Legal Opinion: GCH-0070

Index: 2.600, 2.651
Subject: Section 11(b) Bond Refunding

May 4, 1993

MEMORANDUM FOR: Donald A. Kaplan, Director
Office of Evaluation, HFE

FROM: Robert S. Kenison, Associate General Counsel
Office of Assisted Housing and Community Development, GC

SUBJECT: OIG Report: Bond Refunding of Section 8 Projects

This is in response to your requests for an opinion with respect to the legality of adopting the following IG recommendations.

1A. Issue regulations that require State HFAs and PHAs with Trustee Sweeps to apply the AAF to a rent figure that would have resulted had the ACC, HAP contract and mortgage been amended; or, take steps to eliminate the Trustee Sweep and amend the ACC, HAP contracts and mortgages.

State HFAs that have refunded FAF bonds entered into Refunding Agreements with HUD that provided for the Trustee Sweep. Those Agreements are legally binding contracts between HUD and the HFAs and cannot be unilaterally altered or abrogated by HUD. The Supreme Court ruled in Lynch v. U.S., 292 U.S. 571 (1934), that the United States is as bound by its contracts as are individuals. It further stated that the United States cannot abrogate contractual rights to reduce expenditures. The only reason of which we are aware that HUD could use to justify such a regulation is to reduce its expenditures and this is not a sufficient basis for unilateral abrogation of a contract by the Government. Therefore, regulations cannot be issued to require State HFAs that have already entered into Refunding Agreements with HUD which provide for the Trustee Sweep to apply the AAF retroactively to a rent figure that would have resulted had the ACC, HAP Contract and mortgage been amended.

There is no legal impediment to eliminating the Trustee Sweep prospectively and amending the ACC, HAP contract and mortgage for any project for which HUD has not entered into a Refunding Agreement. HUD can issue regulations for those projects to require that the contract rents and contract and budget authority be reduced. However, a regulation is not required to eliminate the Trustee Sweep because it was provided for contractually. We note that the Appropriations Act has consistently included language which clearly permits the Trustee Sweep. It states:

> Provided further, That up to fifty percent of the amount of budget authority, or in lieu thereof 50 per cent of the cash amounts associated with such budget authority, that are recaptured from projects described in section 1012(a) of the Stewart B. McKinney Homeless Assistance Amendments Act of 1988 shall not be rescinded, or in the case of cash, shall not be remitted to the Treasury, and such amounts of budget

authority or cash shall be used by State housing finance agencies in accordance with such section. (Emphasis added.)

It is our understanding that former Congressman Bill Green's staff contacted HUD for language to be included in the FY 1990 Appropriations Act. In July 1989, HUD's Budget Office provided the above language for FAF recaptures to the Appropriations Committee. This language was drafted purposefully to give HUD the flexibility of recapturing section 8 subsidy through reduction of contract rents or through the Trustee Sweep. With the Trustee Sweep, the contract rents are not reduced. Instead, 50 percent of the cash amounts associated with the budget authority for the contract rents are remitted to the Treasury and 50 per cent of the cash amounts are used by the agencies pursuant to the Appropriations Act.

2B. Determine whether any of the inappropriately paid Section 8 subsidies can be recovered for rent increases already paid.

At the time HUD implemented the Trustee Sweep, a determination was made to exclude those owners who would not participate in the refunding. For those owners who were excluded from participating in the refunding, there is no basis to recapture section 8 subsidies that were paid in accordance with the HAP Contract. For those owners who participated in the refunding, HUD could have provided that as a condition of the refunding the application of future AAFs would be based on contract rents that would have resulted if the ACC, HAP Contract and mortgage had been amended. Since HUD did not impose that condition, we see no legal basis to require it after the fact.

The annual adjustments have been made pursuant to a contract which the owner of the project and the PHA entered into in good faith. Even in the face of the refunding, we see no legal basis for HUD to retroactively alter that contract. Citing Perry v. U.S., 294 U.S. 330 (1935) and Lynch, the Supreme Court held in Bowen v. Public Agencies Opposed to Social Security Entrapment, 477 U.S. 41 (1986), that while the Federal Government, as sovereign, has the power to enter contracts that confer vested rights, it has the concomitant duty to honor those rights. With respect to the HAP Contract these rights include the owner's right to receive a rent increase in accordance with the terms of the HAP Contract.

3.A. Determine whether State HFA bond refundings represent substantive changes in the financing documents that need Departmental approval. B. If the change is substantive, require HUD approval of Non-FAF project bond refundings to ensure that section 8 savings are realized and received by HUD. C. If the change is substantive, take action to recover savings from past Non-FAF project bond refundings by State HFAs.

The regulations at 24 CFR 883.109 (effective prior to February 29, 1980) and 24 CFR 883.307 (effective February 29, 1980) require that State housing finance agencies submit their financing documents to HUD for review prior to receiving HUD approval of their "first" proposal for a section 8 project, such documents to include the bond resolutions or indentures, loan agreements, regulatory agreements, notes, and mortgages or deeds of trust and other related documents. The regulations also require that HUD review the documents if substantive changes affecting section 8 are made subsequent to approval. Pursuant to section 883.307(b)(1), the scope of HUD's review is "limited to making certain that the documents are not inconsistent with or in violation of these regulations or the administrative procedures used to implement them." The types of substantive changes that affect the Section 8 program (which are generally contained in the ACC, HAP Contract and Regulatory Agreements) would include provisions that change HUD requirements with respect to rents,

occupancy, and relocation. However, as stated in section 883.211 of the regulations that were in effect prior to February 29, 1980, the HFA can certify that the terms and conditions of the financing for the particular project are consistent with those specified in the documents which were approved by HUD. In addition, the Preamble to the Interim Rule to Part 883 (effective February 29, 1980) states that "the relationship between State Agencies and HUD which allows them to certify that program requirements are met has not been altered in this interim regulation." HUD generally accepts these certifications unless it has substantial reasons to question them.

If the HFA or owner seeks to assign the HAP Contract as security for refunding bonds, HUD must approve the terms of the financing pursuant to the HAP Contract.

3D. Pursue legislative or regulatory changes that would require owners of Non-FAF Section 8 projects to refund bonds where savings can be realized and that those savings be passed on to HUD.

Bonds are issued by State HFAs and PHAs. Unless the owner of the project is the State HFA or PHA, owners (who are generally private individuals) cannot refund bonds. We doubt that even a Federal legislative change would readily accomplish the proposal, given State bonding structures. There is explicit language in the Note to Schedule A to Part 888 which implemented the FAF that grants HUD the authority to require that State HFAs and PHAs refund bonds for FAF projects. The Note provided that the financing documents shall include a provision providing for advance refunding "at the request of HUD." (46 FR 51906, October 23, 1981). But we see no authority for HUD to require State HFAs or PHAs to refund bonds for Non-FAF projects.

You also ask for any advice on how to comply with the following recommendations.

4A. Issuing a directive instructing Field Offices to ensure, where appropriate, that administrative fees are not allowed when a State agency receives an override. 4B. Taking action to determine the amount of duplicate administrative payments that have been paid in the past and require State agencies to reimburse HUD.

In a conversation with Jim Mitchell of your staff concerning clarification of your request, he indicated that you are requesting advice regarding the ability of HUD to require that State HFAs (Oregon in particular) reimburse HUD where the State HFAs have received the duplicate fees.

Agencies that received the FAF were subject to the FAF regulations and the section 8 regulations that were in effect at that time (24 CFR 883.306). The FAF regulations provided that the State HFAs could receive a .5 percent override. Section 883.306 provided that a State HFA could not receive both an administrative fee and an override. If the State HFA received the override, it should not have received the administrative fee. We understand that an administrative fee was approved by the Field Office for Oregon when the section 8 application was approved. When the bonds were refunded, Oregon received the 1.5 percent override allowed under the Code. In addition, the Refunding Agreement provided that the Oregon HFA would continue to receive the administrative fee. A regulatory waiver would have been needed to allow the State HFA to continue to receive the administrative fee. If a waiver was not granted, the State HFA is in violation of the regulations.

If a determination is made that any State HFA received an administrative fee and an override in violation of the regulations and a waiver of the regulations was not granted, HUD should seek to recover the amount of the administrative fee or of the override. So long as HUD did not know or could not reasonably be expected to know that the HFA collected both the administrative fee and the override, recovery should be sought. In the instant case the OIG Audit Report states that "The Office of Housing indicated that the duplicate collection of fees was unknown to them."

In a separate request, Jim Mitchell asked that we respond to the following.

6A. Obtain a legal opinion on the applicability of the .5 percent override limitation to refunding of FAF project bonds. B. If legally applicable, ensure that the .5 percent override limit is applied to future bond refundings for FAF projects.
C. If legally applicable, issue directives requiring the recovery of override in excess of the .5 percent override limitation from past FAF project refundings.

The regulations at 24 CFR 883.308(g)(2), which affect all State Agency projects, provide that the override will be no greater than the override allowed for the borrowing as a whole under applicable regulations, i.e., the Department of Treasury regulations regarding arbitrage (1.5 percent). HUD conditioned receipt of the FAF upon HFAs' agreement that they would not charge an override of more than .5 per cent on project financing involving the FAF. This provision was included in the FAF regulations and applied to the initial financing only. The Preamble to the Interim Rule implementing the FAF, 46 FR 51904 (October 23, 1981), stated that the regulation was urgently needed if owners and State and local finance agencies were to continue to process Section 8 projects. It provided that:

> To take into account current, temporary increases in prevailing interest rates, the interim rule adds a Note to Schedule A of Part 888. The Note provides a financing adjustment for the fiscal year 1981 FMRs. The Department will not issue such a procedure for the 1982 FMRs nor for any subsequent years.

We conclude that there is no legal basis for HUD to retroactively reduce the override to 50 basis points when, as you stated, HUD agreed to the larger spread that is allowed under the Internal Revenue Code (1.5 percent) when it reviewed and approved the refunding. State HFAs must comply with the current regulations at 24 CFR 883.308(g) upon a refunding. These regulations could be changed to impose a .5 percent cap on refunding override. We defer to the Office of Housing on the policy desirability of such a change. However, it is our understanding that over 90 percent of the State HFA FAF projects have already been refunded.

Subsequent to your original request for an opinion, we received another request in a paper captioned "Housing/OGC Discussion Items," which raised both new issues and issues similar to those addressed above. We consider Issues 2, 3, 4 and 5 of that paper to have been addressed. Issues 1 and 6 are addressed below.

1. Does HUD have any legal basis for treating all State Agency refundings of non-FAF 1979-1984 projects as transactions subject to 50/50

sharing of savings under the McKinney Act?

On it face, section 163 of the Housing and Community Development Act of 1992 (1992 Act) applies to all projects. Subsection (b) defines "qualified project" as:

> . . . any State financed project or local government or local agency financed project, that--
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> (1) was--
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> (A) provided a financial adjustment factor under section 8 of the United States Housing Act of 1937; or
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> (B) constructed or substantially rehabilitated pursuant to assistance provided under a contract under section 8(b)(2) of the United States Housing Act of 1937 (as in effect on September 30, 1983) entered into during any of calendar years 1979 through 1984; and
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> (2) is being refinanced.

Subsection (c)(1) further provides:

> This section shall apply to refinancings of projects for which settlement occurred or occurs before, on, or after the date of the enactment of the Housing and Community Development Act of 1992, subject to the provisions of paragraph (2).

However, HUD's position on the clear facial reading of the statute might be challenged by State HFAs because the language of the Committee Report does not expressly give HUD rights with respect to savings, but focuses on giving agencies rights. It states that:

> The committee bill requires, subject to the availability of amounts for this purpose, HUD to make available to state housing finance agencies, local governments, or local housing agencies, up to 50 percent of the amounts that are recaptured when these entities refinance debt associated with federally assisted affordable housing. This provision is very similar to the provision originally included in the housing technical amendments in the Stewart B. McKinney Homeless Assistance Amendments Act of 1988, except that the Committee makes the sharing of project refinancing retroactive.
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> The 1988 amendments only allowed State housing finance agencies to retain funds from the refinancing of their projects. The Congress extended the sharing of recaptured funds from refinancing to local housing agencies in P.L. 102-273; however, the provisions apply only to projects for which settlement occurred after January 1, 1992. The Committee bill makes the sharing provision retroactive to allow the Secretary to share any savings received from refinancing that occurred prior to the enactment of this Act. The amount of such savings shall be determined from the date of the original refinancing. (Emphasis added.)

It is our understanding that prior to January 1, 1992, HUD received all of such savings from over 400 local agency FAF and Non-FAF projects that had

been refunded. In this connection, State HFAs might contend that the language in the Committee Report supports the argument that it is only these savings that HUD is entitled to share. Nevertheless, we believe the Department can rely on the broad coverage of the statute.

6. You request our advice on whether HUD's prior approval in three cases of the allocation of 40% of the debt service savings to the Project Reserve for Replacement to fund capital improvements if and when approved by the Field Office, was permissible under section 880.205(e).

Section 880.205(e) provides that:

> If HUD determines at any time that project funds are more than the amount needed for project operating reserve requirements and permitted distribution, HUD may require the excess to be placed in an account to be used to reduce housing assistance payments or for other project purposes. Upon termination of the contract, any excess funds must be remitted to HUD. (Emphasis added.)

It is our opinion that the allocation of debt service savings to the project Reserve for Replacement to fund capital improvements is permissible under the section 8 regulations. As stated above, section 880.205(e) provides that excess project funds may be used to reduce housing assistance payments or for other project purposes. Those purposes would presumably encompass repair, rehabilitation or improvement of the project. The limitation to a project purpose clearly limits use of the funds to the particular project. The fact that the Field Office must approve the use of the funds guarantees that the funds will be used for the project. It is to HUD's advantage that the economic viability of the project is maintained so that the provision of low-income housing continues. The Trust Indentures for those projects where HUD has approved such an allocation require that any funds remaining after all improvements have been made must be returned to the Treasury.