if you are an agricultural producer, food manufacturer, or pesticide manufacturer. The following list of North American Industrial Classification System (NAICS) codes is not intended to be exhaustive, but rather provides a guide to help readers determine whether this document applies to them. Potentially affected entities may include:

- Crop production (NAICS code 111).
- Animal production (NAICS code 112).
- Food manufacturing (NAICS code 311).
- Pesticide manufacturing (NAICS code 32532).

B. How can I get electronic access to other related information?

You may access a frequently updated electronic version of EPA's tolerance regulations at 40 CFR part 180 through the Government Printing Office's e-CFR site at http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?&c=ecfr&tpl=/ecfrbrowse/Title40/40tab_02.tpl. To access the OCSPP test guidelines referenced in this document electronically, please go to <http://www.epa.gov/ocspp> and select "Test Methods and Guidelines."

C. How can I file an objection or hearing request?

Under FFDCA section 408(g), 21 U.S.C. 346a, any person may file an objection to any aspect of this regulation and may also request a hearing on those objections. You must file your objection or request a hearing on this regulation in accordance with the instructions provided in 40 CFR part 178. To ensure proper receipt by EPA, you must identify docket ID number EPA-HQ-

OPP-2012-0202 in the subject line on the first page of your submission. All objections and requests for a hearing must be in writing, and must be received by the Hearing Clerk on or before February 4, 2013. Addresses for mail and hand delivery of objections and hearing requests are provided in 40 CFR 178.25(b).

In addition to filing an objection or hearing request with the Hearing Clerk as described in 40 CFR part 178, please submit a copy of the filing (excluding any Confidential Business Information (CBI)) for inclusion in the public docket. Information not marked confidential pursuant to 40 CFR part 2 may be disclosed publicly by EPA without prior notice. Submit the non-CBI copy of your objection or hearing request, identified by docket ID number EPA-HQ-OPP-2012-0202, by one of the following methods:

- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the online instructions for submitting comments. Do not submit electronically any information you consider to be Confidential Business Information (CBI) or other information whose disclosure is restricted by statute.

- **Mail:** OPP Docket, Environmental Protection Agency Docket Center (EPA/DC), (28221T), 1200 Pennsylvania Ave. NW., Washington, DC 20460-0001.

- **Hand Delivery:** To make special arrangements for hand delivery or delivery of boxed information, please follow the instructions at <http://www.epa.gov/dockets/contacts.htm>.

Additional instructions on commenting or visiting the docket, along with more information about dockets generally, is available at <http://www.epa.gov/dockets>.

II. Summary of Petitioned-for Tolerance

In the *Federal Register* of October 17, 2012 (77 FR 63782) (FRL-9366-2), EPA issued a document pursuant to FFDCA section 408(d)(3), 21 U.S.C. 346a(d)(3), announcing the filing of a pesticide petition (PP 1F7955) by Syngenta Crop Protection, LLC, P.O. Box 18300, Greensboro, NC 27419-8300. The petition requested that 40 CFR 180.559 be amended by lowering the established tolerance for residues of the herbicide clodinafop-propargyl in or on wheat, grain from 0.1 to 0.02 parts per million (ppm). That document referenced a summary of the petition prepared by Syngenta Crop Protection, LLC, the registrant, which is available in the docket, <http://www.regulations.gov>. Comments were received on the notice of filing. EPA's response to these comments is discussed in Unit IV.C. Finally, EPA is revising the tolerance

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II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

A. Title II Insured Housing Programs Forward Mortgages

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

The Mortgagee must identify each item paid by Interested Party Contributions.

(j) Real Estate Tax Credits

Where real estate taxes are paid in arrears, the seller's real estate tax credit may be used to meet the MRI, if the Mortgagee documents that the Borrower had sufficient assets to meet the MRI and the Borrower paid closing costs at the time of underwriting.

This permits the Borrower to bring a portion of their MRI to the closing and combine that portion with the real estate tax credit for their total MRI.

(C) Reserves (TOTAL)

The Mortgagee must verify and document all assets submitted to the AUS.

Reserves refer to the sum of the Borrower's verified and documented liquid assets minus the total funds the Borrower is required to pay at closing.

Reserves do not include:

- the amount of cash taken at settlement in cash-out transactions;
- incidental cash received at settlement in other loan transactions;
- equity in another Property; or
- borrowed funds from any source.

Required Reserves for Three- to Four-Unit Properties

The Mortgagee must verify and document Reserves equivalent to three months' PITI after closing for three- to four-unit Properties.

ii. Source Requirements for the Borrower's Minimum Required Investment (TOTAL)

(A) Definition

Minimum Required Investment (MRI) refers to the Borrower's contribution in cash or its equivalent required by Section 203(b)(9) of the National Housing Act, which represents at least 3.5 percent of the Adjusted Value of the Property.

(B) Standard

The Mortgagee may only permit the Borrower's MRI to be provided by a source permissible under Section 203(b)(9)(C) of the National Housing Act, which means the funds for the Borrower's MRI must not come from:

- (1) the seller of the Property;

II. ORIGATION THROUGH POST-CLOSING/ENDORSEMENT

A. Title II Insured Housing Programs Forward Mortgages

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

- (2) any other person or Entity who financially benefits from the transaction (directly or indirectly); or
- (3) anyone who is or will be reimbursed, directly or indirectly, by any party included in (1) or (2) above.

While additional funds to close may be provided by one of these sources if permitted under the relevant source of funds requirements above, none of the Borrower's MRI may come from these sources. The Mortgagee must document permissible sources for the full MRI in accordance with special requirements noted above.

Additionally, in accordance with Prohibited Sources of Minimum Cash Investment Under the National Housing Act -Interpretive Rule, HUD does not interpret Section 203(b)(9)(C) of the National Housing Act to prohibit Governmental Entities, when acting in their governmental capacity, from providing the Borrower's MRI where the Governmental Entity is originating the insured Mortgage through one of its homeownership programs.

(C)Required Documentation

Where the Borrower's MRI is provided by someone other than the Borrower, the Mortgagee must also obtain documentation to support the permissible nature of the source of those funds.

To establish that the Governmental Entity provided the Borrower's MRI in a manner consistent with HUD's Interpretive Rule, the Mortgagee must document that the Governmental Entity incurred prior to or at closing an enforceable legal liability or obligation to fund the Borrower's MRI. It is not sufficient to document that the Governmental Entity has agreed to reimburse the Mortgagee for the use of funds legally belonging to the Mortgagee to fund the Borrower's MRI.

The Mortgagee must obtain:

- a canceled check, evidence of wire transfer or other draw request showing that prior to or at the time of closing the Governmental Entity had authorized a draw of the funds provided towards the Borrower's MRI from the Governmental Entity's account; or
- a letter from the Governmental Entity, signed by an authorized official, establishing that the funds provided towards the Borrower's MRI were funds legally belonging to the Governmental Entity, when acting in their governmental capacity, at or before closing.

Where a letter from the Governmental Entity is submitted, the precise language of the letter may vary, but must demonstrate that the funds provided for the Borrower's MRI legally belonged to the Governmental Entity at or before closing, by stating, for example:

II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

A. Title II Insured Housing Programs Forward Mortgages

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

(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

5. Manual Underwriting of the Borrower

ii. Source Requirements for the Borrower's Minimum Required Investment (Manual)

(A) Definition

Minimum Required Investment (MRI) refers to the Borrower's contribution in cash or its equivalent required by Section 203(b)(9) of the National Housing Act, which represents at least 3.5 percent of the Adjusted Value of the Property.

(B) Standard

The Mortgagee may only permit the Borrower's MRI to be provided by a source permissible under Section 203(b)(9)(C) of the National Housing Act, which means the funds for the Borrower's MRI must not come from:

- (1) the seller of the Property;
- (2) any other person or Entity who financially benefits from the transaction (directly or indirectly); or
- (3) anyone who is or will be reimbursed, directly or indirectly, by any party included in (1) or (2) above.

While additional funds to close may be provided by one of these sources if permitted under the relevant source of funds requirements above, none of the Borrower's MRI may come from these sources. The Mortgagee must document permissible sources for the full MRI in accordance with special requirements noted above.

Additionally, in accordance with Prohibited Sources of Minimum Cash Investment Under the National Housing Act -Interpretive Rule, HUD does not interpret Section 203(b)(9)(C) of the National Housing Act to prohibit Governmental Entities, when acting in their governmental capacity, from providing the Borrower's MRI where the Governmental Entity is originating the insured Mortgage through one of its homeownership programs.

(C) Required Documentation

Where the Borrower's MRI is provided by someone other than the Borrower, the Mortgagee must also obtain documentation to support the permissible nature of the source of those funds.

To establish that the Governmental Entity provided the Borrower's MRI in a manner consistent with HUD's Interpretive Rule, the Mortgagee must document that the Governmental Entity incurred prior to or at closing an enforceable legal liability or obligation to fund the Borrower's MRI. It is not sufficient to document that the Governmental Entity has agreed to reimburse the Mortgagee for the use of funds legally belonging to the Mortgagee to fund the Borrower's MRI.

II. ORIGINATION THROUGH POST-CLOSING/ENDORSEMENT

A. Title II Insured Housing Programs Forward Mortgages

5. Manual Underwriting of the Borrower

The Mortgagee must obtain:

- a canceled check, evidence of wire transfer or other draw request showing that prior to or at the time of closing the Governmental Entity had authorized a draw of the funds provided towards the Borrower's MRI from the Governmental Entity's account; or
- a letter from the Governmental Entity, signed by an authorized official, establishing that the funds provided towards the Borrower's MRI were funds legally belonging to the Governmental Entity, when acting in their governmental capacity, at or before closing.

Where a letter from the Governmental Entity is submitted, the precise language of the letter may vary, but must demonstrate that the funds provided for the Borrower's MRI legally belonged to the Governmental Entity at or before closing, by stating, for example:

- the Governmental Entity has, at or before closing, incurred a legally enforceable liability as a result of its agreement to provide the funds towards the Borrower's MRI;
- the Governmental Entity has, at or before closing, incurred a legally enforceable obligation to provide the funds towards the Borrower's MRI; or
- the Governmental Entity has, at or before closing, authorized a draw on its account to provide the funds towards the Borrower's MRI.

While the Mortgagee is not required to document the actual transfer of funds in satisfaction of the obligation or liability, the failure of the Governmental Entity to satisfy the obligation or liability may result in a determination that the funds were provided by a prohibited source.

iii. Sources of Funds (Manual)

The Mortgagee must verify liquid assets for cash to close and Reserves as indicated.

(A) Checking and Savings Accounts (Manual)

(1) Definition

Checking and Savings Accounts refer to funds from Borrower-held accounts in a financial institution that allows for withdrawals and deposits.

(2) Standard

The Mortgagee must verify and document the existence of and amounts in the Borrower's checking and savings accounts.

For recently opened accounts and recent individual deposits of more than 1 percent of the Adjusted Value, the Mortgagee must obtain documentation of the deposits. The Mortgagee must also verify that no debts were incurred to obtain part, or all, of the MRI.

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

March 3, 2000

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

MORTGAGEE LETTER 00- 8

TO: ALL APPROVED MORTGAGEES ALL APPROVED NONPROFIT AGENCIES

SUBJECT: Nonprofit Agency Participation in Single Family FHA Activities

This Mortgagee Letter provides instructions to nonprofit agencies on obtaining approval from FHA to 1) act as a mortgagor using FHA mortgage insurance; 2) purchase the Department's Real Estate Owned Properties (HUD Homes) at a discount; and 3) provide secondary financing. In addition, it outlines the reporting and recertification requirements for the nonprofit agency to remain a participant in these activities and announces a limitation on the number of 203(k) FHA insured loans available to nonprofit agencies. This Mortgagee Letter also announces additional programmatic changes. Both current and prospective nonprofit agencies will be assessed pursuant to the standards and procedures set forth in this Mortgagee Letter. Mortgagees must assure that nonprofit agencies adhere to requirements contained under the heading "Responsibilities of the Mortgagee." The procedures described in this Mortgagee Letter and all attachments are effective 30 days from the date of this letter.

INFORMATION FOR NONPROFIT AGENCIES REGARDING PARTICIPATION IN FHA ACTIVITIES

All nonprofit agencies must follow the uniform standards for participation and recertification in FHA activities. All approved nonprofit agencies must carefully read the section entitled "Recertification," because if the nonprofit agency fails to submit an acceptable recertification package within 45 days from the date of this Mortgagee Letter, they will be removed from the list of approved nonprofit agencies. Further, the approval and recertification requirements ensure that participating nonprofit agencies work to fulfill FHA's goal of creating homeownership opportunities for low and moderate income persons.

Approval Letters

Nonprofit agencies that are approved for participation in the above described activities will be issued an approval letter. This letter will describe which activities the nonprofit was approved for and any conditions associated with that approval. Mortgagees should not process any loan application on behalf of the nonprofit agency without this approval letter. In addition, the mortgagee should verify that the nonprofit is approved as a participating nonprofit agency. Mortgagees can verify this by visiting the applicable HOC website. The addresses of these websites are listed below:

Philadelphia HOC: http://www.hud.gov/offices/hsg/sfh/talk/addr_phi.cfm
 Atlanta HOC: http://www.hud.gov/offices/hsg/sfh/talk/addr_atl.cfm
 Denver HOC: http://www.hud.gov/offices/hsg/sfh/talk/addr_den.cfm
 Santa Ana HOC: http://www.hud.gov/offices/hsg/sfh/talk/addr_sna.cfm

Questions concerning a nonprofit agency's approval should be directed to the appropriate HOC.

- **Recertification:** Nonprofit agencies must be recertified by FHA every two years, as the approval granted is only valid for a two year period. However, in an attempt to verify that all nonprofit agencies are meeting and furthering the goals of the Department, within 45 days from the date of this Mortgagee Letter, **all approved nonprofit agencies** are to submit a complete recertification package (refer to Attachment 1, page 4, for more information) to the applicable HOC. A complete list of the HOC mailing addresses can be found in attachment 1 as part of the application package. Nonprofit agencies that fail to submit an acceptable recertification package within 45 days from the date of this Mortgagee Letter will have their approval withdrawn. Attachment 4 provides additional information on about FHA's recertification procedures.
- **Monitoring and Reporting Process:** Periodically, FHA will perform field reviews of nonprofit agencies that participate in FHA activities. The purpose to this review is to ensure compliance with FHA requirements and to ascertain the management and financial capacity of the nonprofit agency. These reviews may include, without limitation, a review of projects under development, the agency's internal control procedures, adherence to the goals of the approved affordable housing program, and verification that HUD Homes purchased at the 30 percent discount level are sold to persons at or below the applicable median income.

Nonprofit agencies that purchase HUD Homes at the 30 percent discount level must submit an annual report to the applicable HOC Director providing information about their program accomplishments over the previous calendar year by February 1 of the following year. The HOC will review these accomplishments and supporting documentation to determine, among other things, that substantial benefits are passed on to the homeowner as a result of the nonprofit agency receiving a 30 percent discount on the property. Failure to pass on adequate savings to the ultimate homeowner

- **Application Process:** Nonprofit agencies wanting to participate with FHA as a mortgagor (#1 above) and/or purchase HUD Homes at a discount (#2 above) must apply to FHA by completing attachments I and 2 (Application Package for Nonprofit Agency Approval for FHA Activities and Affordable Housing Program-Format for Narrative, respectively) and submitting them to the appropriate Homeownership Center (HOC). The affordable housing program details the nonprofit agency's plan to develop successful homeownership opportunities for low and moderate income persons. In addition, nonprofit agencies are to refer to Mortgagee Letter 96-52 for details regarding successful elements of an affordable housing program. For those nonprofit agencies applying only for approval to provide secondary financing (#3 above), only attachment I (Application Package for Nonprofit Agency Approval for FHA Activities) is required to be submitted. Attachment 2 (Affordable Housing Program-Format for Narrative) is not required.

Information Collection Requirements

The information collection requirements referred to in this Mortgagee Letter have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). The OMB number issued for this requirement is OMB 2502-0540.

Incomplete Application and Recertification Packages

Nonprofit agencies that submit incomplete application or recertification packages will receive a letter indicating the information required to cure the deficiency. This letter will give nonprofit agencies 15 days to correct any deficiencies. If the nonprofit agency does not satisfy the outstanding requirement in its entirety and within the prescribed deadline, it must wait an additional 90 days prior to re-applying. In the case of failure to comply with the deficiency letter related to recertification, the nonprofit agency's approval will be withdrawn.

Application Approval or Denial

The jurisdictional HOC approves or denies the nonprofit agency's participation in FHA activities. The approval is valid for a two year period. An approval granted by one HOC will be recognized and accepted by all other HOCs, with the exception of the affordable housing program. A nonprofit agency's affordable housing program (see Attachment 2) must be separately approved by every HOC with jurisdiction over the geographic areas in which the nonprofit agency wishes to do business. The approval of the affordable housing program assures that it serves local needs. If a nonprofit agency is found to not be in compliance with any aspect of their approval, it may be rescinded by any HOC prior to the expiration of the two year period.

below. For those nonprofit agencies with limited housing experience, FHA may further restrict the number of **203(k)** mortgages it will insure to less than 10.

Mortgagees must verify that nonprofit agencies do not exceed this 10 (or less as stated above) 203(k) FHA insured mortgages limit. In all cases, the mortgagee must review the nonprofit agency's approval letter from FHA. This letter will clearly outline the amount of 203(k) financing available to the nonprofit agency. Questions concerning the nonprofit agency should be directed to the approving HOC.

- **Exceptional Performance Waiver:** Nonprofit agencies with an exceptional performance record of successfully completing 203(k) developments (defined as those agencies that have successfully completed 20 or more 203(k) developments) may apply to the HOC for a waiver of the limitation on 203(k) loans. This waiver request should contain a narrative describing the nonprofit agency's homeownership or long term rental program, audited financial statements with an unqualified opinion from a Certified Public Accountant for the prior three years, a listing of all properties currently owned by the nonprofit agency (both conventional and government financed), a record of performance on **all** 203(k) loans (current as well as previous loans) as well as the evidence to support the sale or rental of these properties. Nonprofit agencies that are approved for this waiver for financing for more than 10 203(k) mortgages at one time will have it stated in their approval letter from the HOC.
- **Requirement for Federal Tax Identification Number:** Lenders must obtain the tax identification number *of the nonprofit agency* when a) the nonprofit agency is acting as a mortgagor or b) when the nonprofit agency provides downpayment assistance in the form of a gift.

If the nonprofit agency is acting as a mortgagor, lenders are to enter the Federal Tax identification number of the nonprofit agency into the social security number field in the Computerized Homes Underwriting Management System (CHUMS). Failure to do this will result in the loan not being insured by FHA. If the nonprofit agency is providing downpayment assistance in the form of a gift, lenders are to enter into the CHUMS system the Federal Tax identification number of the nonprofit agency in the field designated for a charitable organization's tax identification number. Failure to do this will result in the loan not being insured by FHA.

- **Approval of Downpayment Assistance Programs in the Form of Gifts:** There has been widespread confusion regarding the Department's role in approving downpayment assistance programs in the form of gifts. FHA does not "approve" downpayment assistance programs in the form of gifts administered by charitable organizations. Mortgage lenders are responsible for assuring that the gift to the homebuyer from the charitable organization meets the instructions described in HUD Handbook 4155.1, REV-4, Change 1 (e.g., no repayment implied, etc.). Thus,

may result in removal from the approved list of nonprofit agencies. For additional information about this requirement, nonprofit agencies should review Mortgagee Letter 97-5. Although nonprofit agencies that purchase properties at the 10 percent discount level are not required to submit a report, the Department reserves the right to monitor the nonprofit agency's activities relating to these transactions.

If the nonprofit agency has not already submitted this report, it should be submitted with the recertification package as described above. Failure to submit this report to the HOC may result in FHA's rescinding the nonprofit agency's approval. Nonprofit agencies approved to purchase HUD Homes at less than a 30 percent discount level, or only to act as a mortgagor, or to provide secondary financing to homebuyers are not required to submit an annual report. Further information about monitoring and reporting is found in Attachment 3.

- **Removal:** FHA may remove a nonprofit agency from the list of approved nonprofit agencies for reasons including, but not limited to, excessive defaults, foreclosure or claim status associated with the nonprofit agency acting as a mortgagor on FHA insured loans, failure to comply with the goals established by the nonprofit agency as outlined in its approved affordable housing program, violations of the conditions of FHA's approval, noncompliance with reporting requirements or for any action detrimental to the Department. Attachment 4 provides additional information about FHA's removal procedures.

RESPONSIBILITIES OF THE MORTGAGEE

Mortgagees may not process any loan application on behalf of the nonprofit agency without an approval letter and without verifying that it is a participating nonprofit agency. In addition the Department has developed additional controls for nonprofit agencies and requirements for mortgagees. The mortgagee is responsible for ensuring that the participating nonprofit agency meets and adheres to the requirements described below.

- **Limitation on the Number of 203(k) FHA Insured Mortgages:** In order to ensure that nonprofit agencies will not overextend their financial and management capabilities, a nonprofit agency will now be prohibited from borrowing under the 203(k) program if the agency has 10 or more incomplete 203(k) developments at that time. FHA defines completed 203(k) developments as those that have completed all rehabilitation/construction work *in a timely manner*, received all appropriate certificates of occupancy, and EITHER the property has been sold and the nonprofit has successfully repaid the 203(k) loan in full, OR the property is occupied by a renter and the rental receipts exceed all property expenses, including mortgage payments, generating a positive cash flow. In the case of a rental property, the nonprofit agency must provide evidence that the property has been occupied by a renter for at least three months and that rental receipts exceed expenses.

Nonprofit agencies already having more than 10 incomplete developments may not obtain additional 203(k) financing until they reduce the number of incomplete 203(k) developments to less than ten. Therefore, in the future, nonprofit agencies shall not have more than ten incomplete 203(k) developments at any time unless they qualify for the exceptional performance waiver described

while FHA will issue approval letters to nonprofit agencies for their participation as mortgagors, providers of secondary financing, and as purchasers of HUD Homes at a discount, such letters **are not** to be construed as approval of the nonprofit agency's downpayment assistance gift programs. FHA will not issue approval letters for downpayment assistance gift programs.

- **Mortgagee's Responsibility for Credit Approval:** Mortgagees are required to follow sound underwriting judgment in approving a nonprofit agency as mortgagor. This includes performing a credit evaluation, a financial analysis and assessing the nonprofit agency's development and management capacity. In addition, mortgagees are responsible for reviewing the nonprofit agency's approval letter, as described in the "approval letter" section of this Mortgagee Letter, provided by FHA to determine if any conditions or restrictions apply. Mortgagees should also inquire/verify that the nonprofit organization remains eligible under Section 501(c)(3) as exempt from taxation under Section 501 (a) of the Internal Revenue Code of 1986, as amended. Loans that are processed that do not meet the requirements of the approval letter may be ineligible for FHA insurance. Attachment 6 to this Mortgagee Letter and Mortgagee Letter 96-52 provide additional information regarding the responsibility of the mortgagee in determining the management ability and financial capacity of the nonprofit agency acting as a mortgagor.
- **Continued Requirement for Compliance with the Seven Unit Limitation:** Mortgagees are reminded that any borrower, including nonprofit agencies that act as a borrower, is restricted from obtaining FHA-insured financing for a property that may be rented if it has or will have a financial interest in more than seven rental units (regardless of financing type) in a contiguous area, generally defined as within a two-block radius. This regulation is designed to limit FHA's insurance exposure on multiple mortgages to any one borrower in any one area.

The restrictions discussed above do not apply if (1) the neighborhood has been targeted by a State or local government for redevelopment or revitalization; and (2) the State or local government has submitted a plan to HUD that defines the area, extent, and type of commitment to revitalize the area.

Mortgagees seeking a waiver of the seven unit limitation must submit written requests to the appropriate HOC, stating the basis for the requested waiver. Waiver of this limitation will be granted only if the waivers pose no significant risk to HUD, and where the properties are in an area that is economically viable and with a demonstrated need for additional rental housing for families of low and moderate income.

- **Continued Requirement for Credit Alert and Limited Denial of Participation Screening:** Mortgagees are reminded that they must also screen nonprofit agencies acting as a mortgagor through the Credit Alert Interactive Voice Response System (CAIVRS) and against the Department's Limited Denial of Participation Lists. This is used to determine if the nonprofit agency has any Federal delinquencies or defaults or has been barred from participation in FHA programs.

Questions regarding this Mortgagee Letter should be directed to the FHA Homeownership in Atlanta (1-888-696-4687), Denver (1-800-543-9378), Philadelphia (1-800-440-8647) and Santa Ana (1-888-827-5605).

Sincerely,

William C. Apgar
Assistant Secretary for Housing-
Federal Housing Commissioner

Attachments:

Attachment 1: Application Package for Nonprofit Agency Approval for FHA Activities

Attachment 2: Affordable Housing Program-Format for Narrative

Attachment 3: Nonprofit Agency Reporting Requirements and FHA Monitoring Activities

Attachment 4: Nonprofit Agency Recertification Requirements and Reasons for Removal

Attachment 5: Recertification for Nonprofit Agencies-Property Listing Format

Attachment 6: Mortgagee Responsibility in the Credit Evaluation of the Nonprofit Borrower



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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

May 25, 2006

MORTGAGEE LETTER 2006 -13

TO: ALL APPROVED MORTGAGEES

SUBJECT: Charitable Organizations Making Downpayment Gifts

Federal Housing Administration (FHA) approved mortgagees that seek FHA mortgage insurance on loans secured by single family houses, on which downpayment assistance has been provided to the borrower in the form of gifts, are required to determine that the gifts are from sources acceptable to FHA.

Paragraph 2-10 C of handbook HUD-4155.1 REV-5 provides that the donor of any such gift must be the borrower's relative, the borrower's employer or labor union, a charitable organization, a governmental agency or public entity that has a program to provide homeownership assistance to low- and moderate-income families or first-time homebuyers, or a close friend with a clearly defined and documented interest in the borrower. For FHA, charitable organizations are those nonprofits that are exempt from income taxation under section 501(a) of the Internal Revenue Service Code (IRC) of 1986 pursuant to section 501(c)(3) of the IRC.

This Mortgagee Letter advises mortgagees about how to determine whether a gift from a charitable organization can be used for all, or part, of the borrower's downpayment when the organization providing the gift for the downpayment loses or gives up its federal tax-exempt status. Provided that the homebuyer 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, FHA will recognize the gift—if made to the homebuyer and properly documented—as an acceptable source of the downpayment. FHA believes this policy avoids harm to any homebuyer who, in good faith, has entered into a contract of sale in anticipation of receiving a gift for the downpayment from such a charitable organization.

The mortgagee is responsible for ensuring that an entity is a charitable organization as defined above. One resource available to mortgagees for obtaining this information is the Internal Revenue Service (IRS) Publication 78, *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986*, which contains a list of organizations eligible to receive tax-deductible charitable contributions. The IRS has an online version of this list that can help mortgagees and others conduct a search of these organizations. The online version can be found at: <http://apps.irs.gov/app/pub78>, using the following instructions to obtain the latest update.

- Enter search data and click "Search"
- Click "Search for Charities" under "Charities & Non-Profits Topics"
- Click "Recent Deletions from Cumulative List" under "Additional Information"

- Click name of organization if that name appears on list of names under “Recent Deletions from Cumulative List (Publication 78)”

In addition, FHA has developed a web page that provides a listing of downpayment assistance providers whose nonprofit status has been revoked. This page can be found at: <http://www.hud.gov/offices/hsg/sfh/np/irstatus.cfm>

FHA continues to examine downpayment assistance programs and will provide appropriate notification about any changes that may be made to existing policies.

Please note that Mortgagee Letter 2005-02 provides guidance to mortgagees and appraisers about their responsibilities for reporting sales concessions and verifying sales data, including downpayment assistance provided by the seller or any other party involved in the transaction.

If you have any questions regarding this Mortgagee Letter, call 1-800-CALLFHA.

Sincerely,

Brian D. Montgomery
Assistant Secretary for Housing-
Federal Housing Commissioner



ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Date: May 9, 2013

To: All FHA-Approved Mortgagees

Mortgagee Letter 2013-14

Subject Minimum Cash Investment and Secondary Financing Requirements – Acceptable Documentation for Funds Provided by Federal, State, or Local Governments, their Agencies or Instrumentalities

Purpose This Mortgagee Letter sets forth the documentation mortgagees must provide to demonstrate eligibility for FHA mortgage insurance of loans when a Federal, State, or local government, its agency or instrumentality directly provides the borrower's required Minimum Cash Investment in accordance with the principles set forth in the December 5, 2012 Interpretive Rule ("Interpretive Rule"), Docket No. FR-5679-N-01.

This Mortgagee Letter also provides mortgagees with guidance on resolving concerns with extending secondary financing by the Federal, State, or local government, its agency or instrumentality when those entities provide the borrower's required Minimum Cash Investment through secondary financing.

Effective Date This Mortgagee Letter is effective July 1, 2013.

Affected Topics HUD Handbook 4155.1 Sections 5.B.1.a, 5.C.2.c, 5.B.5.b and Mortgagee Letter 2008-23 are affected by this guidance. The changes will be integrated into the FHA Single Family On-Line Handbooks.

Continued on next page

Mortgagee Letter 2013-14, Continued

Background The originating FHA-approved mortgagee must document that all funds for the borrower's required Minimum Cash Investment necessary to close the FHA-insured mortgage belong to the borrower or were provided by a permissible source in accordance with FHA requirements. Section 2113 of the Housing and Economic Recovery Act of 2008 (HERA), amended section 203(b)(9) of the National Housing Act (NHA). This amendment requires the borrower to provide a required Minimum Cash Investment equal to but not less than 3.5 percent of the appraised value of the property. None of this required minimum cash investment can be provided by the seller of the property or any other person or entity who financially benefits from the transaction, or from any person who is reimbursed by any prohibited source. Mortgagees must ensure compliance with sections 203(b)(9)(A) and (C) of the NHA in order for the borrower's mortgage to be eligible for FHA insurance.

On December 5, 2012, HUD published an Interpretive Rule, Docket No. FR-5679-N-01. This rule expressed HUD's interpretation that section 203(b)(9)(C) of the NHA does not prohibit FHA from insuring mortgages originated as part of the homeownership programs of Federal, State, or local government or their agencies or instrumentalities (hereinafter referred to as "Government Entities") when the Government Entities also directly provide funds toward the required Minimum Cash Investment.

Additionally, HUD's requirements have historically required all secondary financing being put in place by Government Entities to be "made" by the Government Entity. However, due to the variety and complexity of state and local laws governing the conduct of these types of Government Entities, FHA will streamline this process for the Government Entity in FHA-insured transactions.

Continued on next page

Mortgagee Letter 2013-14, Continued

Acceptable Documentation To establish that the Government Entity provided the borrower's required Minimum Cash Investment in a manner consistent with HUD's Interpretive Rule, the mortgagee must document that the Government Entity incurred prior to or at closing an enforceable legal liability or obligation to fund the borrower's required Minimum Cash Investment. While it is not sufficient to document that the Government Entity has agreed to reimburse the lender for the use of funds legally belonging to the lender to fund the borrower's required Minimum Cash Investment, the documentation described below will demonstrate that the Government Entity's funds, generated through the creation of a legal liability or obligation were the permissible source of the required Minimum Cash Investment.

Acceptable forms of documentation include the following:

- A cancelled check, evidence of wire transfer or other draw request showing that prior to or at the time of closing the Government Entity had authorized a draw of the funds on its account provided towards the borrower's required Minimum Cash Investment from the Government Entity's account; **or**
- A letter from the Government Entity, signed by an authorized official, establishing that the funds provided towards the borrower's required Minimum Cash Investment were funds legally belonging to the Government Entity at or before closing.

Where a letter from the Government Entity is submitted, the precise language of the letter may vary because of differences in the funding and legal authority of each Government Entity. Examples of acceptable language, which would establish the funds were legally belonging to the Government Entity, would include the following:

- A statement that the Government Entity has, at or before closing, incurred a **legally enforceable liability** as a result of its agreement to provide the funds towards the borrower's required Minimum Cash Investment;
- A statement that the Government Entity has, at or before closing, incurred a **legally enforceable obligation** to provide the funds towards the borrower's required Minimum Cash Investment; **or**
- A statement that the Government Entity has, at or before closing, authorized a draw on its account to provide the funds towards the borrower's required Minimum Cash Investment.

Continued on next page

Mortgagee Letter 2013-14, Continued

Acceptable Documentation (continued)

The mortgagee is not required to document the actual transfer of funds in satisfaction of the obligation or liability, which resulted from the funding of the borrower's required Minimum Cash Investment by the Government Entity, before closing, provided the mortgagee has obtained documentation that a legally enforceable liability or obligation was incurred at or before closing. Where such documentation is provided establishing that a legally enforceable liability or obligation was incurred at or before closing, the funds provided at closing for down payment assistance will be considered by HUD to be funds legally belonging to the Government Entity. However, failure of the Government Entity to satisfy the obligation or liability may result in a determination that the funds were provided by a prohibited source.

Note: The Mortgagee is reminded to document a Gift Letter for the borrower's Cash to close including the required Minimum Cash Investment as described in HUD Handbook **4155.1 5.B.5.a Gift Letter Requirement**. The Mortgagee must place the Gift Letter and the documentation evidencing the provision of the borrower's required Minimum Cash Investment in compliance with the Interpretative Rule on the right side of the endorsement binder with Asset Verification documentation needed to close. These instructions on the placement of documentation in the endorsement file supersede the guidance in 4155.1 5.B.5.b.

Making of Secondary Financing On behalf of Government Entities

FHA recognizes the importance of compliance with state and local law to the conduct of any Government Entity providing down payment assistance in the form of secondary financing. Where the Government Entity cannot legally or operationally ensure that secondary financing is "made" by the Government Entity, FHA will permit the secondary financing component to be made by an FHA-approved mortgagee or FHA-approved non-profit on behalf of the Governmental Entity provided the mortgagee or non-profit is not a prohibited source and the Government Entity holds the secondary financing prior to endorsement of the first mortgage for FHA insurance until further notice. Mortgagees must document that the secondary financing is held by the Government Entity prior to submission of the mortgage to HUD via the Direct Endorsement process for insurance, or the endorsement of the mortgage for insurance through the Lender Insurance process.

Continued on next page

THE
FINANCIAL
CRISIS
INQUIRY REPORT



**Final Report of the National Commission
on the Causes of the Financial and
Economic Crisis in the United States**

• OFFICIAL GOVERNMENT EDITION •

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not the outcome he and other investment bankers had expected. “None of us wrote and said, ‘Oh, by the way, you have to be responsible for your actions,’” Ranieri said. “It was pretty self-evident.”²⁷

The starting point for many mortgages was a mortgage broker. These independent brokers, with access to a variety of lenders, worked with borrowers to complete the application process. Using brokers allowed more rapid expansion, with no need to build branches; lowered costs, with no need for full-time salespeople; and extended geographic reach.

For brokers, compensation generally came as up-front fees—from the borrower, from the lender, or both—so the loan’s performance mattered little. These fees were often paid without the borrower’s knowledge. Indeed, many borrowers mistakenly believed the mortgage brokers acted in borrowers’ best interest.²⁸ One common fee paid by the lender to the broker was the “yield spread premium”: on higher-interest loans, the lending bank would pay the broker a higher premium, giving the incentive to sign the borrower to the highest possible rate. “If the broker decides he’s going to try and make more money on the loan, then he’s going to raise the rate,” said Jay Jeffries, a former sales manager for Fremont Investment & Loan, to the Commission. “We’ve got a higher rate loan, we’re paying the broker for that yield spread premium.”²⁹

In theory, borrowers are the first defense against abusive lending. By shopping around, they should realize, for example, if a broker is trying to sell them a higher-priced loan or to place them in a subprime loan when they would qualify for a less-expensive prime loan. But many borrowers do not understand the most basic aspects of their mortgage. A study by two Federal Reserve economists estimated at least 38% of borrowers with adjustable-rate mortgages did not understand how much their interest rates could reset at one time, and more than half underestimated how high their rates could reach over the years.³⁰ The same lack of awareness extended to other terms of the loan—for example, the level of documentation provided to the lender. “Most borrowers didn’t even realize that they were getting a no-doc loan,” said Michael Calhoun, president of the Center for Responsible Lending. “They’d come in with their W-2 and end up with a no-doc loan simply because the broker was getting paid more and the lender was getting paid more and there was extra yield left over for Wall Street because the loan carried a higher interest rate.”³¹

And borrowers with less access to credit are particularly ill equipped to challenge the more experienced person across the desk. “While many [consumers] believe they are pretty good at dealing with day-to-day financial matters, in actuality they engage in financial behaviors that generate expenses and fees: overdrawing checking accounts, making late credit card payments, or exceeding limits on credit card charges,” Annamaria Lusardi, a professor of economics at Dartmouth College, told the FCIC. “Comparing terms of financial contracts and shopping around before making financial decisions are not at all common among the population.”³²

Recall our case study securitization deal discussed earlier—in which New Century sold 4,499 mortgages to Citigroup, which then sold them to the securitization trust, which then bundled them into 19 tranches for sale to investors. Out of those 4,499 mortgages, brokers originated 3,466 on behalf of New Century. For each, the

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June 18, 2012

Victor J. James
Acting General Counsel
California Housing Finance Authority
500 Capitol Mall, Suite 1400
Sacramento, California 95814

RE: Request for Advice on the Jurisdictional Authority of a Local Housing Authority and an Out-of-State Housing Authority Under State Law

Dear Mr. James:

This letter responds to your request for legal advice on the jurisdictional authority of local and out-of-state housing authorities to operate statewide in California. Your questions relate to a Notice of Funding Availability issued by the United States Department of Housing and Urban Development ("HUD") for its Performance-Based Contract Administrator Program. In connection with this federal program, you have asked for advice on the following state law issues:

Discussion

1. Does a local housing authority have legal authority to operate throughout the entire state?

Although there is no case or statute precisely on point, our review of the relevant authorities leads us to conclude that a local housing authority likely lacks the necessary legal authority to operate statewide.

Public housing is generally administered through local housing authorities pursuant to the Housing Authorities Law. (Health & Saf. Code, § 34200 et seq.)¹ The Housing Authorities Law creates in each county and city a local housing authority to provide safe and sanitary dwellings to persons of low income. (§§ 34201, 34240, 34242, 34312, 34315, 34322.) California has more than 80 local housing authorities operating in various areas throughout the state. The rights,

¹ All statutory references are to the Health and Safety Code unless otherwise provided.

duties, powers and privileges of a housing authority are vested in its board of commissioners, who are appointed by local county or city officials. (§§ 34275, 34290.)

We have previously advised that the operation of a housing authority is local in nature, being essentially limited to a defined geographic area. (64 Ops.Cal.Atty.Gen. 677 (1981).) Under the Housing Authorities Law, the area of operation of a housing authority is a defined term. The area of operation of a city housing authority is the city and the area within five miles of its territorial boundaries, except it does not include any area which lies within the territorial boundaries of another city. (§ 34208.) For a county housing authority, the area of operation is the unincorporated areas of the county, and any incorporated areas of the county upon consent of the incorporated area. (§ 34209.) The area of operation of an area housing authority is the combined possible areas of operation of the participating cities and counties. (§ 34247.) We believe these definitional provisions indicate that the Legislature intended to limit the jurisdictional powers of a local housing authority to the geographic area in which it operates.²

This conclusion is supported by case law. In *Torres v. Board of Commissioners of the Housing Authority of Tulare County* (1979) 89 Cal.App.3d 545 (*Torres*), the court determined that local housing authorities are not “state agencies” even though they administer matters of state concern because they are local in scope and character, restricted geographically in their area of operation, and do not have statewide power or jurisdiction. (*Torres, supra*, 89 Cal.App.3d at 550.)

2. Does a corporation or other instrumentality formed by a local housing authority have legal authority to exercise the statutory powers of a local housing authority throughout the entire state?

A local housing authority which lacks legal authority to operate statewide may not delegate authority it does not have to operate statewide to a corporation or other instrumentality.

As described above, we view the powers of a local housing authority as being limited to the geographic area in which it operates. The issue then is whether a corporation or other instrumentality formed by one or more local housing authorities may exercise power outside of the geographic area in which the creating authorities operate. In *Cabrillo Community College Dist. v. California Junior College Assoc.* (1975) 44 Cal.App.3d 367 (*Cabrillo College*), the court considered a similar issue. In that case, several community colleges created an association to regulate athletic competition among its member colleges. The association imposed a local residency requirement on student athletes. The new requirement, however, was at odds with state law, which does not require students to be residents of a community college district to gain admission. The court held that when the member colleges created the association, they delegated

² See *Housing Authority of City of Los Angeles v. City of Los Angeles* (1953) 40 Cal.2d 682, 687 (city housing authority did not exceed jurisdiction by developing a housing project on a site outside the city where city agreed to annex the site).

some of their power to the association and they could only delegate as much power as they themselves derive by statute. (*Cabrillo College, supra*, 44 Cal.App.3d at 372.) Thus, the association could not exercise greater power than its member colleges.

Applying *Cabrillo College*, a local housing authority cannot delegate more power than it has. If the legal authority of one or more local housing authorities is limited to a certain geographic area, then the legal authority of a corporation or instrumentality formed by the authorities is similarly limited.

3. Does a local housing authority have legal authority to accept a federal grant for a housing project that is outside its territorial jurisdiction?

A local housing authority which lacks legal authority to operate statewide may not accept a federal grant for a housing project that lies outside its defined area of operation.

A valid administrative action must be within the scope of authority conferred by statute. (*US Ecology, Inc. v. State of California* (2001) 92 Cal.App.4th 113, 131-132.) As a creature of statute, a local housing authority may not exceed the powers given to it by the Legislature. Section 34311, subdivision (d) authorizes local housing authorities to make and execute contracts necessary or convenient to the exercise of its powers. In addition, section 34315.3 authorizes local housing authorities to accept financial or other assistance from any public or private source for activities permitted by state law. More specifically, section 34327, subdivision (a) authorizes a local housing authority to borrow money or accept grants or other financial assistance from the federal government for any housing project that is "within its area of operation." As described above, we view the powers of a local housing authority as being limited to the geographic area in which it operates. Thus, we believe the grants of power in the three statutes above are also limited and only apply to housing projects and programs within a local housing authority's geographic area of operation.

4. Does an out-of-state housing authority have legal authority to exercise the powers of a housing authority in California?

An out of state housing authority lacks legal authority to exercise the powers of a housing authority in California.

As a sovereign state, California has a right to exercise its police power and the power of eminent domain to protect the safety, health, and welfare of its citizens. When enacting the Housing Authorities Law, the Legislature expressly declared that the shortage of safe and sanitary dwelling accommodations for persons of low income cause an increase in and spread of disease and crime and constitutes a menace to the health, safety, morals, and welfare of California residents. (§ 34201.) The Legislature has delegated some of its sovereign power to local housing authorities through the Housing Authorities Law to address these threats to public health and safety. A local housing authority may, among other things, acquire property, enter

into contracts, exercise the power of eminent domain, and issue bonds to finance its functions. (§ 34310 et seq.)

Like California, other states have passed laws creating housing authorities. But a housing authority created under the sovereign power of another state does not have authority to exercise that power in California. (See *Hall v. University of Nevada* (1972) 8 Cal.3d 522, 524.) Under our federal system of government, individual states may adopt distinct policies to protect their own residents and every state enjoys the same power. (*Sullivan v. Oracle Corp.* (2011) 51 Cal.4th 1191, 1205.) It is true that each state must give full faith and credit to the “public acts, records, and judicial proceedings” of every other state.” (U.S. Const., art. IV, § 1.) But a state does not have to substitute another state’s statutes in place of its own laws on a subject matter it is competent to govern. (*Baker by Thomas v. General Motors Corp.* (1998) 522 U.S. 222, 232.)

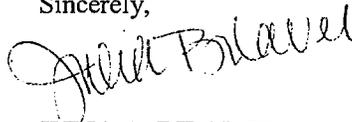
The Housing Authorities Law does not delegate powers to out-of-state housing authorities, and we are not aware of any other statutes that delegate the powers of a housing authority to out-of-state housing authorities. Thus, an out-of-state housing authority does not have legal authority to exercise the same powers as a housing authority in California.

5. Does a corporation formed by an out-of-state housing authority have legal authority to exercise the powers of a housing authority in California?

An out-of-state housing authority lacks legal authority to exercise the powers of a housing authority in California, and so would any corporations formed by it.

A corporation formed by an out-of-state housing authority can only exercise as much power as that out-of-state housing authority. (See *Cabrillo College, supra*, 44 Cal.App.3d at 372.) Because state law does not delegate any sovereign power to out-of-state housing authorities, a corporation formed by an out-of-state housing authority would also lack legal authority to exercise the powers of a local housing authority in California.

Sincerely,



JULIA A. BILAVER
Deputy Attorney General

COURT OF APPEALS
THE STATE OF WASHINGTON
DIVISION I

NATIONAL HOMEBUYERS
FUND, INC., et al.,

Appellants,

v.

WASHINGTON STATE
HOUSING FINANCE
COMMISSION,

Respondent.

No. 76510-8-I

PROOF OF SERVICE

I am and at all times hereinafter mentioned was a citizen of the United States, a resident of the State of Washington, over the age of 21 years, competent to be a witness in the above action, and not a party thereto; that on the 26th day of July, 2017, I caused to be served via electronic mail, per agreement of the parties, true copies of the following documents to the parties listed below:

- 1) Brief of Respondent Washington State Housing Finance Commission; and
- 2) Appendix to Brief of Respondent Washington State Housing Finance Commission.

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I declare under penalty of perjury under the laws of the State of
Washington that the foregoing is true and correct.

DATED this 26th day of July, 2017.



Dawn M. Taylor