

Legal Opinion: CFR-0001

Index: 6.011

Subject: Davis-Bacon Applicability to Housing with CDBG  
Permanent Financing

November 20, 1996

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Dear Mr. Hetzel:

This is in response to your letter of July 31, 1996 to Christopher H. Hartenau of this office, concerning the applicability of Davis-Bacon prevailing wage requirements to Almond Courts Apartments, a low/moderate income housing development in Kern County, California. The development is expected to receive permanent financing from Community Development Block Grant (CDBG) funds, but the CDBG funds were not requested to be used on the development until after construction contracts for the project were let.

We conclude that under the circumstances of Kern County's proposed use of CDBG funds, as described below, the use of CDBG funds for permanent financing would constitute financing of the construction work on the development and would therefore require payment of Davis-Bacon wages. It appears to us, however, that in accordance with regulations of the U.S. Department of Labor, HUD could request the Department of Labor to permit application of Davis-Bacon wage rates for the remainder of the construction from the date of approval of the use of CDBG funds for the project, rather than retroactively to work already performed from the commencement of the construction.

We note that your letter did not raise, and this response does not address, questions concerning the program eligibility of the proposed use of CDBG funds for permanent financing of the new construction of low/moderate income housing. You should be aware that the use of CDBG funds for the new construction of housing is generally not an eligible expense unless the entity being assisted is a Community-Based Development Organization (CBDO). See the CDBG regulations at 24 CFR 570.207(b)(3). Permanent as well as interim financing for the construction of new housing would fall within this restriction. If you have any questions regarding eligibility of the proposed use of CDBG funds in this case, please contact the Community Development Division of this office at 202-708-2027.

Background

We understand from your letter and other submissions that

the Almond Courts project was originally to have received construction funding from the HOME program for 11 units of HOME-assisted housing in a 36 unit mixed income development. Under Section 286 of the HOME Investment Partnerships Act (42 U.S.C. 12836) and implementing regulations, contracts for the construction of fewer than 12 units of HOME assisted housing are not subject to Davis-Bacon prevailing wage requirements. Thus, the construction contracts let on the project do not contain Davis-Bacon provisions. However, due to a failure to complete the appropriate Federal environmental review procedures before the start of construction, HOME funds could not be released for the project and the County substituted county general funds in lieu of the HOME construction funds. You indicated that subsequently, the County "requested and has received clearance by HUD to utilize CDBG funds to provide permanent financing through a qualified non-profit."

A memorandum to Mr. Hartenau from the Kern County Counsel dated and faxed on September 16, 1996 indicated that the use of CDBG funds was not contemplated at the time of the County's original understanding that non-Federal funds would have to take the place of HOME funds, and arose only after County funds were committed to completing the project.

A faxed note from you to Mr. Hartenau dated September 18, 1996 provided further information on the use of the County and prospective CDBG funds. The note indicated that the County transferred its own funds, to be used in lieu of the HOME funds, to the Community Development HOME Program Investment Trust Fund. From there, the County funds were paid out as progress payments for project construction undertaken by Self Help Enterprises, a non-profit corporation. The payments constitute a loan to Self Help pursuant to a promissory note of \$1 million executed in March 1996 and secured by a Deed of Trust to the County as lender. It was contemplated originally that the note would convert to permanent financing after the project was completed. After HOME funds were no longer available, the substituted County funds were intended only as interim construction financing pending determination of an alternative source of permanent financing.

#### Discussion

Section 110(a) of the Housing and Community Development Act of 1974 (HCD Act) (42 U.S.C. 5310(a)) requires payment of Davis-Bacon wage rates, on residential properties of 8 or more units, to laborers and mechanics employed by contractors or subcontractors "in the performance of construction work financed in whole or in part with assistance received under this title", including CDBG funds. The issue you raise is whether in the circumstances in question the construction work being undertaken is "financed" with the CDBG assistance that is proposed to be used for the permanent financing.

Beginning with a 1978 legal opinion from the Associate General Counsel for Finance and Administrative Law at the inception of the Urban Development Action Grant (UDAG) program

under title I, this office has held that under Section 110, limiting CDBG/UDAG involvement solely to permanent financing of a project involving construction work in which the entire construction loan is privately financed did not exclude the construction work from the applicability of Davis-Bacon wage rates, where it was known or contemplated at the time the construction financing was arranged that the CDBG/UDAG funds would form all or part of the permanent financing.

This position was affirmed in the March 20, 1989 Associate General Counsel opinion cited in your letter, which concluded that the use of CDBG funds as permanent financing "fits squarely within the definition of 'finance', where it is known or contemplated when construction financing is arranged that the Federal funds will be used as the permanent financing, because in such cases the CDBG/UDAG funds are intended to, and do, 'provide funds or capital for [or] . . . furnish [the] necessary funds' for the construction work by repaying the private interim construction loan. The 1989 opinion indicated that continuation of the original position:

is based in part on our presumption that where the permanent financing is arranged prior to or simultaneously with the construction financing, the commitment of Federal permanent funding to pay off the interim loan is relied upon by the construction lender in its determination of whether to provide such interim funds. By virtue of the timing of the arrangements and the reliance upon the permanent financing, the interim and permanent financing transactions . . . should be viewed as for the same purpose, i.e., to pay for the construction work.

However, the 1989 opinion concluded that:

[i]n the event that it could be shown that the interim lender for a particular project did not rely on the commitment of Federal funds to pay off the interim loan in its determination to provide the construction financing, even though permanent federal financing was known or contemplated at the time construction financing is arranged, we would be willing to reconsider whether Davis-Bacon would be applicable to such a project.

Thus, the position taken in the original 1978 opinion and the 1989 opinion was concerned with CDBG/UDAG permanent financing that is arranged at or before the time the construction financing is arranged, while the 1989 opinion raised the possibility that even a contemporaneous commitment of Federal permanent financing might not trigger Davis-Bacon applicability if an interim lender did not rely on the commitment of Federal permanent financing. The opinion did not, however, conclude that the lack of such reliance on Federal permanent financing meant that the construction work was not "financed" with the Federal funds. Nor did this office express an opinion that permanent CDBG financing arranged after the construction financing, but before completion

of the construction work, necessarily led to the conclusion that the work would not be considered to be "financed" with the CDBG funds. These questions were left open.

Neither opinion distinguished among the various situations in which permanent CDBG financing might be employed. In our view, these circumstances can be relevant in determining whether CDBG financing is employed simply to pay off the construction loan or for some other purpose. For example, where construction financing as well as conventional permanent financing is already arranged for an office building, but before the construction is complete, a CDBG recipient might offer to buy the building with permanent financing from its CDBG funds. In the present case, the CDBG recipient, the County, has provided the interim financing to the borrower from HOME funds and then from its own funds. As we understand it, the proposed use of CDBG funds for permanent financing would not involve the provision of financing to a purchaser, but would simply involve converting the interim financing to a permanent financing arrangement between the same parties upon completion of the construction. While the County did not rely on the availability of CDBG funds in making the interim financing available, it did provide the financing on an interim basis only, pending determination of an alternative (non-HOME) source of permanent financing. We presume that the CDBG funds to be lent to the borrower would be used by the County to repay to itself the funds it advanced as interim lender, and that the borrower in turn would eventually repay the CDBG loan.

In considering the issue of Davis-Bacon applicability, we must also take into account Davis-Bacon regulations of the U.S. Department of Labor (DOL), which has responsibility under Reorganization Plan No. 14 of 1950 for prescribing "appropriate standards, regulations, and procedures, which shall be observed by" agencies responsible for various Davis-Bacon related provisions, including Section 110 of the HCD Act. Section 1.6(g) of the DOL regulations (29 CFR 1.6(g)) provides as follows:

If Federal funding or assistance under a statute requiring payment of wages determined in accordance with the Davis-Bacon Act is not approved prior to contract award (or the beginning of construction where there is no contract award), the agency shall request a wage determination prior to approval of such funds. Such a wage determination shall be issued based upon the wages and fringe benefits found to be prevailing on the date of award or the beginning of construction . . . and shall be incorporated in the contract specifications retroactively to that date, Provided, That upon the request of the head of the agency in individual cases the Administrator [of the Wage and Hour Division] may issue such a wage determination to be effective on the date of approval of Federal funds or assistance whenever the Administrator finds that it is necessary and proper in the public interest to prevent injustice or undue hardship, Provided further That the Administrator finds no evidence of intent to

apply for Federal funding or assistance prior to contract award or the start of construction, as appropriate.

We do not view this regulation as dispositive of the question of Davis-Bacon applicability where the statute in question conditions such applicability on the "financ[ing]" of the construction work with the Federal assistance being provided. Read in conjunction with Section 110 of the HCD Act, however, the regulation does indicate that if construction work becomes financed with CDBG assistance, even if that financing is provided after construction begins, the work will be subject to Davis-Bacon rates, either back to the beginning or, with DOL's agreement, prospectively. Therefore, the question of whether CDBG permanent financing constitutes financing of construction work is not determined simply by whether the CDBG permanent financing was provided or foreseen at the time the construction contract was signed or the interim financing was arranged.

In the present case, the County did not envision or rely on the use of CDBG funds for permanent financing either at the beginning of construction or at the time that it committed to provide interim financing. Nevertheless, we believe that where a determination or commitment is made by the County, during the construction process, to reimburse itself with CDBG funds lent to the borrower once construction is completed, such a use of CDBG funds must be viewed as financing of the construction work. While the use of the CDBG funds is in the form of permanent financing and the actual drawdown of the funds would presumably be postponed until completion of the construction, we can see no other purpose for the funds except to reimburse the County for temporarily shouldering the cost of the construction work. In other words, during the construction process, a decision would be made to commit CDBG funds to provide capital, albeit on a delayed basis, to carry out the construction work.

Where permanent financing is committed, after construction begins, to be provided as a loan to a purchaser upon completion and sale, and where interim construction financing as well as conventional permanent financing had previously been arranged, it may be more arguable that the direct purpose of the CDBG funds is to assist the purchase by the borrower, rather than to provide the funds for construction. We do not express an opinion on whether such a mid-construction commitment to aid the purchase of a building would constitute financing of the construction work. We note, however, that depending on the specific circumstances, such a use of CDBG funds might be less directly related to the construction work than is the use of funds in the present case.

Accordingly, we conclude that in the circumstances outlined in this letter, a commitment or decision by the County, before completion of the construction work, to use CDBG funds as permanent financing would constitute the use of CDBG funds to finance the construction work and would require Davis-Bacon wage rates under Section 110 of the HCD Act and Section 1.6(g) of the DOL regulations. Because of the circumstances here, however, it would appear to be appropriate for HUD, if requested by the

County, to request DOL to issue wage rates that would apply prospectively only, from the date of approval of the use of CDBG assistance with respect to the development.

Sincerely,

Nelson A. Diaz  
General Counsel