

Opinion No. 58-172

August 18, 1958

BY: OPINION OF FRED M. STANDLEY, Attorney General Alfred P Whittaker, Assistant Attorney General

TO: Mr. John C. Hays, Executive Secretary, Public Employees Retirement Association of New Mexico, P. O. Box 2237, Santa Fe, New Mexico

QUESTION

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1. May the Public Employees Retirement Board invest funds of the Association in mortgages unconditionally guaranteed by the United States, through its Federal Housing Administration pursuant to Subchapter VIII of the National Housing Act?
2. Assuming an affirmative answer to the first question, may the Board invest funds of the Association in part of such a mortgage?

CONCLUSIONS

1. Yes.
2. Yes.

OPINION

ANALYSIS

The investment authority of the retirement board is found at Section 5-5-4(1), N.M.S.A., 1953, which is relevant part provides:

"The retirement board shall be the trustees of the several funds created by the act and it shall have full power to invest and re-invest same in bonds, or other obligations of the United States; or in general obligation bonds of the state of New Mexico, any city, town, school district, or conservancy district in the state of New Mexico; or in any obligations of any governmental agency in which both interest and principal are guaranteed by the United States government."

The mortgages referred to are mortgages insured by the Federal Housing Administration pursuant to Subchapter VIII of the National Housing Act, relating to the insurance of mortgages on property utilized for family housing accommodations by personal of the armed services and situated at or near a military installation. As we understand it, the Secretary of Defense or his designee enters into contracts for the

construction of such housing accommodations pursuant to provisions of the National Housing Act, as amended, relating to housing of military personnel. (See 42 U.S.C.A., § 1594). Such construction is accomplished through a corporation organized for the purpose, and subject to control by the Federal Housing Administration as to its capital structure and methods of operation. Such corporation, approved by the F.H.A., becomes the mortgagor in the situation. The entire transaction is closely regulated by the F.H.A., as set forth in 12 U.S.C.A., § 1748 through § 1748g, and regulations pursuant to the statutory provisions set forth the procedures to be followed in considerable detail. 24 C.F.R., 1958 P.S., Ch. II, Part 292a (Armed Services Housing Insurance; Eligibility Requirements of Mortgage); Part 293 a (Armed Services Housing Insurance; Rights and Obligations of the Mortgagee under the Insurance Contract). These regulations, among other things, appear to contemplate the provision of interim financing during the construction period by the original mortgagee, the insurance of such advances under the program, the acquisition of all of the stock of the mortgagor corporation by the Department of Defense, upon completion of the project, and the operation and maintenance of the project by the military so long as the insured mortgage is outstanding. Statutory authorization for acquisition of the corporate stock and operation of the project is found at 42 U.S.C.A., § 1594(c). Upon execution of the contract of insurance, its validity is incontestable in the hands of an approved mortgagee, except for fraud or misrepresentation. 12 U.S.C.A., § 1748(j). Appropriations for quarters allowances are utilized by the military department concerned to meet debt service requirements of the mortgagor corporation.

Whether or not the obligation of the mortgagor corporation might be viewed as an obligation of the United States, following acquisition of the capital stock thereof, it is clear that upon completion of the project and issuance of the contract of insurance, the obligation of the mortgagor corporation is unconditionally guaranteed by the United States. Accordingly such mortgages are clearly authorized investments for the retirement board under the express provisions of Sec. 5-5-4, supra. In making this statement, we have reference to the permanent financing of such military housing projects under mortgages insured as above set forth, and not to construction loans which, we understand, are not unconditionally guaranteed under the procedures followed as to such interim financing.

In view of the substantial size of some of the mortgage loans involved in these military housing projects, you inquire further whether or not it would be proper to invest in part of such a mortgage, the remainder being subscribed by other (presumably institutional) investors.

The governing statute creates four separate funds to be administered by the association, the employees' savings fund, employers' accumulation fund, retirement reserve fund and income fund. While Sec. 5-5-8(1) requires separate accounting controls as to each of said funds, the same section further provides:

"The maintaining of the said separate accounting controls is not to be interpreted as requiring the actual segregation of the assets of the association within the various funds and divisions."

Thus, there is no statutory requirement that the various funds be segregated as to investments, and no prohibition against the allocation of a share of an investment to each of the several funds. This is important, and bears on the second question, since the obligations of the retirement board as to the several funds administered, under Secs. 5-5-4(1) and 5-5-8(2), are the obligations of trustees, and the funds are trust funds.

We conclude that under Sec. 5-5-4(1), and without violating its fiduciary obligation as trustee, the retirement board may properly invest in a share in such a mortgage. Although that provision does not specifically deal with this precise situation, in our opinion, a share of such a mortgage is included within the board terms used, ". . . any obligations of any governmental agency . . .". Several objections are urged to investment by the trustee of a private trust in mortgage participations, but none of these apply here, in our view. The primary objection is stated by Scott on Trusts, in Volume II, § 179.4, p. 1325, as follows:

"There is some question, however, whether it is proper to invest trust funds in a share of a mortgage. The objection is that if the trustee invests trust funds, in a part of a mortgage, he does not as trustee for the beneficiaries of the trust have complete control of the situation, whether the balance of the money lent on the mortgage is let by a third person, or by the trustee individually, or by him as trustee under other trusts. The same objection is to be met where he invests trust funds in a participating interest in a group of mortgages. By the weight of authority, however, it is held that such an investment is not improper, at least if none of the objections dealt with hereafter are present."

One of the other objections commonly raised is that the trustee is guilty of improper self-dealing. This applies when the trustee is a trust company which purchases a whole mortgage and places participations therein in the portfolio of the individual trusts administered. The objection has no bearing on the transaction here considered. Another objection is the failure of the trustee adequately to earmark the investment as made for a particular trust, the only identification being on the trustee's books and records, rather than on the face of the mortgage instrument. Again, this question arises when the corporate trustee makes the original investment in its own name and allocate shares to the various trusts administered. As already indicated, Sec. 5-5-8(1) expressly obviates this objection as it might be urged to apply to the four trust funds administered by the retirement board, by providing that actual segregation of assets to the various funds is not required. Identification of the association's share in the mortgage will be necessary, of course, so that the association's interest can be distinguished from the interests of co-investors in the mortgage; and procedures must be developed to insure that the association receives its proper share of the income from the investment.

Another objection raised as to the investment of trust funds by a corporate trustee in mortgage participations is that ordinarily there is no market for such participations other than that created by the trustee in repurchasing them for itself or for other trusts - which market disappears with a collapse for the real estate market. In our case, the marketability of a share in a mortgage of the type considered probably is the same as, or greater than, the marketability of a whole mortgage of the same type. The question is merely one of the prudence of the trustee, here, and no more than that question, which applies equally to all investments made by the retirement board.

In connection with the foregoing discussion, see generally Scott on Trusts, Vol. I, § 170.14, p. 1229; § 179.4, p. 1325; and Vol. II. § 227.9 p. 1677.

We conclude that investment in a share of a mortgage of the type considered is authorized by Sec. 5-5-4(1), and does not violate the fiduciary obligations of the retirement board, in dealing with the trust funds administered.