

Date of Completion for Sec. 223(d) Operating Loss Loans

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Subject: Date of Completion for Sec. 223(d) Operating Loss Loans

October 1, 1992

MEMORANDUM FOR: Linda D. Cheatham, Director, Office of Insured
Multifamily Housing Development, HMI

FROM: David R. Cooper, Assistant General Counsel,
Multifamily Mortgage Division, GHM

SUBJECT: The Date of Completion for Section 223(d)
Operating Loss Loans

Your Office has advised this Division that Housing is in the process of revising HUD Handbook 4470.1 REV, "Mortgage Credit Analysis For Project Mortgage Insurance Section 207." Because there is often a substantial delay between the date of final completion and the final endorsement date, on May 11, 1992, Kerry Mulholland of your Office requested this Office to render a legal opinion on whether "the completion date for insurance upon completion cases requesting an operating loss loan can be defined as the day after the cost certification cut-off date." Your Office has pointed out that there is a conflict between HUD Handbook 4470.1 REV, issued in August, 1979 and HUD Handbook 4260.1, "Miscellaneous Type Home Mortgage Insurance Section 223(a), (e), and (d)" issued in November, 1972, relative to the date to be used as the starting point to determine a project's eligibility for an operating loss loan. Currently paragraph 3-2.b(1) of HUD Handbook 4470.1 REV states:

The loss period begins upon the day after completion. In the case of a mortgage with insured advances, completion is determined as the date after the cut-off date established for the inclusion of interest, taxes and insurance for cost certification purposes. For projects insured upon completion, the completion date is the date following the date of initial/final endorsement.

On the other hand, Paragraph 5-2.a(1) of HUD Handbook 4260.1, states that for a project to be eligible for an operating loss loan:

Two years have elapsed since the date the final project Inspection Report, FHA Form 2449, was signed by the Field Office, Chief Architectural and Engineering Section/Chief Architect.

2

Section 223(d)(2)(B) of the National Housing Act provides

that "the operating loss shall have occurred during the first 24 months after the date of completion of the project, as determined by the Secretary." Section 223(d)(3)(B) provides that the operating loss shall have occurred "during any period of consecutive months (not exceeding 24 months) in the first 10 years after the date of completion of the project, as determined by the Secretary"

24 C.F.R. 207.4(f) states:

When the Commissioner determines that an operating loss has occurred during the first 2 years following completion of the project, he may in his discretion, accept for insurance under this part, a loan to cover such loss.

Sections 223(d)(2)(B) and (d)(3)(B) of the National Housing Act specifically grant the Secretary complete discretion to decide what date will be used as the date of project completion in the determination of a project's eligibility for an insured operating loss loan. HUD's regulations provide that the Commissioner has the discretion to insure an operating loss loan for a project when he/she determines that a loss has occurred during the first two years after completion, without defining the date of completion. HUD has chosen to define the date of completion, for operating loss loan purposes, in its mortgage insurance program handbooks.

The date the Chief of the Architecture, Engineering and Cost Branch endorses Trip Report, HUD Form 5379 which replaced FHA Form 2449 referred to in Handbook 4260.1, is the date that he/she checks the project's final inspection report and if acceptable he/she endorses the report as follows: "Construction acceptably completed." The date the HUD representative signs HUD Form 5379 and the report is endorsed by the Chief of the Architecture, Engineering and Cost Branch that the " c onstruction is acceptably completed," subject to acceptable items of delayed completion is considered to be the building contractor's final completion date of the physical development of the project. This is the date that is used in Handbook 4260.1, "Miscellaneous Type Home Mortgage Insurance Section 223(a), (e), and (d)." This certainly is a plausible date for the determination of project completion, but we believe that it is not the only one possible.

A second possible date for project completion is the date of final endorsement. This last date is the one currently used for insurance upon completion cases in HUD Handbook 4470.1 REV at paragraph 28-1, and that also has been used in the draft revision of Handbook 4470.1 REV-2 at paragraph 17-1.B.1.b., concurred in by this Division on April 10, 1991. Certainly, from the

standpoint of simplicity this is a very easy date to ascertain, and even though Congress chose to refer to the completion date of the project, which at least implies a date more closely

associated with the physical completion of the project than with the completion of the financial transaction, it is still a reasonable and plausible choice of dates to be used for determining the date of project completion, though not the only one possible.

A third possible date for determining the date of project completion is the Cost Certification Cut-Off Date, which represents the mortgagor's developmental costs completion date. HUD Handbook 4470.1 REV states in paragraph 2-28.e.(1) that the mortgagor must designate a cost-certification cut-off date within the 60 day period following either: (a) the final completion date of the physical development of the project (as represented by the date the HUD representative signs the Trip Report, i.e., HUD Form 5379, and the Chief of the Architecture, Engineering and Cost Branch, endorses the report that "construction is acceptably completed," subject to acceptable items of delayed completion); or (b) the date the Area Office Manager or Service Office Supervisor designates as the early completion date. The "cut-off" date is for purposes of calculating the total developmental costs of the project that the mortgagor must list on FHA Form 2330 "Certificate of Actual Cost." FHA Form 2330 sets out the mortgagor's actual costs under the construction contract, plus the following additional developmental "soft costs" during the construction period: taxes, property insurance, mortgage insurance, FHA examination and inspection fees, title and recording expenses, costs of financing, legal and organizational costs, and any off-site costs.

One can view the completion of the project as including developmental "soft costs" incurred after the date the HUD representative signs the Trip Report, Form HUD-5379, and the Chief of the Architecture, Engineering and Cost Branch endorses the report as representing final inspection. Consequently, HUD permits the mortgagor to add to FHA Form 2330 "Certificate of Actual Cost" the "soft costs" of interest, taxes, insurance, mortgage insurance premiums and finance fees that are incurred between the date the final Trip Report is endorsed and the date the mortgagor designates as the "cut-off" date for all developmental costs. Conversely all income earned during this time period is deemed to be a reduction of the actual cost of the project. As a result of the above, we understand the view of Howard Mayfield and Kerry Mulholland of your staff to be that the owner's actual completion date for purposes of determining the final amount of the insured mortgage is the cost certification cut-off date, because it is as of this date that all of the developmental costs of the project are established. We understand from Mr. Mayfield and Mr. Mulholland that the official operation of the project is deemed to begin on the day after the

4

cost certification cut-off date. Though not the only possible date for calculating what the term "completion of the project" as utilized in the Section 223(d) statute is to mean, the cost certification cut-off date is a very plausible date for determining project completion because from the standpoint of the

mortgagor, and consequently from the standpoint of the final dollar amount of the insured mortgage, the cost certification cut-off date concludes the developmental phase of the project.

We have been informed by members of your staff that HUD Handbook 4260.1, "Miscellaneous Type Home Mortgage Insurance Section 223(a), (e), and (d)" has been out of print for many years, is not in very wide circulation, and has not been used for determining the completion date of the project for operating loss loan purposes since, at least, the publication of HUD Handbook 4470.1 REV in 1979. Your staff has also informed us that the practice has been to use the dates shown in HUD Handbook 4470.1 REV, i.e., the cost certification cut-off date for insurance of advances cases, and the final endorsement date for insurance upon completion cases, to determine the project completion date for purposes of calculating an operating loss loan. However, they noted that there have been only a handful of insurance upon completion cases during the last five to ten years, and they were not immediately aware of any applications for operating loss from projects with insurance upon completion.

As quoted earlier in this memorandum, Section 223(d)(2)(B) and Section 223(d)(3)(B) grant to the Secretary the discretion to determine the actual date of project completion for purposes of an operating loss loan. Further, HUD's regulations do not provide a definitive project completion date, but, instead provide the Commissioner with the discretion to provide a project with an operating loss loan if he/she determines that an operating loss loan has occurred during the first 2 years following completion. All three dates that we have discussed in this memorandum are perfectly reasonable and plausible choices for fixing the date of completion of the project for operating loss loan purposes. All three have been used by handbooks in the operating loss loan context, and in our opinion any of the three would be appropriate and acceptable under the statute.

Even though your request for an opinion was only relative to the revisal of HUD Handbook 4470.1, we are very much of the opinion that all of the program handbooks should be consistent, and further, once the Department chooses a date, it should then utilize such date, and may be precluded from switching back to alternate dates since the date chosen will reflect HUD's interpretation of what Congress intended. Therefore, we are providing your Office with this opinion that HUD Handbook 4470.1, "Mortgage Credit Analysis For Project Mortgage Insurance

Section 207" may be revised to use the day after the Cost Certification Cut-Off Date as the first day for the calculation of the operating loss loan period, for insurance upon completion cases (as such date is presently in use for insurance of advances cases), subject to the rescission of HUD Handbook 4260.1, "Miscellaneous Type Home Mortgage Insurance Section 223(a), (e), and (d)," or the revisal of it, as soon as possible, so that it also states that the day after the Cost Certification Cut-Off Date is the beginning of the time period used in the calculation

of an operating loss loan. We are definitely concerned about your having two Handbooks outstanding with contradictory policies, even though HUD Handbook 4260.1 is out of print, and not widely distributed.

We have also considered the possible regulatory consequences of your proposed change in policy relative to the determination of the date of completion for insurance upon completion projects that apply for an operating loss loan. When there is a significant change in a long-standing policy that adversely impacts a sizeable universe of projects, our sense would be that the change must be effected by regulation, even when it is a change in a policy previously expressed only by way of a handbook. If there have been as few insurance upon completion cases as suggested by your staff, and further, if there have not been a significant number of projects with insurance upon completion that have received an operating loss loan, we believe those circumstances would suggest that the impact of the proposed change may be minimal. The circumstances would, thus, appear to permit the proposed change to be made by handbook revision only. We have consulted with Grady J. Norris, Assistant General Counsel, Regulations, and he agrees with our conclusion that the proposed change does not require a regulation.

If you have any questions regarding this matter, please contact Edward Ferguson at 708-4107.