The Miller Act--Performance Bonds

Legal Opinion: GHM-0018

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Subject: The Miller Act--Performance Bonds

December 31, 1991

George M. Sellinger
Chief, Branch 1
Office of Chief Counsel
Internal Revenue Service
Room 3319
950 L'Enfant Plaza South, SW
Washington, DC 20024

Re: The Miller Act (40 U.S.C. § 270a et seq.)

Dear Mr. Sellinger:

This responds to your letter of November 15, 1991 regarding certain tax indemnification provisions that the Miller Act (40 U.S.C. § 270a et seq.) requires in performance bonds that are furnished for federally funded projects. In your letter you ask us to assess whether the performance bonds used by HUD's office in Puerto Rico, namely FHA Forms 2452 and 2452-EH, may be modified to incorporate the Miller Act's tax indemnification provisions. FHA Form 2452 is used in HUD's multifamily mortgage insurance programs and FHA Form 2452-EH is used in HUD's section 202 direct loan program for the elderly and handicapped. Since the section 202 program is within the jurisdiction of the Assistant General Counsel for Assisted Housing, Michael Reardon, we have referred your letter to him for response in connection with FHA Form 2452-EH. With respect to FHA Form 2452, we have reviewed your request and determined that the Miller Act does not apply to HUD's multifamily mortgage insurance programs. This determination is consistent with a prior opinion of our office, dated July 29, 1968, which although not concerned solely with the Miller Act, takes the position that the Miller Act is not applicable to projects insured pursuant to HUD's multifamily mortgage insurance programs. (Attachment A). Therefore, we do not believe it is necessary to modify FHA Form 2452 as you suggest.

As you are aware, the Miller Act requires that before the award of any contract exceeding $25,000 in amount for the construction, alteration, or repair of any public building or public work of the United States, the contractor must furnish both a performance bond and a payment bond to the United States. The Miller Act further directs that the performance bond must specifically provide coverage for federal employment taxes that are collected, deducted, or

withheld from wages paid by the contractor in carrying out

the contract with respect to which the performance bond is given.

In our review of your letter, and its accompanying documentation and memoranda, we observed that your recommendation to modify FHA Form 2452 is based upon two assumptions. These assumptions, as set forth in the first full paragraph on page 2 of the October 4, 1991 memorandum, are: (1) the projects for which FHA Form 2452 is utilized are federally funded; and (2) the Federal Housing Administration ("FHA"), which administers HUD's housing programs, requires bonds i.e., performance bonds furnished in connection with the construction or rehabilitation of projects obtained in favor of the United States. However, with respect to HUD's multifamily mortgage insurance programs, these assumptions are not correct.

To begin, HUD's multifamily mortgage insurance programs do not involve the federal funding of projects. The FHA provides federal mortgage and loan insurance for borrowers in order to encourage investment by private lenders, and thereby facilitate home ownership and the construction or improvement of housing. Pursuant to its multifamily mortgage insurance programs, the FHA insures mortgages and loans made by mortgage lenders to developers and builders who are constructing or rehabilitating apartments and other multifamily housing projects. Although the mortgage insurance is provided by the federal government, it is supported by premiums paid by the borrowers. Accordingly, the FHA does not appropriate or expend funds to construct or rehabilitate the projects for which it has insured mortgages. Each project is built or rehabilitated by a non-FHA entity with non-FHA funds, and is encumbered by a mortgage given by a non-FHA mortgagor to a non-FHA lender, albeit mortgagors that are FHA-approved, but are not a part of, or subsidiaries of FHA. Accordingly, the FHA is not even a party to the construction contract. In addition, payment by the FHA of a lender's insurance claim occurs only if there is a default on the mortgage, and a resulting assignment of the mortgage to FHA, or foreclosure on the mortgage and conveyance of title to FHA. Only in the event of a default can FHA become the holder of the mortgage or acquire title to the project.

In connection with the foregoing, See Annotation, What Constitutes "Public Work" Within Statute Relating to Contractor's Bond, 48 ALR4th 1170, 1195 (1986), which characterizes United States for the use of General Electric Distributing Corporation v. Centerline Gardens, Inc., 253 F.2d 133 (6th Cir. 1958) for the proposition that a contract for the privately financed, but FHA insured, construction of privately operated housing was not within

the terms of the Miller Act, notwithstanding that the housing was intended at least in part for the use of military personnel and their dependents. We would point out that in the Centerline Gardens case, the degree of federal involvement appears greater than that in the typical FHA mortgage insurance transaction because the project was built upon land leased from the United States, and the lease agreement provided that all units of the project would be made available to personnel designated by a Commanding Officer of the military.

In addition, the FHA does not obtain a bond in favor of the United States when it insures the mortgages of multifamily housing projects. HUD Form 2452, the performance bond utilized by the FHA in such transactions, is not executed by the FHA. In fact, HUD Form 2452 designates only the mortgagor and mortgagee of the project as joint obligees. This underscores the private nature of the project, and stands in contrast to GSA Standard Form 25, which contains the Miller Act tax indemnification provisions, and binds the principal and surety directly to the United States. FHA Form 2452 does state that any right of action which either of the obligees might have under the performance bond may be assigned to HUD. However, this is only to provide for the above-described contingency of a default and assignment of the mortgage to FHA, or a foreclosure on the mortgage, and conveyance of title to FHA. In the event of such a contingency, the FHA will need to ensure completion of the project, so as to be able to sell the project to an outside purchaser for a price sufficient to minimize losses incurred in payment of the insurance claim. It should be noted that a mortgagor has the option of providing a completion assurance agreement secured by a cash deposit in lieu of corporate surety bonds for payment and performance. See 24 C.F.R. 207.19(c)(6).

In sum, the FHA multifamily mortgage insurance programs are not programs that federally fund the construction or rehabilitation of projects. Further, in connection with these programs, the FHA does not demand that a performance bond be issued in favor of the United States or that the bonds be issued at all. Therefore, we do not believe that the Miller Act performance and payment bond requirements are applicable to such FHA transactions. Consequently, we do not consider that it is necessary to modify FHA Form 2452 to incorporate the Miller Act's tax indemnification provisions regarding coverage for federal employment taxes.

Please contact Frances MacFarlane at (FTS) 458-4107 with any questions on this matter.

Very sincerely yours,

David R. Cooper
Assistant General Counsel,
Multifamily Mortgage Division

Attachment