

## Opinion No. 65-87

June 8, 1965

**BY:** OPINION OF BOSTON E. WITT, Attorney General Thomas A. Donnelly, Assistant Attorney General

**TO:** Mr. Robert G. Mead, State Investment Officer, State Land Office Building, Santa Fe, New Mexico

### QUESTION

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May the State Investment Council lawfully contract to hold a participating fractional interest with other parties in mortgages which are insured by the Federal Housing Administration?

#### CONCLUSION

Yes.

### OPINION

#### {\*150} ANALYSIS

By State Constitutional provision (Article XII, Section 7) the principal of the permanent school fund, and other permanent funds, are required to be invested by the State Investment Officer in accordance with policy regulations promulgated by the State Investment Council, and such constitutional section sets out in part:

". . . The legislature may by a three-fourth's vote of the members elected to each house provide that said funds **may be invested in interest bearing or other securities . . .**" (Emphasis supplied)

In implementing this constitutional provision, the State Legislature enacted Section 11-2-8.12, N.M.S.A., 1953 Compilation, (being Laws 1957, Chapter 179, Section 9, as amended) and which provides in part:

"Securities and Investment. -- Moneys made available for investment for a period in excess of one year may be invested in the following classes of securities and investments:

A. Bonds, notes, or other obligations of the United States, or those guaranteed by, **or for which the credit of, the United States is pledged for the payment of the principal and interest or dividends thereof;**

C. Bonds, debentures, or other obligations issued by a federal land bank, or by a federal intermediate credit bank, under the Act of Congress of July 17, 1916, known as the 'federal farm Loan Act,' as amended or supplemental from time to time;

**D. Bonds, debentures, or other obligations issued by any national mortgage association under the Act of Congress of June 27, 1934, known as the 'National Housing Act.' as amended;**

**E. Bonds, notes, debentures, car-trust certificates or other certificates of indebtedness, preferred stock or common stock of any corporation organized and operating within the United States;** Provided that it shall have minimum net assets of ten million dollars (\$ 10,000,000) or more and securities listed on one or more national stock exchanges; . . . ." (Emphasis supplied)

As declared by statute, the State Investment Officer, under the direction of the State Investment {<sup>\*151</sup>} Council, may invest permanent fund monies in bonds, notes, or debentures which are guaranteed by the United States or for which the credit of the Federal government is pledged for the payment of principal and interest or dividends. Additionally, such investments may be made in bonds, notes or debentures or certificates of indebtedness of corporations organized and operating within the United States and possessing minimum net assets of ten million dollars or more, and securities listed on one or more national stock exchanges.

Under the participation device commonly employed in financial transactions, a principal party, often a bank or trust company, purchases a note and mortgage upon a FHA insured project and then by contract agreement sells a "participating interest" to one or more other parties. Generally such participating agreements specify that the principal will hold the loan documents in its physical possession, collect all payments due under the mortgage and remit to participant all amounts to which the participant is entitled, less any servicing fees, make such advances as are required to protect mortgaged premises and the FHA insurance with participant, notify the participant of any default and foreclose the loan or, with the consent of the participants accept a deed in lieu of foreclosure or assign the loan to FHA, keep at all times proper books of account and records, will not without consent of participant make or consent to any alteration of the terms of any note, collateral or instrument, or sue or waive any claim against the borrower, and will see that at all times the mortgaged premises are insured against fire and other hazards, as provided in the FHA insured mortgage.

FHA Regulation 207.261 governs in part any transfer of a partial interest under a participation agreement when the loan is FHA insured. Such regulation sets out in part:

". . . (e) Transfer of partial interest under participation agreement. A partial interest in an insured mortgage may be transferred without obtaining the approval of the Commissioner under a participation agreement or arrangement if the following conditions are met:

(1) The insured mortgage shall be held by an approved mortgagee subject to the inspection and supervision of a governmental agency authorized by law to make periodic examination of its books and accounts, and which shall for the purpose of this section be hereinafter referred to as the 'principal' mortgagee:

(2) The 'principal' mortgagee shall at all times retain at least a ten percent beneficial interest in the insured mortgage up to the time of final endorsement and at least a five percent beneficial interest thereafter:

(3) A participation or partial interest in an insured mortgage shall be issued to and held only by holders meeting the following qualifications:

(i) A mortgagee approved by the Commissioner:

(ii) A pension or retirement fund or a profit sharing plan maintained and administered by a corporation or by a governmental agency or by a trustee or trustees, which the 'principal' mortgagee determines has lawful authority to acquire a partial interest in an insured mortgage under the conditions set forth in this paragraph:

(iii) A charitable or nonprofit organization.

It is our opinion, based upon a careful reading of Article XII, Section 7 of the State Constitution, Section 11-2-8.12, N.M.S.A., 1953 {*\*152*} Compilation, and applicable FHA regulations, that the State Investment Officer may, with the approval of the State Investment Council and upon compliance with FHA regulations, purchase a participating fractional interest in a note and mortgage of the same type which State permanent funds could be used to purchase the entire note and mortgage.