

Auth. to Disburse 'IRP' Before Construction Completed

Legal Opinion: GHM-0001

Index: 3.165

Subject: Auth. to Disburse "IRP" Before Construction Completed
FOIA Exemption 4: Names/Address Withheld

October 1, 1991

RE:

Dear Mr. :

This is in response to your letter of July 26, 1991, to Frank Parker of the Office of Multifamily Housing Management and David Cooper of the Office of General Counsel, written on behalf of the mortgagors of several uninsured Section 236 projects located in the State of Massachusetts which will each receive mortgage increases from the Massachusetts Housing Finance Agency ("MHFA") for the purpose of installing sprinkler systems and to undertake other required repairs.

You say in your letter that all of these projects are occupied and were constructed approximately 18 years ago. These repairs will not require that any unit be taken out of rental occupancy during the term of the repairs. Using the

building as an example, you have submitted a copy of Amendment No. 3 to the Interest Reduction Agreement (hereafter "IRP Contract") which was executed by the owner, MHFA, and on behalf of the Secretary on October 1, 1990, which shows a new unpaid principal balance attributable to subsidized units of \$4,465,618 and a new maximum annual IRP payment of \$262,430. You ask whether IRP may be disbursed by HUD to MHFA for the owner's account while the loan is being disbursed instead of awaiting the completion of the repairs.

In a memorandum to all state housing agencies dated September 11, 1973, entitled "Revised Procedures- State and Local Program", HUD announced certain changes being made to the uninsured State and Local subsidized housing program including a new rule that IRP payments would henceforth not be made until all of the units in the development have been completed. As you have pointed out, the Secretary was authorized under Section 236(b) to pay IRP "during such time as the project is operated as a rental housing project...." You have argued that since these projects have already been constructed and tenant occupancy will not be disturbed by the contemplated repairs, HUD should have no objection to subsidizing new mortgage advances with IRP as they are advanced provided that the work to be performed under the construction contracts is actually performed within budget and without any overruns of cost. The purpose of the rule that HUD would not commence the payment of subsidy until all construction work had been satisfactorily completed was to assure that the

maximum liability of the Secretary for IRP payments would be

2

fixed at the time assistance payments were commenced. If MHFA advances all of the mortgage increase and the scope of work of the construction contract has not been satisfactorily completed within the expected amount, the door would be left open for the mortgagor to demand a further mortgage increase and an additional increase in IRP.

We construe the policy enunciated in the aforementioned memorandum dated September 11, 1973, to mean that IRP payments on a mortgage increase relative to an uninsured project may not begin until the scope of work covered by the mortgage increase has been satisfactorily completed. Interest earned on advances of mortgage proceeds during the construction period must be included as part of the principal amount of the mortgage increase. In short, it is the policy of this Department that Section 236 IRP payments may not be used to cover construction interest. HUD pays out IRP to subsidize permanent and not construction debt.

The fact that the project is constructed and occupied by tenants is not determinative of our decision on this issue. We construe Amendment No. 8 to the Interest Reduction Agreement relative to the _____ project to mean that the Secretary is not obligated to subsidize a payment on the mortgage increase with IRP until the loan has been fully disbursed.

We agree with your statement that, in order to be subsidized, the first payment on the mortgage increase need not be an amortization payment, but such payment may consist of interest alone. Payments consisting of interest alone which represent construction draws, however, are not eligible for subsidy. Paragraph 4(a) of your client's IRP Contract clearly contemplates that IRP may be payable on permanent mortgage payments comprising interest alone. You are correct in your assertion that HUD may pay IRP on uninsured mortgages at times when the mortgage is not amortizing.

Please address any questions you may have to Joel Robinson who can be reached on 708-4167.

Sincerely,

Gains E. Hopkins
Managing Attorney
Multifamily Mortgage Division