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Vet. Aff. Op. Gen. Couns. Prec. 03-91

TEXT:

Legal Opinion on the Secretary's Authority to Comply with certain Conditions Specified in Loan Sale Agreement for AHT VIII and to Amend AHT VI and AHT VII Documents.

QUESTIONS PRESENTED:

a. May the Secretary agree to terms imposed by the draft American Housing Trust (AHT) VIII loan sale agreement, which will require, as a condition to the sale, that if the master servicer and the trustee fail in their obligations to advance for a shortfall in scheduled monthly interest and principal, VA will make the advance plus reimbursement of all reasonable expenses incurred by certificateholders in connection with delay?

b. May the provision described in question (a) above, be added to existing AHT VI and AHT VII by amendment of the documents for those transactions?

COMMENTS:

1. In the AHT VIII loan sale, scheduled to close on or about January 29, 1991, all loans will be sold to the trust (more precisely, to an underlying pooling trust in a double REMIC structure employed in AHT VIII because of certain tax rules applicable to the kind of IO tranching used) with a 100 percent VA guaranty, and all of the trust certificates (more precisely, all of the certificates of the AHT VIII issuing trust) will be sold to the public as triple-A rated securities. The trust, as purchaser of the vendee loans and as was the case in AHT VI and AHT VII, will require that VA transfer title to certain subordinate certificates which VA holds from prior sales to a Custodian pursuant to a Master Custody Agreement (a Custody Agreement in AHT VI). Subordinate certificate income will be made available to the AHT VIII reserve fund.

2. A reserve fund will be established and maintained for AHT VIII pursuant to a Custody Agreement and will receive monthly funding up to a specified limit from the Master Custody Agreement. The reserve fund will be used to assist in meeting any AHT VIII scheduled monthly interest and principal shortfalls and to meet loan guaranty claims. In the absence of sufficient

monies in the reserve fund, the master servicer and the trustee are obligated to advance for such shortfalls. VA is obligated to reimburse the master servicer and the trustee for their advances including reimbursement of all reasonable expenses incurred by them in connection with such advances.

3. Establishment and maintenance of the reserve fund will be mandated by the terms of the AHT VIII loan sale agreement, which will also require that if for any reason the balance in the reserve fund is reduced below a specified floor, VA must promptly replenish the reserve fund. In addition, the AHT VIII loan sale agreement will require, as did the AHT VI and AHT VII agreements, that VA reimburse the trust for prepayment interest shortfalls.

4. Approval for the credit structure described in paragraphs 2 and 3, above, was granted in O.G.C. Precedent Opinion 14-90 (May 18, 1990). In that decision, it was determined that the Secretary of Veterans Affairs, based on 38 U.S.C. §§ 1820(a)(5) and 1833, has the authority to agree to establish, maintain, and replenish a reserve fund and to include within the VA guaranty an obligation to reimburse the trust for prepayment interest shortfalls.

5. AHT VIII will extend VA's undertaking a step further. The loan sale agreement for AHT VIII will state that should the master servicer and trustee fail to advance for a shortfall in scheduled interest and principal, as they are unconditionally required to do under the pooling and servicing agreement, VA will be required to pay promptly into the payment account for distribution to certificateholders the amount of such advance plus all reasonable expenses incurred by certificate holders in connection with the delay, with the calculation of such reasonable expense being based upon and limited to the interest rate or rates applicable to the certificates of such holders for the period from the distribution date on which the advance by the master servicer or the trustee was to have been available to the distribution date on which the advance by VA is available. An advance made by VA will be reimbursed to VA from the certificate account. Further, the master servicer and the trustee will be required to reimburse VA for any additional expense it incurs because of their failures to advance. VA has been advised by the underwriters and by its financial advisor that this new undertaking, commonly referred to as a "yield maintenance" provision, is in VA's best interest because it will give important protection to VA against rating agency downgrade of the AHT certificates in the event the master servicer and the trustee should be graded below double-A, thus both benefiting VA and improving the security.

6. Section 1820(a)(5), of title 38, United States Code, provides that, notwithstanding the provisions of any other law, the Secretary is authorized, relative to matters arising under the home loan program, to sell, exchange,

assign, convey or otherwise dispose of any real or personal property upon such terms, and for such prices as the Secretary determines to be reasonable. This section of the law gives the Secretary substantial discretion in selling property and determining reasonable terms and conditions.

7. In addition to the authority under section 1820(a)(5), the Secretary has specific authority to sell loans with recourse. An American Housing Trust sale with a VA guaranty has been determined to constitute a sale of loans with recourse. See O.G.C. Advisory 86-89. Like VA's undertakings in AHT VI and AHT VII to reimburse the trust for prepayment interest shortfalls and to establish a reserve fund and maintain it at a specified level VA's undertaking here to advance for scheduled interest and principal shortfalls if both the master servicer and the trustee default in their obligations to make such advances (which can occur only if the reserve fund is depleted entirely and VA has not yet restored it to the specified level) constitutes a VA guaranty with recourse. Measuring the reasonable expenses incurred by certificateholders in connection with the advancing delay by reference and limit to the interest rates applicable to the various certificates is similar to the specified measurement of expenses reimbursable by VA to the master servicer and trustee when they make an advance. See Section 7 of the AHT VII Custody Agreement. Therefore, in response to the first question posed above, we conclude that the Secretary, under 38 U.S.C. §§ 1833 and 1820, has authority to agree to this provision.

8. It is proposed to amend the loan sale agreements for AHT VI and AHT VII to incorporate the yield maintenance provision described in paragraph 5, above. Thus, the second question which arises is whether it is within the Secretary's authority to enter into such an amendment. Our response to this question is in the affirmative.

9. The AHT VI and VII loan sale agreements authorize amendments by written instrument executed by VA and the trust, provided the requirements of section 10.01 of the pooling and servicing agreement are met. Those requirements appear to be met as regards amending to include the provision in question. In addition, inclusion of the yield maintenance provision will benefit VA by providing important downgrade protection. Indeed, in the case of AHT VI and AHT VII, VA has been informed by Moody's Investors Service that unless VA takes some appropriate action, the AHT VI and AHT VII certificates will be downgraded by Moody's below triple-A, because Moody's already has downgraded the trustee for those transactions, Security Pacific National Bank. VA has been advised by the underwriters and by its financial advisor that the action that is in VA best interest, both with respect to AHT VI and AHT VII and with respect to AHT VIII and future transactions is to incorporate the yield maintenance provision. Accordingly, in response to the second question posed above,

we conclude that the Secretary, under 38 U.S.C. §§ 1833 and 1820, has authority to enter into such amendments.

HELD:

In the AHT VIII transaction and pursuant to the loan sale agreement, the Secretary of Veterans Affairs had the authority to agree that if the master servicer and the trustee fail in their obligations to advance for a shortfall in scheduled interest and principal, VA will make the advance plus reimbursement, as therein provided and described above, of all reasonable expenses. Further, the Secretary has the authority to agree to include such a provision in the AHT VII documents by entering into appropriate amendments.

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