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Opinion No. 09-143

Preemption of Tenn. Code. Ann. § 66-34-103(a) by the National Housing Act

QUESTION

Whether Section 221(d)(4) of the National Housing Act, 12 U.S.C. § 1715l(d)(4) ("Section 221(d)(4)"), under which HUD requires withholding 10 percent of the contract amount in all Section 221(d)(4) projects, preempts Tenn. Code Ann. § 66-34-103(a) (Supp. 2008), which limits the retainage amount in all construction contracts in Tennessee to no more than 5 percent.

OPINION

Yes. Given the extensive federal regulation of multi-family housing projects that are financed under the National Housing Act ("NHA") and by the U.S. Department of Housing and Urban Development ("HUD"), a court would likely determine that Section 221(d)(4) of the National Housing Act, under which HUD requires withholding 10 percent of the contract amount in all Section 221(d)(4) projects, preempts Tenn. Code Ann. § 66-34-103(a) (Supp. 2008), which limits the retainage amount in all construction contracts in Tennessee to no more than 5 percent. However, Section 221(d)(4) would preempt Tenn. Code Ann. § 66-34-103(a) only when the Section 221(d)(4) construction contracts promulgated by HUD, which mandate withholding 10 percent of the contract amount in all projects, are required to be used. Tenn. Code Ann. § 66-34-103(a) would be in full force and effect as to any other construction contracts in Tennessee.

ANALYSIS

Congressional power to preempt state law arises from the Supremacy Clause, which provides that "the Laws of the United States shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. 6, cl. 2. Congressional intent determines whether a federal statute preempts state law. *Wadlington v. Miles, Inc., et al.*, 922 S.W.2d 520, 522 (Tenn. Ct. App. 1996). The Supremacy Clause results in federal preemption of state law when: (1) Congress expressly preempts state law; (2) Congress has completely supplanted state law in that field; (3) adherence to federal and state law is impossible; or (4) the state law impedes the achievements of the objectives of Congress. *Wadlington*, 922 S.W.2d at 522.

Section 221(d)(4) of the NHA insures mortgage loans to facilitate the new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income

families, the elderly, and the handicapped. Single Room Occupancy ("SRO") projects may also be insured under this section. Section 221(d)(4) insures lenders against loss on mortgage defaults. Section 221(d)(4) is used by profit-motivated sponsors.[1] The program assists private industry in the construction or rehabilitation of rental and cooperative housing for moderate-income and displaced families by making capital more readily available. The program allows for long-term mortgages (up to 40 years) that can be financed with Government National Mortgage Association ("GNMA") Mortgage Backed Securities. In order to be eligible for insurance under Section 221(d)(4), the statute imposes strict guidelines for mortgagees, including the amount of the mortgages depending upon the type of family unit and regulations for construction contracts.

Under Section 221(d)(4), insured mortgages may be used to finance the construction or rehabilitation of detached, semidetached, row, walkup, or elevator-type rental or cooperative housing containing 5 or more units. The program has statutory mortgage limits which vary according to the size of the unit, the type of structure, and the location of the project. Profit motivated sponsors using Section 221(d)(4) and all types of sponsors under Section 221(d)(4) can receive a maximum mortgage of 90 percent of the HUD/FHA replacement cost estimate. Contractors for new construction and substantial rehabilitation projects must comply with prevailing wage standards under the Davis-Bacon Act.

HUD authors the construction contracts for Section 221(d)(4) projects, and the owners and contractors on these projects must use these form contracts. Article 3 of form HUD-92442-A provides that the owner must withhold 10 percent of the contract amount as retainage.

Tenn. Code Ann. § 66-34-103 (Supp. 2008) provides, in pertinent part:

> (a) All construction contracts on any project in this state, both public and private, may provide for the withholding of retainage; provided, however, that the retainage amount may not exceed five percent (5%) of the amount of the contract.
>
> . . . .
>
> (e)(1) It is an offense for a person, firm or corporation to fail to comply with subsection (a). . . .
>
> (2)(A) A violation of this subsection (e) is a Class A misdemeanor, subject to a fine only of three thousand dollars ($3,000). . . .

The form contracts used by owners and contractors on all Section 221(d)(4) projects in Tennessee would violate Tenn. Code Ann. § 66-34-103(a) because they require that the owner withhold 10 percent of the contract amount as retainage, instead of the 5 percent maximum retainage amount specified in the Tennessee statute.

[1] Section 221(d)(3) of the NHA is for nonprofit sponsors and also insures lenders against loss on mortgages.

In *Freightliner Corp. v. Myrick*, 514 U.S. 280, 115 S.Ct. 1483, 131 L.Ed.2d 385 (1995), the Supreme Court summarized the principles of implied conflict preemption, noting the high threshold for finding state and local laws impliedly repealed:

> We have recognized that a federal statute implicitly overrides state law either when the scope of a statute indicates that Congress intended federal law to occupy a field exclusively, or when state law is in actual conflict with federal law. We have found implied conflict pre-emption where it is "impossible for a private party to comply with both state and federal requirements," or where state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."

Id. at 287, 115 S.Ct. 1477 (citations omitted).

Section 221(d)(4) of the NHA implicitly overrides Tenn. Code Ann. § 66-34-103(a), which limits the retainage amount in all construction contracts in Tennessee to no more than 5 percent, because it is impossible for a private party to comply with both Tenn. Code Ann. § 66-34-103(a) and Section 221(d)(4) of the NHA, under which HUD requires withholding 10 percent of the contract amount in all Section 221(d)(4) projects.

Furthermore, Tenn. Code Ann. § 66-34-103(a) stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Section 221(d)(4) of the NHA by prohibiting owners and contractors from entering into HUD construction contracts which require withholding 10 percent in retainage. Under Tenn. Code Ann. § 66-34-103(e), a violation of the 5 percent retainage limit is a Class A misdemeanor, each day of noncompliance constitutes a separate offense, and "the punishment for each violation shall be consecutive to all other such violations." Tenn. Code Ann. § 66-34-103(e)(2)(A) – (C). Such a threat of punishment might deter owners and contractors in Tennessee from participating in Section 221(d)(4) programs, which would result in fewer rental and cooperative housing for low or moderate-income families, the elderly, the handicapped, and displaced families sponsored by the federal government. Therefore, it is likely that a court would determine that Section 221(d)(4) of the NHA implicitly overrides Tenn. Code Ann. § 66-34-103(a) with respect to the requirement that owners withhold 10 percent of the contract amount in HUD construction contracts, such as form HUD-92442-A.

This Office notes that Section 221(d)(4) would only preempt Tenn. Code Ann. § 66-34-103(a) when the Section 221(d)(4) construction contracts promulgated by HUD, which mandate withholding 10 percent of the contract amount in all projects, are required to be used. Tenn. Code Ann. § 66-34-103(a) would be in full force and effect as to any other construction contracts in Tennessee.

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