

# FHA Multifamily Mortgage Insurance and Davis-Bacon Wage Rates

The Davis-Bacon Act of 1931 is foundational to the determination of wage rates for federally assisted projects. The manner in which wage rates under the Act are applied is critical to the viability of FHA financing for new construction or substantial rehabilitation of multifamily and residential healthcare properties.<sup>1</sup> As discussed below, the most urgent Davis-Bacon issue is that HUD staff has begun assigning multiple or “split wage” rate determinations to individual projects. The Mortgage Bankers Association (MBA) seeks engagement with the Department of Housing and Urban Development and the Department of Labor to address this and other Davis-Bacon issues that affect the efficiency of FHA financing for the development of multifamily and residential healthcare properties.

## BACKGROUND

*What is the Davis-Bacon Act and how does it apply to FHA?*

The Davis-Bacon Act requires the payment of wages that *prevail in the locality on projects of a character similar to the work that will be performed on direct federal contracts*. The National Housing Act (§ 212) requires Davis-Bacon compliance on multifamily projects assisted with FHA mortgage insurance under Sections 221, 232 and 241.

*Who administers the Davis-Bacon Act?*

The Department of Labor (DOL) prescribes standards and procedures for federal agencies that administer programs subject to Davis-Bacon requirements. HUD's Office of Field Policy and Management/Davis-Bacon and Labor Standards Division (DBLS) administers and enforces Davis-Bacon requirements at HUD.

*How important is FHA Multifamily construction lending and development?*

The FHA Multifamily program has been vital to supporting affordable and workforce rental housing. The historic strength of FHA mortgage insurance programs rests in the capability of borrowers to obtain a seamless construction-to-permanent loan financing – a feature unique in the multifamily finance market. Competitive pricing for the loan is possible due to the safety of a Government National Mortgage Association (Ginnie Mae) security backed by an FHA-insured mortgage loan. Significantly, these programs have maintained strong credit performance as demonstrated by the December 2016 FHA multifamily delinquency ratio of 0.11 percent (i.e., 9 properties out of the 11,057 in the FHA multifamily portfolio).

## AREAS OF CONCERN AND RECOMMENDATIONS

### 1. **Limit burden of multiple or split-wage Davis-Bacon rates on residential projects.**

For purposes of wage rates under the Davis-Bacon Act, there are four categories of construction work: residential, building, heavy and highway. Residential work is defined as: Construction, alteration, or

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<sup>1</sup> For purposes of this document, references to FHA multifamily projects are intended to include residential healthcare projects; FHA new construction includes substantial rehabilitation; and “residential” and “residential projects” means apartment buildings of *four stories or less* and single family homes.

repair of single family houses or apartment buildings of no more than four stories in height. “*This includes all incidental items such as site work, parking areas, utilities, streets and sidewalks...unless there is an established area practice to the contrary.*”<sup>2</sup>

HUD and DOL have historically applied the definition of “residential construction” above. As a result, for decades, HUD has consistently assigned only a single Davis-Bacon residential wage decision (i.e., schedule of wage rates setting the hourly wages and benefits for the project) to projects meeting this definition.

*The issue:* HUD’s Field Policy and Management/DBLS staff recently began requiring individual residential projects (of four stories or less) to use as many as four different wage rate decisions, each containing a different wage schedule.

The change in position is adding substantial and unnecessary costs to the construction of projects. The complexities of tracking every worker as to their precise location vis-à-vis the boundaries of four separate wage decisions, alone, are practically and financially prohibitive. Even in the best of circumstances, the imposition of multiple wage decisions adds enormous administrative burden to every participant in the endeavor: the lender, the developer, the owner, the prime contractor and its subcontractors. Ironically, it adds equally enormous administrative burden to HUD.

### **Recommendations:**

- a. *HUD should ensure compliance with its long-standing policy under which the construction of residential projects, including all incidental items such as site work, parking areas, utilities, streets and sidewalks, are assigned a single, residential Davis-Bacon wage decision unless there is a proven established area practice to the contrary.*
- b. *HUD should request comments and consider the input of its partners, in HUD programs, prior to changing its policies on Davis-Bacon related work, and then publish revised guidance and provide training for HUD staff and partners before implementing changes.*

## **2. Change Davis-Bacon determinations of a “building” wage rate for FHA Residential Healthcare facilities.**

As the housing needs of our population have evolved, residential healthcare facilities have become more prevalent. These facilities offer living units with support services for its residents. Some facilities are developed with fully-equipped units with full bathrooms and kitchens. Some units in a property, such as an Alzheimer’s floor, are developed without full kitchens and/or baths to better serve and protect the special needs of those residents. Except for the lack of a cooking appliance (e.g., microwave), nothing is materially different in the construction or composition of these units.

*The issue:* HUD, following informal/undocumented DOL guidance, assigns residential wage rates to housing projects only if every unit contains a full kitchen and bathroom. Otherwise, the project is assigned a building (commercial) wage decision which typically carries wage rates many times higher than residential rates. This practice ignores the conclusion of the DOL Wage Appeals Board that the

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<sup>2</sup> All Agency Memo 130, DOL Manual of Operations; HUD Handbook 1344.1, Rev 2.

absence of full-scale kitchens or separate bathrooms does not preclude a determination that the character of the work is residential in nature.<sup>3</sup>

**Recommendations:**

- a. *HUD and DOL should discard the concept that any housing unit lacking a full-scale kitchen and bathroom precludes a determination that the project is “residential” in character.*
- b. *HUD and DOL should conform policies to guidance ratified by the Wage Appeals Board that the nature of the project – including the work to be performed as well as the end result (in the context of prevailing area practices) – is the determinative criterion under which the character of work is determined and issue formal written guidance reflecting this position.*

**3. The Davis-Bacon wage decision must be “locked-in” earlier in the FHA process.**

Unexpected changes in Davis-Bacon wage rates can occur late in the FHA process and increase development costs which can result in higher rents to tenants or may totally derail a project.

Davis-Bacon wage decisions are modified from time to time to keep them current. At times, the increases can be significant (e.g., up 100 to 400 percent). DOL regulations (29 CFR 1.6) prescribe conditions under which a wage decision becomes effective (i.e., when it locks-in). The rules for FHA projects lock-in the wage decision at the time of the initial endorsement provided construction starts within 90 days. This process and timeline create a minefield for developers/borrowers between the firm commitment and initial endorsement stages in FHA multifamily mortgage processing because all of the terms of the FHA mortgage transaction are set at firm commitment except that the Davis-Bacon wage rates may change. There is *no transition period* granted to incorporate updated wage rates into these projects, nor are developers permitted to include additional construction cost contingencies in their budgets to cover unanticipated increases in Davis-Bacon wage rates that occur between firm commitment and initial endorsement.

**Recommendations:**

- a. *Establish a process to lock-in Davis-Bacon prevailing wage rates earlier in the FHA process and send it as a recommendation to DOL’s Wage and Hour Division.* HUD and the FHA multifamily industry should collaborate on a proposal for DOL. We believe that an appropriate protocol should emulate those in place for competitive bidding. Thus, the wage decision should lock-in on the date HUD issues the firm commitment with a 90-day period to initial endorsement.
- b. *Streamline a hardship-based waiver process for FHA projects.* As an interim measure, until pertinent regulations or directives can be revised, establish a hardship waiver process for the projects affected by a late-breaking wage rate change just prior to loan closing.

**4. Encourage DOL to adopt the GAO Report recommendations on Davis-Bacon wage rate methodology.**

There have been improvements in the administration of Davis-Bacon requirements; however, significant issues related to methodologies of surveys remain. These were identified in a General Accountability Office report issued in March 2011, *Methodological Changes Needed to Improve Wage*

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<sup>3</sup> WAB Case No. 90-29, Dutch Hotel Single-room Occupancy.

Survey (GAO 11-152). Major findings in the GAO report that are still relevant include: issues with representativeness and the utility of using county-level data as the basis for the wage calculation. And, GAO observed that insufficient survey responses prevent DOL from issuing wage rates at the county level, thus forcing multi-county and state-wide wage determinations, and in some cases, wage rates are based on very few workers.

**Recommendation:**

*Support DOL efforts to address the issues raised by GAO about the Davis-Bacon wage rate determination process as a foundation for cooperative HUD-DOL multifamily improvement efforts.*

**5. Request HUD and DOL to determine whether Davis-Bacon wage rate requirements could be waived for affordable rental FHA new construction projects.**

In contemplating the cost of constructing a new affordable rental housing property that meets strict income restriction standards for targeted affordable housing, and in recognizing that in some jurisdictions, the Davis-Bacon wage rates could be distorted on the high side. We suggest it could be worthwhile for HUD and DOL to consider approaches to permitting a waiver to reduce costs to the government. In this case, any savings in the wage rates for a 100 percent targeted affordable property could save government dollars for use at another affordable housing property.

**Recommendation:**

*HUD and DOL could work together to explore ways (or what statutes could be proposed to be amended) to waive use of Davis-Bacon wage rates for a FHA insured multifamily mortgage if the property will have 100 percent use restrictions or subsidies that restrict occupancy to residents who meet income restrictions.*

**6. Permit contractors on FHA Multifamily New Construction projects to use DOL approved reporting for payroll wage data including paper forms.**

New HUD-specified electronic systems for Davis-Bacon reporting payroll wage data are beneficial for many firms; however, many smaller firms do not have a back-office operation to document and submit electronically. This can discourage new minority/ disadvantaged/veteran and/or women entrepreneurs, as well as non-English proficient contractors, who together represent many of the sectors in employment that the federal government has sought to support. Firms complying with Davis-Bacon payroll reporting requirements should be able to use any DOL-permitted system of its choosing. This would help provide HUD-related work opportunities to small businesses.

**Recommendation:**

*Allow each contractor to use the payroll reporting format and method of its choice, provided the format/method conforms to DOL regulations.*

*If you have questions or to discuss these comments, please contact Eileen Grey at [egrey@mba.org](mailto:egrey@mba.org).*