

UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF HEARINGS AND APPEALS

In the Matter of:

NEWCASTLE HOME LOANS LLC,

Respondent.

24-JM-0364-MR-014

November 18, 2024

INITIAL DECISION AND ORDER GRANTING SUMMARY JUDGMENT

On July 30, 2024, the Mortgagee Review Board (“Board”) of the United States of Department of Housing and Urban Development (“HUD”) issued a Notice of Withdrawal withdrawing approval of NewCastle Home Loans LLC (“NewCastle”) as a Federal Housing Administration (“FHA”) mortgagee for one year. On September 3, 2024, this Court received Respondent’s request for a hearing to challenge HUD’s decision to withdraw Respondent from the FHA program.

On October 24, 2024, HUD moved for summary judgment on the basis that there is no genuine dispute that Respondent failed to meet the minimum required liquid asset balance in fiscal years 2021 and 2022, which is a core FHA requirement. Respondent filed a *Memorandum in Opposition to Government’s Motion for Summary Judgment* on November 5, 2024.¹

APPLICABLE LEGAL PRINCIPLES

I. FHA Applicable Law & Guidance

FHA Approval of Lenders. The National Housing Act (“the Act”), Pub. L. No. 84-345, 48 Stat. 1246 (1934), 12 U.S.C. §§ 1701 *et seq.* created the Federal Housing Administration and the Board, provided for the insurance of mortgages by the federal government, and established the Mutual Mortgage Insurance Fund, with which the government could guarantee qualifying mortgages. To be eligible for FHA insurance, the Act requires that all qualifying mortgages shall “[h]ave, or be held by, a mortgagee approved by the Administrator as responsible and able to service the mortgage properly.” 12 U.S.C. § 1709(b)(1). Pursuant to the Act, the FHA established requirements that lenders must satisfy to obtain, and to annually renew, approval to originate FHA-insured loans. These are set forth at 24 C.F.R. Part 202 and the FHA Title II Mortgagee Approval Handbook 4060.1, REV-2 (2006).

¹ Respondent’s reply to the *Motion* was filed late. Respondent did not request leave to file late, but this Court will accept the filing as it is one day late.

FHA’s Minimum Net Adjusted Worth Requirement. Against the backdrop of one of the most significant real estate crises in U.S. history, HUD revised its regulations to increase the net worth minimum benchmarks for all annual mortgagee recertification packages submitted after May 2013. Federal Housing Administration: Continuation of FHA Reform; Strengthening Risk Management Through Responsible FHA-Approved Lenders, 75 Fed. Reg. 20718, 20733 (Apr. 20, 2010). In its explanation of the changes to the net worth requirements, HUD stated that the requirements had not been adjusted since 1993 and that changes were being made “to ensure that FHA-approved mortgagees are sufficiently capitalized for the financial transactions occurring, and concomitant risks present, in today’s economy.” Id. at 20718.

The applicable net worth requirement is set out at 24 C.F.R. § 202.5(n)(3)(i) and states that:

[i]rrespective of size, ... each approved lender or mortgagee, for participation solely under the FHA single family programs, shall have a net worth of not less than \$1 million, plus an additional net worth of one percent of the total volume in excess of \$25 million of FHA single family insured mortgages originated, underwritten, purchased, or serviced during the prior fiscal year, up to a maximum required net worth of \$2.5 million. No less than 20 percent of the applicant’s or approved lender or mortgagee’s required net worth must be liquid assets consisting of cash or its equivalent acceptable to the Secretary.

HUD issued the FHA Single Family Housing Policy Handbook (“Handbook”), which includes FHA approval and eligibility requirements for both Title I lenders and Title II mortgagees. The Handbook sets forth that lenders must meet the FHA’s adjusted net worth requirements at all times. FHA SINGLE FAMILY HOUSING POLICY HANDBOOK 4000.1, Section I.A.3.c.vii. Therefore, HUD requires that each lender annually certify that it has complied with all FHA regulations and requirements necessary to maintain approval. 24 C.F.R. § 202.5(m); HANDBOOK at § I.A.8.b.

FHA’s Requirement that Lenders Notify of Liquid Asset Deficiency. FHA rules require that an approved lender notify FHA if the lender experiences a liquid asset deficiency by submitting a Notice of Material Event online within 30 business days of the liquid asset deficiency. Additionally, the lender must submit a Corrective Action Plan that outlines, among other things, the steps taken to mitigate the deficiency. See HANDBOOK 4000.1, Sections I.A.7.a.ii, I.A.7.g.

II. Mortgagee Review Board

The Act also established the Mortgagee Review Board (“Board”) and empowered it to take certain actions, including a withdrawal of any lender found to be engaging in activities that violate FHA requirements or nondiscrimination requirements. 12 U.S.C. § 1708(c)(1). The violation of these requirements may result in the withdrawal of the approval of a lender to participate in the single-family mortgage insurance program. Specifically, the Board is

empowered to initiate the withdrawal of any mortgagee “found to be engaging in activities in violation of [FHA] requirements.” 12 U.S.C. § 1708(c)(1). The Board may issue an order withdrawing a mortgagee “if the Board has made a determination of a serious violation or repeated violations by the mortgagee.” *Id.* at § 1708(c)(3)(D). The Board shall “determine the terms of such withdrawal, but the term shall not be less than 1 year.” *Id.* The violations creating grounds for an administrative action by the Board, including a withdrawal action, are listed in 24 C.F.R. § 25.6. These violations include among other things:

(g) Failure to comply with any agreement, certification, undertaking, or condition of approval listed on, or applicable to, either a mortgagee’s application for approval or an approved mortgagee’s branch office notification;

(h) Failure of an approved mortgagee to meet or maintain the applicable net worth, liquidity or warehouse line of credit requirements of 24 CFR part 202 pertaining to net worth, liquid assets, and warehouse line of credit or other acceptable funding plan;

...

(j) Violation of the requirements of any contract or agreement with the Department, or violation of the requirements set forth in any statute, regulation, handbook, mortgagee letter, or other written rule or instruction;

...

(ff) Any other violation of the Federal Housing Administration requirements that the Board or the Secretary determines to be so serious as to justify an administrative sanction.

24 C.F.R. § 25.6(g), (h), (j), and (ff).

In situations where the Board seeks to impose a withdrawal, it must issue a notice that describes the nature and duration of the administrative action, specifically states the reasons for the action, and informs the lender of its right to a hearing regarding the administrative action and of the manner and time in which to request a hearing. 24 C.F.R. § 25.9(b); see also 12 U.S.C. § 1708(c)(4).

Part 202 of Title 24 of the Code of Federal Regulations establishes the minimum requirements for continued approval to participate in FHA’s mortgage insurance programs. See 24 C.F.R. § 202.1. Approved lenders renew their FHA approval on an annual basis through, inter alia, submission of audited financial statements, supplemental information such as an adjusted net worth computation, and other information requested by the Secretary. 24 C.F.R. §§ 202.5(g), 202.7(b)(4). Approved lenders are subject to the HUD Uniform Financial Reporting Standards. See 24 C.F.R. § 5.801(a)(5); see also 24 C.F.R. § 202.7(b)(3) (referencing 24 C.F.R. § 5.801(a)(5)). Under those standards, the mortgagee “must provide to HUD such financial information as required by HUD...on an annual basis ... [and these] must be ... [p]repared in accordance with Generally Accepted Accounting Principles as further defined by HUD in supplementary guidance,” such as the OIG Audit Guide. See 24 C.F.R. § 5.801(b)(1).

III. Summary Judgment

Hearings concerning the Board's withdrawal of lender's FHA approval are conducted in accordance with procedures set forth at 24 C.F.R. Part 26, Subpart B. See 24 C.F.R. § 25.10. Pursuant to 24 C.F.R. § 26.32(l), this Court is authorized to "decide cases, in whole or in part, by summary judgment where there is no disputed issue of material fact." The Court may exercise its discretion in application of Rule 56 of the Federal Rules of Civil Procedure ("FRCP"). 24 C.F.R. § 26.40(f)(2).

Under 24 C.F.R. § 26.40(f), a party may timely move for summary judgment on all or part of the claim. Although Part 26 does not set forth a standard for the granting of a motion for summary judgment, the FRCP and case law interpreting the rules provide useful guidance. See, e.g., In re Salvador Alvarez, HUDALJ 04-25-PF, at 4 (June 23, 2005) (using FRCP, Rule 56 states that summary judgment shall be granted if the moving party "shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law"). A "genuine" issue exists when "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (1986). Additionally, a fact is not "material" unless it affects the outcome of the suit. Id.

DISCUSSION

HUD claims there is no dispute as to the material facts and, as such, HUD is entitled to judgment as a matter of law. Specifically, HUD asserts that Respondent reported year-end liquid assets that included notes receivable as liquid assets. HUD adds that such categorization is, as a matter of law, impermissible. As such, HUD claims it is entitled to a judgment in its favor, because Respondent did not meet the minimum liquid asset requirement.

In response, Respondent disputes HUD's claim that there are no material facts in dispute. Rather, Respondent alleges there exists a dispute as to the material fact of whether a lender may count notes receivable as cash equivalents.² Respondent also disputes HUD's alleged fact that Respondent admitted that its notes receivable secured loans disbursed to its members. However, as more fully explained below, this fact is not material because withdrawal is nonetheless warranted for Respondent's failure to meet FHA requirements.

I. Material Facts Not in Dispute.

Respondent is an Illinois limited liability company engaged in the business of underwriting mortgages insured by the FHA and is approved to participate as a single-family lender in the FHA mortgage insurance program.

FHA rules require a lender to notify FHA if the lender experiences an adjusted net worth deficiency within 30 business days of the deficiency by submitting a Notice of Material Event. The lender must also submit a Corrective Action Plan that outlines things, such as the steps taken to mitigate the deficiency. HANDBOOK 4000.1, Sections I.A.7.a.ii, I.A.7.g. Respondent notified

² This issue is a legal question and not a factual dispute.

FHA of a Notice of Material Event #1-351153867 for a Net Worth Deficiency on October 31, 2022.

In accordance with FHA requirements, Respondent engaged in the services of an independent public accounting firm to conduct an audit of its financial statements the fiscal year that ended December 31, 2022. On December 16, 2022, the Board advised Respondent that it was considering taking an administrative action against the company based on one violation. In response, Respondent submitted its audit report of its financial statements prepared by Craig Shaffer of Craig Shaffer and Associates Ltd. Mr. Shaffer was tasked with reporting on, among other things, whether Respondent had complied with FHA requirements.

Respondent reported year-end liquid assets of \$1,443,582 for fiscal year 2022 which included seven notes secured by mortgages with a total value of \$1,320,000. On April 20, 2023, the Board requested documentation to support Respondent's liquid assets. After reviewing further documentation submitted by Respondent, the Board determined that Respondent's liquidity amounted to \$123,582, which is less than the required \$200,000 minimum. The liquidity deficiency was attributed to the fact that Mr. Shaffer included seven notes receivable in the liquidity computation.

Upon further investigation, FHA determined that Respondent had been treating, since at least 2021, some of the various notes as cash or cash equivalent for purposes of satisfying FHA's liquid asset requirement and Respondent had been experiencing an uninterrupted liquid asset deficiency since its fiscal year 2021. On this basis and other perceived discrepancies, the Mortgagee Review Board determined administrative action was warranted. On December 9, 2023, FHA issued a Superseding Notice of Violation and Notice of Intent to Seek Civil Money Penalty ("NOV") for violations in fiscal years 2019 - 2022 on December 9, 2023. The NOV was based on twelve violations of FHA requirements including failure to maintain the minimum adjusted net worth, failure to timely notify FHA of a net worth deficiency, failure to maintain the minimum liquid assets required, and failure to timely notify FHA of a liquid asset deficiency over the last few years.

After considering the violations and Respondent's continued noncompliance through fiscal year end December 31, 2023, the Board voted to withdraw FHA approval of the company for a period of one year based on the twelve violations of FHA requirements. On September 3, 2024, Respondent filed an appeal of its withdrawal from the FHA program. The *Motion* before the Court only concerns Respondent's failure to meet FHA's minimum liquid asset requirements in fiscal years 2021 and 2022.

II. HUD is entitled to judgment as a matter of law.

In the *Hearing Request*, Respondent did not dispute the Board's determination that, if Respondent's notes receivable were excluded from the liquidity calculations for fiscal years 2021 and 2022, then Respondent was noncompliant with FHA's minimum liquid asset requirements throughout those fiscal years.³ However, Respondent claims that the Generally Accepted

³ The Mortgagee Review Board issued a Notice of Withdrawal dated July 30, 2024, to Respondent. That Notice of Withdrawal constitutes the *Complaint* in this matter.

Accounting Principles (“GAAP”) permits the inclusion of notes receivable as cash equivalents if the notes have an original maturity of three months or less from the date of purchase and are highly liquid with minimal risk of changes in value.

A. Respondent failed to maintain the liquid asset requirement for Fiscal Year Ending December 31, 2021.

HUD seeks a finding that Respondent failed to satisfy one of the keystone requirements for participation in the mortgage insurance programs overseen by the FHA by not maintaining an excess of \$200,000 in liquid assets for multiple years. Specifically, HUD alleges after excluding the notes receivable from the liquid asset computation, Respondent’s liquid assets were deficient of the regulatory required amount in its fiscal years 2021 and 2022. As noted *supra*, no less than 20 percent of the lender’s required net worth must be liquid assets consisting of cash or its equivalent *acceptable to the Secretary*. 24 C.F.R. § 202.5(n)(3)(i) (emphasis added). With a baseline of \$1,000,000, FHA required Respondent to maintain at least \$200,000 in liquid assets consisting of cash or cash equivalents.

FHA utilizes the GAAP and the Office of Inspector General Handbook 2000.04, Consolidated Audit Guide for Audits of HUD Programs (“OIG Audit Guide”) to compute liquidity for purposes of its eligibility requirements. Under the OIG Audit Guide, “cash” means cash on hand, checking accounts, savings accounts, and certificates of deposit; and “cash equivalents” mean readily marketable investments. OIG Audit Guide, CHG-22, Ch. 7-5(F)(1) n.3. Readily marketable investments are commonly understood to include investments that can feasibly be sold quickly on a public market. The OIG Audit Guide also states to be considered a liquid asset, the cash or cash equivalent must not be restricted or otherwise reserved for any purpose other than the payment of a current liability. Under the OIG Audit Guide, FHA does not consider a line of credit or loans or mortgages held for resale by the lender to be liquid assets. *Id.* Under GAAP, “loan” encompasses notes receivable. A company can categorize short-term notes as cash equivalents, under the Accounting Standards Codification (ASC), which provides structure for GAAP, if the note has an original maturity of three months or less from the date of purchase, and the note must be highly liquid with a minimal risk in changes in value. FIN. ACCOUNTING STANDARDS BD., ACCOUNTING STANDARDS CODIFICATION § 230-10-20 (2024).

Respondent categorized short-term notes that mature within three months as cash equivalents in 2021 and 2022 in an attempt to satisfy FHA’s liquid assets requirement. In March 2022, Respondent reported year-end liquid assets of \$1,153,562 for fiscal year 2021 which included six notes secured by mortgages with a total value of \$1,020,000. Respondent disclosed that the company considers all highly liquid investments purchased with original maturities of three months or less on their acquisition date to be cash equivalents. Respondent also explained the 90-day notes are cash equivalents because they are unrestricted investments that can be converted to cash to pay current liabilities.

HUD claims Respondent was noncompliant with FHA’s minimum liquid asset requirement in fiscal year 2021. Although Respondent classifies its notes as cash equivalents, HUD classifies notes receivable as loans, which are not liquid assets. Moreover, cash and cash

equivalents are liquid assets because they can feasibly be sold quickly on a public market, but HUD claims this is not the case with Respondent's notes.

By Respondent's own disclosure, the notes receivable are classified as cash equivalents because they are highly liquid investments purchased with original maturities of three months or less on their acquisition date. However, Respondent's six notes receivable cannot be considered as cash equivalents as they are not short term nor converted to cash within 90 days. Most of the due dates are illusory and there is no evidence that Respondent has received repayment of the notes receivable during the fiscal year in question. Specifically, four of the notes have an automatic 90-day extension from the due date until the loan is paid off, and the due dates have been continuously extended for several years. The remaining two notes became due in July 2020, and there is no evidence that Respondent has collected any portion of the principal. Respondent is focused on the original maturity date while overlooking the highly liquid aspect of a cash equivalent. Both aspects are required for a note to be considered a cash equivalent. See ACCOUNTING STANDARDS § 230-10-20.

Thus, the notes receivable do not meet the definition of cash equivalent for HUD's requirements nor the definition put forth by Respondent. The controlling language in the GAAP and the OIG Audit Guide do not qualify notes receivable as liquid assets. Notes receivable are considered loans, and liquid assets consisting of cash or its equivalent must be acceptable to the Secretary. The Secretary does not consider notes receivable as cash equivalents, so they must be omitted from the liquid asset computation.

After excluding the six notes receivable, Respondent's liquid asset balance was \$133,562 (\$1,153,562 - \$1,020,000), less than the minimum \$200,000 requirement. Therefore, Respondent failed to meet the liquid asset requirement in its fiscal year end December 31, 2021. Accordingly, the Court finds Respondent violated the FHA rules requiring a lender to meet the FHA's minimum liquidity requirement of \$200,000. 24 C.F.R. §202.5(n) and 202.7(b)(1); HANDBOOK 4000.1, at § I.A.3.c.vii.

B. Respondent's failure to maintain the liquid asset requirement for Fiscal Year Ended December 31, 2022.

HUD also claims Respondent was noncompliant with FHA's minimum liquid asset requirement for fiscal year ended December 31, 2022. On April 1, 2023, Respondent reported year-end liquid assets of \$1,443,582 for fiscal year 2022 which included seven notes secured by mortgages with a total value of \$1,320,000. Six of the notes were referenced in fiscal year 2021 and the Court already held that they are not cash equivalents. The seventh note has a maturity date of October 2022, and the record does not reflect Respondent received repayment of the note. On September 23, 2024, Respondent submitted evidence that it had received repayment of the borrowed funds. However, the deposits in the bank statements document the receipt of interest payments only on one or more of the notes receivable, and nothing indicates that it was collecting on the principal of the notes. It is clear Respondent has not recouped money from the notes receivables, and the notes are not short term.

Thus, the notes receivable do not meet the definition of cash equivalent for HUD's requirements nor the definition put forth by Respondent. To reiterate, the controlling language in the GAAP and the OIG Audit Guide do not qualify notes receivable as liquid assets. Notes receivable are considered loans. Liquid assets consisting of cash or its equivalent must be acceptable to the Secretary. The Secretary does not consider notes receivable as cash equivalents, so they must be removed from the liquid asset computation.

After excluding the seven notes receivable, Respondent's liquid asset balance was \$123,582 (\$1,443,582 - \$1,320,000), less than the minimum \$200,000 requirement. Therefore, Respondent failed to meet the liquid asset requirement in its fiscal year end December 31, 2022. The Court finds Respondent violated the FHA rules requiring a lender to meet the FHA's minimum liquidity requirement of \$200,000. 24 C.F.R. §202.5(n) and 202.7(b)(1); HANDBOOK 4000.1, at § I.A.3.c.vii.

C. Respondent's violation was serious and non-waivable thus warranting Respondent's withdrawal from the FHA program.

The liquidity asset requirement is an important requirement that Respondent fell short of in 2021 and 2022. An administrative action imposed under 12 U.S.C. § 1708(c) must be based upon one or more of the violations enumerated by 24 C.F.R. § 25.6. The failure of an approved lender to meet or maintain the applicable liquidity requirement set forth by the FHA constitutes a violation for which an administrative action may be imposed. 24 C.F.R. § 25.6(h). "A failure to maintain sufficient liquid assets leaves the agency's mortgaged insurance funds vulnerable[.]" Fidelity Homes and Loans Inc., HUDALJ 10-E-111-MR-72, at 30 (Aug. 27, 2010).

Respondent's liquid asset deficiency is an issue that has been ongoing since fiscal year 2021 and has continued into the fiscal year that ended December 31, 2023. This issue involves an FHA requirement for approving a lender or mortgagee. See 24 C.F.R. § 202.5 (setting forth the net worth requirement for lenders and mortgagees as a requirement to receive and maintain approval by the FHA).

As an FHA approval standard, the minimum liquid asset requirement is non-waivable. A1 Mort. Group, HUDOHA 19-AF-0168-MR-004, at 7 (June 4, 2020), Secretarial appeal filed July 2, 2020. Fidelity, at 32; R&G Mortg. Corp., HUDALJ 07-052-MR, at 13 (Nov. 20, 2007); see also 24 C.F.R. § 26.50(a) (citing 57 Fed. Reg. 31048 (July 13, 1992)). If violations of mortgagee requirements deal with a non-waivable lender approval requirement, implementing a withdrawal action is nondiscretionary. R&G Mortg. Corp., at 11 (citing 57 Fed. Reg. 31048 (July 13, 1992)). Respondent's serious violations of FHA requirements regarding fiscal year 2021 creates the basis for FHA to take administrative action. See 24 C.F.R. §§ 25.6(e) and (h); see also Fidelity, at 32.

In its appeal, Respondent did not dispute the Board's determination that, if Respondent's notes receivable were excluded from the liquidity calculations for fiscal years 2021 and 2022, then Respondent was noncompliant with FHA's minimum liquid asset requirements throughout those fiscal years. Because the Court has found that Respondent failed to meet the liquid asset

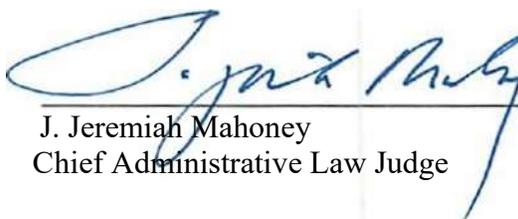
requirement in its fiscal year end December 31, 2021, and December 31, 2022, and this is a non-waivable requirement, the Boards's withdrawal action is non-discretionary.

The Board's administrative action withdrawing FHA approval of Respondent for one year is appropriate and warranted.

CONCLUSION

The Court finds that HUD has met its burden to demonstrate that no genuine issue of material fact exists in this matter. The material facts support the findings that Respondent failed to maintain the required minimum liquidity in fiscal year ended December 31, 2021, and December 22, 2022. Respondent's failure to maintain the required liquidity is a serious violation of FHA requirements warranting its withdrawal from the FHA program. HUD is therefore entitled to judgment as a matter of law and its *Motion for Summary Judgment* is **GRANTED**.

So **ORDERED**,



J. Jeremiah Mahoney
Chief Administrative Law Judge

Notice of appeal rights. The appeal procedure is set forth in detail in 24 C.F.R. § 26.52. This order may be appealed to the Secretary of HUD by either party within 30 days after the date of this decision. The Secretary (or designee) may extend this 30-day period for good cause. If the Secretary (or designee) does not act upon the appeal within 30 days, this decision becomes final.

Service of appeal documents. Any petition for review or statement in opposition must be served upon the Secretary by mail, facsimile, or electric means at the following:

U.S. Department of Housing and Urban Development
Attention: Secretarial Review Clerk
451 7th Street, S.W., Room 2130
Washington, DC 20410
Facsimile: (202) 485-9475
Scanned electronic document: secretarialreview@hud.gov

Copies of appeal documents. Copies of any Petition for review or statement in opposition shall also be served on the opposing party(s), and on the HUD Office of Hearings and Appeals.

Judicial review of final decision. Judicial review of the final agency decision in this matter may be available, as appropriate, under 5 U.S.C. § 702.