

**DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT****24 CFR Part 990**

[Docket No. FR-4874-F-08]

RIN 2577-AC51

**Revisions to the Public Housing Operating Fund Program**

**AGENCY:** Office of the Assistant Secretary for Public and Indian Housing, HUD.

**ACTION:** Final rule.

**SUMMARY:** This rule amends the regulations of the Public Housing Operating Fund Program (Operating Fund Program) to provide a new formula for distributing operating subsidy to public housing agencies (PHAs) and to establish requirements for PHAs to convert to asset management. HUD developed the final rule with the active participation of PHAs, public housing residents, and other relevant parties using the procedures of the Negotiated Rulemaking Act of 1990. These regulatory changes improve and clarify the current regulations governing the Operating Fund Program and take into consideration the recommendations of the congressionally funded study by the Harvard University Graduate School of Design on the cost of operating well-run public housing. The final rule follows publication of an April 14, 2005, proposed rule, and takes into consideration the public comments received.

**DATES:** *Effective Date:* November 18, 2005.

**FOR FURTHER INFORMATION CONTACT:** Elizabeth Hanson, Public Housing Financial Management Division, Office of Public and Indian Housing, Department of Housing and Urban Development, 550 12th Street SW., Suite 100, Washington, DC 20410; telephone (202) 475-7949 (this telephone number is not toll-free). Individuals with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 1-800-877-8339.

**SUPPLEMENTARY INFORMATION:****I. Background**

Section 519 of the Quality Housing and Work Responsibility Act of 1998 (Pub. L. 105-276, approved October 21, 1998) amended section 9 of the United States Housing Act of 1937 (42 U.S.C. 1437 *et seq.*) (1937 Act). As amended, section 9 of the 1937 Act established an Operating Fund to make assistance

available to PHAs to operate and manage public housing. Section 9 of the 1937 Act also required that the amount of the assistance to be made available to a PHA from that fund be determined using a formula developed through negotiated rulemaking procedures as provided in subchapter III of chapter 5 of title 5, United States Code, commonly referred to as the Negotiated Rulemaking Act of 1990 (5 U.S.C. 561 *et seq.*).

Negotiated rulemaking on the Operating Fund Program was initiated in March 1999, and the negotiated rulemaking committee consisted of 25 members representing PHAs, tenant organizations, community-based organizations, and the three national organizations representing PHAs—the Public Housing Authorities Directors Association (PHADA), Council of Large Public Housing Authorities (CLPHA), and National Association of Housing and Redevelopment Officials (NAHRO). Based on the recommendations made by the negotiated rulemaking committee, HUD published a proposed rule on July 10, 2000 (65 FR 42488), which was followed by an interim rule published on March 29, 2001 (66 FR 17276). The March 29, 2001, interim rule established the Operating Fund Program regulations that are currently in effect. These regulations are located in part 990 of HUD's regulations in title 24 of the Code of Federal Regulations.

During the negotiated rulemaking for the Operating Fund Formula, Congress directed that HUD contract with the Harvard University Graduate School of Design (Harvard GSD) to conduct a study on the costs incurred in operating well-run public housing (Cost Study). This congressional direction was contained in the Conference Report (H.R. Rep. No. 106-379 at 91 (1999)) accompanying HUD's Fiscal Year (FY) 2000 Appropriations Act (Pub. L. 106-74, approved October 20, 1999). Congress further directed that HUD make the results of the Cost Study available to the negotiated rulemaking committee and appropriate congressional committees.

The Harvard GSD performed extensive research on the question of what the expense level of managing well-run public housing should be. HUD, consistent with congressional direction, made the results of the Cost Study available to the members of the negotiated rulemaking committee who developed the current Operating Fund Program regulations, and also invited the committee members to be active participants in the Harvard GSD's research for and development of the Cost Study. The Harvard GSD also

conducted several public meetings to allow for an exchange of views and expectations with the public housing industry, beyond those industry members who were part of the negotiated rulemaking committee. The Cost Study was completed and officially released in July 2003.

**II. The Negotiated Rulemaking Advisory Committee on the Operating Fund**

The FY 2004 Consolidated Appropriations Act (Pub. L. 108-199, approved January 23, 2004) required HUD to undertake further negotiated rulemaking to make changes to the Operating Fund formula.

In response to this statutory language, HUD convened a negotiated rulemaking advisory committee (Committee) for the purposes of developing possible changes to the Operating Fund Program in response to the Cost Study. The Committee consisted of 28 members, including representatives of PHAs, public housing tenant organizations, public housing advocacy groups, the three national PHA organizations (CLPHA, NAHRO, and PHADA), the National Organization of African Americans in Housing (NOAAH), multifamily housing providers, and HUD. The Committee held four meetings. The meetings were held on March 30-April 1, 2004, in Washington, DC; April 13-15, 2004, also in Washington, DC; May 11-12, 2004, in Atlanta, Georgia; and June 8-9, 2004, in Potomac, Maryland. Committee sessions were announced in the **Federal Register** and were open to the public. Members of the public were permitted to make statements during the meetings at designated times and to file written statements with the Committee for its consideration.

The Committee developed a report containing several recommendations for revising the current Operating Fund Program regulations (Committee Recommendations). HUD developed a draft proposed rule based on these recommendations. Consistent with HUD's obligations under Executive Order 12866 (entitled "Regulatory Planning and Review") and other rulemaking authorities, the draft rule underwent further HUD and executive branch review prior to publication.

On April 14, 2005 (70 FR 19858), HUD published its proposed rule to revise the Operating Fund Program in the **Federal Register**. As a result of the pre-publication review processes, ten substantive modifications were made to the Committee Recommendations. Specifically, the April 14, 2005, proposed rule did not include seven of

the changes recommended by the Committee. In addition, the proposed rule contained three modifications to the Operating Fund Program that were not part of the Committee Recommendations. Additional information regarding the proposed regulatory changes to the Operating Fund Program, and the modifications made to the Committee Recommendations, can be found in the preamble to the April 14, 2005, proposed rule.

### III. Differences Between This Final Rule and the April 14, 2005, Proposed Rule

This final rule follows publication of the April 14, 2005, proposed rule and takes into consideration the public comments received on the proposed rule. Sections IV, V, and VI of this preamble provide a summary of the significant issues raised by the public commenters on the proposed rule and HUD's responses to the comments. After reviewing the public comments, HUD has made the following changes to the April 14, 2005, proposed rule.

#### *Adoption of Five Committee Recommendations*

HUD has adopted five of the seven Committee Recommendations that were omitted from the April 14, 2005, proposed rule. These are:

1. The ten percent non-profit coefficient.
2. The three percent vacancy allowance.
3. The phase-in of operating subsidy gains over two years.
4. The provision regarding the discontinuation of subsidy reduction through demonstration of successful conversion to asset management (*i.e.*, "stop-loss provision").
5. The language requiring use of an advisory committee to review the Project Expense Level (PEL) methodology and utility benchmarking, convened in accordance with the Federal Advisory Committee Act (FACA).

With respect to the remaining two Committee Recommendations not adopted in the April 14, 2005, proposed rule (*i.e.*, the change in methodology for inflating PELs and the elimination of the \$2 per unit per month public entity fee), the final rule remains unchanged.

#### *Removal of Provisions Not Contained in the Committee Recommendations*

Additionally, HUD has removed the three proposed rule provisions that were not part of the Committee Recommendations. These are:

1. The adjustment in § 990.190(i) based on the Committee Recommendations for certain PHAs.
2. The two-year limit on a higher subsidy for vacant units due to changing market conditions, and the related requirements that PHAs requesting such subsidy submit a plan for ending the higher subsidy within the two-year period.
3. The provision authorizing sanctions on PHAs that fail to comply with the asset management requirements or that do not submit accurate and timely data.

#### *Energy Loan Amortization Expenses*

In response to comments, HUD has also added language relating to the eligible expenses that can be funded under the "add-on" for energy loan amortization. This language was included in the Committee Recommendations, but was inadvertently omitted in the April 14, 2005, proposed rule.

#### *Technical Non-Substantive Changes*

In addition to the changes described above, HUD has also made several technical non-substantive corrections to the April 14, 2005, proposed rule, such as correcting cross-references and making other grammatical and editorial changes.

### IV. Public Comments Received on the April 14, 2005, Proposed Rule

The public comment period for the proposed rule closed on June 13, 2005. The proposed rule was of significant interest to the public. HUD received 573 public comments on the April 14, 2005, proposed rule. Comments were submitted by PHAs, PHA industry groups, resident organizations, advocates for low-income housing, housing experts, and other organizations and individuals. Many of the comments were part of a letter-writing campaign consisting of several form letters that were similar in substance. In some instances, individual commenters submitted multiple comments consisting of different form letters. In general, the comments objected to the modifications made to the Committee Recommendations and urged that HUD issue a rule adopting the recommendations.

The next two sections of the preamble present a summary of the significant issues raised by the public comments, and HUD's responses to the comments. Comments are organized in two categories. Section V of the preamble discusses the public comments regarding the changes to the Committee Recommendations. Section VI of the

preamble discusses additional topics that were raised by the commenters. Within each category of comments, the headings present the issue or question, followed by a brief description of the comment and HUD's response to the comment.

### V. Public Comments Regarding the Changes to Committee Recommendations

#### *General Comments*

*Comment: Support for proposed rule.* Four commenters supported implementation of the April 14, 2005, proposed rule. The commenters wrote that although the proposed rule contained changes to the Committee Recommendations and did not fulfill every resident's and PHA's needs, the rule maintained "some of the more prevailing themes of the negotiated rulemaking agreement," such as the conversion to the PEL, which will "lead to more efficient property-based management." The commenters wrote that with the resulting increase in subsidy, PHAs will be able to provide additional services to their residents and urged HUD to quickly implement the April 14, 2005, proposed rule.

*HUD Response.* HUD agrees that this final rule will result in better-managed PHAs and improved services to residents.

*Comment: HUD should fully implement the Committee Recommendations.* As noted above, the majority of the public commenters objected to the changes made to the Committee Recommendations and urged that HUD either fully implement the regulatory proposals developed during the negotiated rulemaking process or reconvene the Committee for new negotiations. Several of the commenters expressed concern that the "proposed rule modification of the funding methodology will have a long term negative impact on PHAs in order to achieve a short-term solution for this budget year" and that "budget constraints should more appropriately be handled by prorating the budget based on the level of congressional appropriations."

*HUD Response.* While it is true that the Committee Recommendations were developed as part of a formal process, the completion of the Committee's work did not conclude the rulemaking process. HUD indicated throughout the negotiated rulemaking sessions that the Committee Recommendations, like all significant rulemakings, would undergo further HUD and Executive Order 12866 review prior to publication and that the recommendations might be revised as a

result of those review processes. The changes made to the Committee Recommendations were designed to further the goals of the Operating Fund program and the Administration policies and budgetary priorities, while also advancing the goals of the Committee to implement an improved and more accurate Operating Fund formula.

HUD recognizes that, as part of a negotiated rulemaking process, concessions were made by all parties to arrive at the proposed regulatory changes recommended by the Committee. In light of the issues raised by the public commenters, HUD has reconsidered the changes to the Committee Recommendations, and this final rule adopts all but two of the provisions recommended by the Committee. HUD believes that the final rule furthers the implementation of the recommendations of the Cost Study, the policy and budgetary goals of the Administration, and the consensus decisions reached during the negotiated rulemaking process.

*Comment: HUD should initiate new rulemaking on the Operating Fund.* Several commenters wrote that HUD should discard both the April 14, 2005, proposed rule and the Committee Recommendations, and start the rulemaking process again to produce a rule that would be more reflective of the costs associated with well-managed public housing. The commenters wrote that the cuts recommended by the Cost Study would impair the ability of PHAs to carry out necessary functions to maintain decent, safe, and sanitary housing.

*HUD Response.* While the Committee Recommendations and the April 14, 2005, proposed rule may not meet with the complete satisfaction of all parties, both reflect the results of extensive deliberations based on the sound and thorough Cost Study. As HUD has previously indicated, it believes that the Cost Study's methodology is an interim solution, with the ultimate goal to establish funding levels based on actual and reasonable cost data by property, which is to be achieved with the implementation of asset management. However, HUD has acknowledged that PHAs that face a reduction under the new formula will need some time to align their resources with the new funding. Accordingly, HUD has provided a 5-year transition period.

#### *Comments on Specific Regulatory Provisions*

*Comment: The non-profit coefficient should be increased to ten percent.* The Cost Study and the Committee had

recommended a non-profit coefficient of ten percent based on estimated differences in operating costs between for-profit and non-profit entities according to the Federal Housing Administration (FHA) database of properties that was used for the Cost Study. The April 14, 2005, proposed rule reduced the non-profit coefficient from ten percent to four percent, reflecting the belief that the difference in costs between for-profit and non-profit entities represented inefficiencies that should not be supported in the formula.

Many comments objected to HUD's reduction of the non-profit coefficient from ten to four percent on the grounds that it was contrary to the recommendations of both the Committee and the Cost Study, and that it would not provide PHAs with sufficient funding to support their specific non-profit operating functions.

*HUD Response.* As noted above, HUD has adopted the suggestion made by the commenters and has adopted the non-profit coefficient as contained in the Committee Recommendations.

*Comment: Support for a \$2 Per Unit Per Month (PUM) Public Entity Fee.* The Committee recommended that a public entity fee of \$2 PUM be added to the initial PELs. The public entity fee was intended to reimburse PHAs for additional services (above and beyond the non-profit coefficient) that are unique to PHAs as public entities. The April 14, 2005, proposed rule did not adopt this additional fee. HUD's position was that these expenses were addressed through other means in the proposed rule.

Many commenters recommended adoption of the \$2 PUM public entity fee. Several of the commenters asked where in the April 14, 2005, proposed rule such expenses were covered, especially given the fact that the non-profit coefficient had been reduced.

*HUD Response.* HUD has not revised the rule in response to these comments. The FHA portfolio, which was the basis for the new Project Expense Level (PEL) calculation, contains a high percentage of assisted properties, which are also subject to HUD regulations. Thus, the expenses associated with the public entity fee are reflected in the PEL's percent-assisted coefficient and the non-profit coefficient. Furthermore, the final rule adopts the Cost Study's recommendation of a ten percent non-profit coefficient, which HUD believes adequately covers the additional services unique to PHAs.

*Comment: Support for the three percent allowance for vacant units.* Under the Committee

Recommendations, PHAs would receive a subsidy for occupied dwelling units and dwelling units with an approved vacancy. PHAs would also receive an operating subsidy for a limited number of vacancies if the annualized rate is less than or equal to three percent, or for up to five units if the PHA has 100 or fewer units. The April 14, 2005, proposed rule did not adopt these recommendations.

Many commenters recommended that HUD adopt the vacancy allowance, indicating that it would be unrealistic to expect any housing operator to maintain 100 percent occupancy at all times. Several commenters mentioned that the three percent vacancy allowance is the industry standard and that the monthly rent charge in FHA's multifamily housing program also reflects assumptions on occupancy loss.

*HUD Response.* HUD has revised the rule in response to the suggestion made by the commenters. The final rule adopts the recommendation of the Committee with regard to vacancies. Hence, PHAs will receive an operating subsidy for a limited number of vacancies if the annualized rate is less than or equal to three percent, or for up to five units if the PHA has 100 or fewer units.

*Comment: Support for Committee recommendation regarding the PEL inflation factor.* The annual inflation factors used to adjust the current Allowable Expense Level (AEL) are based on a 60 percent wage factor and a 40 percent non-wage factor. Under the Committee Recommendations, the weights would have remained the same, but the methodology for calculating the inflation factor would have changed. For the wage component, the factor would have been based on the Employment Cost Index (ECI) instead of the current formula's Bureau of Labor Statistics (BLS) 202 Local Government Wage series. For the non-wage component, this factor would have been based on the Consumer Price Index (CPI) instead of the current formula's Producer Price Index (PPI). The April 14, 2005, proposed rule retained the current formula's inflation factor methodology for adjusting annually the PEL.

Many commenters urged that HUD adopt the methodology recommended by the Committee for calculating the PEL inflation factor. The commenters wrote that the recommended methodology is a more accurate measure of inflation. The commenters wrote that the current wage factor does not keep pace with health care costs, which was addressed by the Committee with the recommended use of the ECI. In

addition, several commenters wrote that because PHAs are not producers, but, instead, purchasers of goods and services, the more appropriate index for non-wage inflation would be the CPI.

**HUD Response.** HUD has not revised the rule in response to these public comments. During negotiated rulemaking, HUD sought to devise a more accurate and transparent inflation factor methodology than the one used under the current regulations, one that PHAs could calculate by accessing the BLS Web site. After further review, HUD believes that the inflation factors recommended by the Committee are less accurate and no more transparent than the current methodology. Specifically, for the wage component, the current BLS-202 local government wage series is more accurate than the BLS—Employment Cost Index (ECI) contemplated by the Committee for the following reasons:

1. The current methodology measures wages of local government employees, which are more similar to PHAs, whereas the ECI data includes State and local government employees.

2. The current methodology includes data that is available at the county level, summed to either state metropolitan and nonmetropolitan level, whereas the methodology recommended by the Committee (*i.e.*, ECI) is available at only a national level and, for private sector wages, at the regional level. Local wage patterns can vary significantly from national averages.

For the non-wage component, the current methodology uses the Producer Price Index (PPI), which excludes the cost of food and energy and measures national average cost changes in finished goods used by businesses. The Committee recommended using the overall CPI, which primarily measures changes in the costs of food, housing, apparel, recreation, transportation, medical expenses, utilities, and other services. HUD believes the PPI is a more appropriate measure of the type of goods and services purchased by PHAs, and that the overall CPI has little relevance to the costs of PHA purchases. In addition, utility costs are covered in the Operating Fund formula under a separate component than the PEL and should be excluded from the PEL inflation factor.

All factors considered, the current methodology for the inflation factor is considerably more appropriate than the methodology recommended by the Committee.

**Comment: Support for two-year phase-in of operating subsidy gains.** Under the Committee Recommendations, PHAs that

experience a gain in their operating subsidy would have those gains phased in over a two-year period. The April 14, 2005, proposed rule would have phased in those gains over a four-year period to more closely align the gains with the five-year phase-in period for those PHAs that would have their subsidy decreased.

Many commenters objected to the change in phase-in for PHAs gaining operating subsidy. The commenters indicated that the four-year phase-in period would be too long and that, for PHAs that have been historically underfunded, increases in subsidy should be distributed expeditiously.

**HUD Response.** HUD has adopted the suggestion of the commenters to adopt the language of the Committee Recommendations so that gains in subsidy will be phased in over two years.

**Comment: Support for adoption of “stop-loss” provision.** The Committee Recommendations allowed PHAs to discontinue their subsidy reduction (stop-loss) by demonstrating successful conversion to asset management. The April 14, 2005, proposed rule did not adopt this stop-loss provision on the grounds that the Cost Study’s results should be equally applied to all PHAs and that this stop-loss would weaken the implementation of the Cost Study. Further, PHAs that feel that their formula is not correctly calculated have remedies under the appeals provision.

Many commenters supported adoption of the stop-loss provision. The commenters indicated that such a provision is necessary to prevent PHAs from experiencing reductions in their subsidy amounts that impact their staffing and PHA services. In addition, commenters wrote that the stop-loss provision would provide PHAs with an incentive to convert to asset management in order to limit their decrease in subsidy.

**HUD Response.** HUD has revised the rule in response to these comments. The final rule adopts the stop-loss provision recommended by the Committee, which allows PHAs to discontinue their subsidy reduction by demonstrating successful conversion to asset management.

**Comment: Opposition to the adjustment for certain PHAs.** The April 14, 2005, proposed rule would have established an “add on” for certain PHAs that would have gained subsidy under the Committee Recommendations, but would have had their subsidy decreased under the proposed rule. These PHAs would receive additional funding at the

formula amount recommended by the Committee.

Many of the public commenters objected to this special add-on. Most believed that this adjustment created a special class of agencies and essentially a two-tier, inequitable funding system.

**HUD Response.** HUD agrees with the public commenters and has removed the adjustment for certain PHAs. All PHAs will be funded under the same Operating Fund formula and provisions.

**Comment: Opposition to the two-year time limit and plan requirements on subsidies for vacant units due to changing market conditions.** The April 14, 2005, proposed rule included a provision that would have required PHAs that appeal to receive subsidy on vacant units due to changing market conditions. The provision would have required such PHAs to submit, along with their appeal, a plan to lease the units within two years, and imposed a two-year limit on receipt of such subsidy. The Committee Recommendations did not include a similar provision for a plan or a two-year time limit.

Many commenters objected to the two-year time limit on subsidies for units vacant due to changing market conditions and the related requirement for submission of a plan for leasing those units within that time period. Many commenters also noted that HUD’s regulations governing the mandatory and voluntary conversion of public housing developments to tenant-based voucher assistance (see 24 CFR part 972) already provide PHAs with guidelines for addressing vacancies based on market conditions.

**HUD Response.** HUD has adopted the suggestion of the commenters and has removed both the two-year limit on receipt of subsidy and the related plan requirement.

**Comment: Opposition to sanctions for failure to convert to asset management and to submit accurate and timely data.** The April 14, 2005, proposed rule included two provisions authorizing sanctions, as deemed necessary and otherwise provided by law, for those PHAs not in compliance with asset management by FY 2011 and that fail to submit accurate and timely data as required by the regulations. These sanctions might include the imposition of a daily monetary fine until the PHA converted to asset management.

Many commenters objected to the new sanction provisions. The commenters wrote that the provisions are unnecessary, since HUD already has numerous remedies if PHAs are not in compliance with applicable requirements. In addition, the

commenters wrote that the imposition of a daily monetary fine is inappropriate and will harm the people the program is designed to assist. Some commenters also wrote that the conversion to asset management is a complex task and that, even with good faith and best efforts, a PHA could be subject to fines for noncompliance.

*HUD Response.* HUD has adopted the suggestion of the commenters and removed the sanction language that was found in proposed §§ 990.200(d) and 990.290(e). HUD agrees with the commenters that it already has the authority to impose a broad range of sanctions for non-compliance with program rules.

*Comment: The 2009 review of PEL methodology should be conducted in accordance with the procedures of the Federal Advisory Committee Act (FACA).* The Committee Recommendations provided that in 2009, HUD will convene a meeting with representatives of appropriate stakeholders to review the methodology to evaluate the PEL based on actual cost data and to establish utility benchmarking for the PEL. The provision stated that the meetings shall be convened in accordance with FACA procedures. The April 14, 2005, proposed rule modified that language to state that the meetings would be convened in accordance with "FACA or such other authority or protocol determined appropriate."

Several commenters objected to the new FACA language included in the proposed rule. The commenters wrote that the issues to address in 2009 as part of the discussions of the PEL methodology and utility benchmarking are inherently complex and that the April 14, 2005, proposed rule language does not provide sufficient assurances that interested stakeholders will have an official role in the 2009 discussions.

*HUD Response.* As noted above, HUD has adopted the language recommended by the Committee. Specifically, this final rule provides that HUD will convene a FACA committee to review the methodology to evaluate the PEL based on actual cost data and establish utility benchmarking.

## VI. Discussion of Additional Public Comments Received on the April 14, 2005, Proposed Rule

### General Comments

This section of the preamble discusses general comments received on the April 14, 2005, proposed rule not related to a specific regulatory provision.

*Comment: HUD should provide updated calculations by property and by*

*PHA so that the impact of the rule can be understood.* One commenter wrote that, in response to a request during the negotiations, HUD did not provide updated calculations modeling the impact of the rule on individual PHAs. Another commenter wrote that the April 14, 2005, proposed rule does not provide sufficient information for each PHA to determine the extent of the gains or losses under the formula and that HUD should provide this information in an easy to understand way that shows the percent of change and the dollar amount of the change.

*HUD Response.* HUD agrees that all PHAs should understand the formula for calculating operating subsidy under the final rule. Data was presented to the Committee and later made available to the public housing community on the projected impact of the rule based on the Committee Recommendations. Similarly, HUD provided data modeling on the projected impact of the April 14, 2005, proposed rule on individual PHAs. This data was shared with representatives of the public housing industry groups and other stakeholders. Finally, HUD has posted a complete report showing the operating subsidy amounts for all PHAs and the methodology documents on the HUD Web site at <http://www.hud.gov>.

*Comment: HUD should clarify what the rule means when it refers to "fiscal year."* Several commenters suggested that HUD clarify in the rule whether references to "fiscal year" mean a PHA's fiscal year or the federal fiscal year.

*HUD Response.* HUD has revised references to the term "fiscal year" in the regulatory text of this final rule to clarify whether the terms refer to a federal or PHA fiscal year.

*Comment: HUD should make permanent Moving to Work Agreements.* One commenter suggested that HUD give PHAs participating in the Moving to Work program the option of making their current agreement permanent.

*HUD Response.* The suggestion made by the commenter is outside the scope of this rulemaking, which is concerned with implementation of the new Operating Fund formula.

*Comment: Concerns regarding implementation of future deregulatory changes.* One commenter expressed concern about the language in the preamble indicating that HUD and its negotiating partners on the Committee may contemplate additional organizational and regulatory changes beyond those included in the Operating Fund in order to implement asset management. The commenter wrote that this language appears to indicate that HUD seeks deregulation, which is

beyond the mandate of the Committee, and that HUD may try to implement significant policy changes by circumventing the normal regulatory process. Another commenter cautioned that HUD should concentrate first on implementing the new formula and, once implemented, then turn to these other regulatory items.

*HUD Response.* Deregulation was part of the Cost Study's recommendations and, although the subject of deregulation was not directly before the Committee, it is an important aspect of the implementation of asset management. Therefore, the Committee discussed deregulation during the negotiated rulemaking sessions. However, any changes to other HUD regulations would be completed through the appropriate regulatory or administrative processes, which would provide opportunities for public comments, as appropriate. Additionally, HUD is sensitive to the timing of the related changes and will take that into consideration as it proceeds on these other elements.

*Comment: Concerns regarding reduced funding for the Operating Fund program.* Several commenters wrote that the Operating Fund should be fully funded in order for PHAs that have historically been underfunded to realize the full gains under the new formula. Several commenters wrote that, with the expected decrease in funding for this program in 2006, PHAs would have to cut critical services to residents including anti-crime and job training activities.

*HUD Response.* The suggestion made by the commenters addresses the annual federal budget process and is outside the scope of this rulemaking, which is concerned with the implementation of the new Operating Fund formula.

*Comment: Rule should consider the needs of small PHAs.* One commenter wrote that the final rule should consider the needs and issues facing small PHAs.

*HUD Response.* HUD agrees that there are special considerations for smaller PHAs. The final rule authorizes small PHAs (those with under 250 units) to treat all of their units as one project. Small PHAs are provided the flexibility of either maintaining their current management practices or converting to asset management.

*Comment: HUD should provide additional funding for PHAs to transition to asset management if additional regulatory relief is not achieved.* One commenter referred to language in § 990.255(b) that provides that "HUD recognizes that appropriate changes in its regulatory and monitoring programs will be needed to support

PHAs'' to undertake asset management. The commenter recommended that a provision be added to the rule that would provide additional funding to transition to asset management systems should HUD fail to timely implement needed regulatory and monitoring changes. The commenter also recommended that this transition funding be based on actual costs data presented through the appeal process for higher project cost data under § 990.245(e).

**HUD Response.** HUD has not adopted the suggestion made by the commenter. Transition costs were discussed by the Committee, but were not part of the Committee Recommendations. The phase-in provisions, as well as the current level of PHA reserves, factored heavily in the decision not to include special transition funding.

**Comment: PHA data requirements.** One commenter asked what additional data PHAs will be required to maintain, other than the current data, at a property level instead of at a PHA-level.

**HUD Response.** In general, PHAs will be asked to submit additional data to HUD with respect to asset management and utility data as referenced under § 990.170(f). Further information on the data submission requirements will be provided in subsequent HUD guidance.

**Comment:** The rule imposes an unfunded mandate on PHAs. Two commenters wrote that the April 14, 2005, proposed rule does not meet the requirements of the Unfunded Mandates Reform Act of 1995 because it fails to take into consideration the significant budgetary impact on PHAs to meet the requirements of the regulation.

**HUD Response.** HUD, in the development of the proposed rule, reviewed the regulatory proposals for compliance with all legal rulemaking requirements, including the requirements contained in title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) (UMRA). The UMRA establishes specific thresholds and other requirements for determining whether a rule would impose an unfunded federal mandate. Neither the April 14, 2005, proposed rule, nor this final rule, impose any federal mandates on any State, local, or tribal government, nor on the private sector, within the meaning of the UMRA.

#### *Comments Regarding Subpart A—Purpose, Applicability, Formula, and Definitions*

**Comment: Disagrees with HUD issuing non-codified guidance.** One commenter objected to the language in § 990.110(c), which provides that, for certain secondary elements that will be

used in the formula, HUD will provide information in various forms of non-codified guidance HUD deems appropriate. The commenter wrote that, without notice and comment procedures, errors in the guidance cannot be challenged and adjusted except through appeals, which may not fit the appeal categories. The commenter suggested that HUD implement secondary formula elements by interim rulemaking, thereby allowing comments and requests for modification.

**HUD Response.** HUD has not revised the rule in response to this comment. HUD will use notice and comment rulemaking procedures when such procedures are appropriate or necessary (for example, when a policy change would require the revision of regulatory language codified by this final rule). In other instances, where rulemaking is neither appropriate nor required, but where HUD has determined that clarification of existing regulatory requirements is needed, HUD will issue such guidance through non-regulatory means. Rulemaking can be a time-consuming process and use of such procedures where not required might unnecessarily delay the issuance of needed guidance. Non-regulatory guidance can be amended or updated in a more expeditious manner. In addition, non-codified guidance provides greater flexibility to make changes, if necessary, in a more expeditious manner. As appropriate, HUD will consult with stakeholders and other interested parties in the development of non-regulatory guidance on the Operating Fund.

**Comment: HUD should establish a definition for the term “asset repositioning fee.”** One commenter made this suggestion.

**HUD Response.** HUD has not added a definition for the term “asset repositioning fee.” During the negotiated rulemaking it was agreed that the definitions would be limited to essential terms. Because the asset-repositioning fee is described in detail in § 990.190(h), it has not been added to the definitions section at § 990.115. The asset repositioning fee established in this final rule is the counterpart to the phase-down funding fee in the current part 990 regulations and, in accordance with the provisions in § 990.190, will be paid to PHAs that transition projects or buildings out of their inventory.

**Comment: The definition of “rolling base consumption level” should state that the 36-month period ends on June 30th.** One commenter made this suggestion.

**HUD Response.** HUD agrees with this suggestion and has revised the rule accordingly.

#### *Comments Regarding Subpart B—Eligibility for Operating Subsidy*

Subpart B of the rule describes the requirements and procedures governing the computation of eligible unit months. A public housing unit may receive operating subsidy for each unit month that it qualifies as an occupied dwelling unit or a dwelling unit with an approved vacancy. The total number of eligible unit months for each PHA will be calculated from July 1st to June 30th prior to the first day of the applicable funding period and will consist of eligible units as defined in this rule. The rule reserves to HUD the right to determine the status of any public housing units based on information in HUD's information systems. In addition, the rule provides for a change in a PHA's formula within each one-year funding period based on the addition and deletion of units in a PHA's inventory.

**Comment: HUD should provide operating subsidy for new units.** One commenter, citing § 990.150, asked how HUD expects PHAs to operate new units without operating subsidy funds. The commenter wrote that the rule requires PHAs to report new units periodically, but does not provide funding until the next funding cycle.

**HUD Response.** The commenter has misinterpreted § 990.150, which requires that PHAs report the addition of new units and deletion of units on a quarterly basis. This section goes on to state that once the PHA has reported that the new unit is online, HUD will assume that the unit is fully occupied for the balance of the funding period, and HUD will provide funds from the current funding cycle. However, in the following year, once actual data is available, HUD will make an adjustment to the PHA's funding amount that would take into account the actual occupancy of the new unit(s).

**Comment: HUD should clarify the definition of “occupied unit.”** One commenter, citing § 990.140, requested that HUD clarify when a unit is considered occupied. Two examples provided were: (1) When a tenant is hospitalized and (2) When a PHA refuses to renew a lease for failure to comply with the community service requirements. The commenter suggested that HUD define “occupied” as a unit with an occupant or where the occupant is paying rent.

**HUD Response.** Consistent with § 990.140 of this final rule, a unit that is under lease to a public housing-eligible family is considered to be occupied.

*Comment: Units with approved vacancies under the current regulations should be included in the final rule.*

Several commenters requested that all of the units for which PHAs may receive subsidy under the current part 990 regulations be included in this final rule, stating that changes would result in decreases in their operating subsidy eligibility. One commenter asked for subsidy for units vacant due to federal and state laws and regulations and another asked for subsidy for units vacant due to HUD approved desegregation plans.

*HUD Response.* HUD has not made any changes to the rule in response to these comments. The provisions on subsidy eligibility for vacant units, which were discussed extensively during the negotiated rulemaking sessions, have been clarified and streamlined. Under § 990.145, units undergoing modernization and units used for special uses, such as resident services or anticrime activities, are eligible for subsidy. On a project-by-project basis, units that are vacant due to litigation (which includes units vacant due to desegregation plans), disasters, and casualties are eligible for subsidy. PHAs may appeal to HUD to receive operating subsidy for units that are vacant due to changing market conditions. While the final rule no longer expressly provides subsidy eligibility for units vacant due to laws (Federal or State laws of general applicability, or their implementing regulations), the final rule does provide subsidy eligibility for units if they are undergoing modernization, including those undergoing modernization in order to meet construction or habitability standards.

*Comment: Add community and management spaces to approved vacancies.* One commenter wrote that the final rule should include a vacancy allowance for units converted to community and management spaces and for units that are reconfigured to comply with litigation and legal requirements.

*HUD Response.* As noted above in this preamble, this final rule has adopted the Committee Recommendation under which PHAs are eligible to receive subsidy for three percent of their vacancies, or up to five units if the PHA has less than 100 units. PHAs also are eligible to receive subsidy for special use units, which are described in § 990.145(b) as units approved and used for resident services, resident organization offices, and related activities such as self sufficiency and anti-crime activities. With regard to unit reconfiguration due to litigation or a legal requirement, if a unit has to be

vacant during this reconfiguration, then the unit may be eligible for subsidy under § 990.145(c), which provides subsidy eligibility for units vacant due to litigation.

#### *Comments Regarding Subpart C—PEL*

Subpart C describes how formula expenses will be calculated under the revised Operating Fund formula. Specifically, the rule provides a detailed description with respect to the computation of the PEL. The PEL is calculated in terms of PUM costs and represents the costs associated with the project except for utilities and add-ons. HUD will calculate the PEL using the ten variables from the Cost Study and their associated coefficients (*i.e.*, values that are expressed in percentage terms).

*Comment: HUD should make further adjustments to the Cost Study methodology for calculating the PEL.* Several commenters suggested changes in the Cost Study's methodology for developing the PEL. Suggestions provided by the commenters included: (1) Eliminating ceilings; (2) providing additional funding to take into account costs associated with older properties; (3) removing the four percent reduction for PELs greater than \$325; and (4) modifying statistical techniques.

*HUD Response.* HUD has not adopted the suggestions made by the commenters for changes in the Cost Study methodology for calculating the PEL. All of the suggested changes to the PEL methodology were discussed by the Committee during the negotiated rulemaking sessions. HUD believes that the Cost Study methodology is sound and should be preserved. The final rule provides certain add-ons that went beyond the Cost Study's recommendations (for example, the information technology (IT) fee) and provides additional financial incentives (for example, the freezing of rental income for three years).

*Comment: HUD should clarify application of the rule to mixed-finance projects.* Referring to § 990.165(g), which grandfathered existing mixed-finance agreements for purposes of funding, one commenter raised technical and implementation issues regarding the applicability of the rule and, in particular, the asset management provisions, including project-based budgeting and accounting, and the calculation of operating subsidy for mixed-finance developments. The commenter asked about the treatment of the development-wide replacement reserves in the determination of the PEL for mixed-finance developments and the use of the non-profit coefficient when determining the PEL for mixed-finance

developments. The commenter also inquired about the requirements for project-based budgeting and accounting, as well as about determination of compliance with asset management for mixed-finance developments that are owned and managed by entities other than PHAs and for which the owner and manager handle all management and provide information and financial reports to PHAs for review and monitoring.

*HUD Response.* HUD views all public housing units under an Annual Contributions Contract (ACC) as public housing assets, regardless of where they are located or whether they are part of a mixed-finance development or a public housing development. As such, the non-profit coefficient will be applied to the PEL for public housing units in mixed-finance developments. However, there will be no separate add-on to cover the cost of replacement reserves that are established in mixed-finance developments, which are not operating costs, *per se*. With regard to how the requirements for project-based budgeting and accounting and how the determination of compliance with asset management will apply to mixed-finance developments, HUD will issue this information in future guidance on these matters.

*Comment: Mixed-finance developments should not receive different subsidy amounts.* One commenter wrote that § 990.165(g) allows PHAs with certain mixed developments to receive a higher PEL immediately, rather than requiring the higher PEL to be phased in, and that this is contradictory to the provisions of § 990.235.

*HUD Response.* The provision in § 990.165(g) regarding the level of funding that PHAs would receive for certain mixed-finance projects was included in the regulation for the express purpose of honoring the structure of those mixed-finance agreements. Because the financing and approval in mixed-finance agreements is tied to a specific level of funding, the Committee agreed that future funding should continue at that level, subject to appropriations.

#### *Comments Regarding Subpart C—Utilities*

Subpart C describes the Utilities Expense Level (UEL) component of the Operating Fund formula. The UEL includes the computation of the current consumption level and the rolling base consumption level. In addition, a PHA that undertakes energy conservation measures financed by an entity other than HUD may qualify under this rule



for financial incentives with HUD approval.

*Comment: HUD should clarify that "other direct costs" are also eligible for additional operating subsidy as part of an energy conservation contract and define what constitutes "direct costs."* Several commenters wrote that proposed § 990.185(a)(3) inadvertently omitted language agreed to by the Committee which provided that the PHA is eligible for additional operating subsidy for the cost of amortizing the loan and "other direct costs related to the energy project under the contract." In addition, the commenter suggested that HUD define the type of costs that are eligible for additional operating subsidy.

*HUD Response.* The language regarding the "other direct costs" was inadvertently omitted from the April 14, 2005, proposed rule. As noted above in this preamble, HUD has adopted the suggestion of the commenters and has inserted the suggested language in § 990.185(a)(3) of this final rule. HUD will provide additional clarification in subsequent guidance as to the types of direct costs that will be eligible for the additional operating subsidy.

*Comment: HUD should modify the definition of "utility rate" from "actual average rate" to "actual weighted average."* The April 14, 2005, proposed rule at § 990.115 defined "utility rate" as "the actual average rate for any given utility for the most recent 12-month period that ended the June 30th prior to the beginning of the applicable funding period." One commenter requested that the definition be modified to provide for an "actual weighted average" rather than an "actual average weight." The commenter wrote that a simple average may understate the true utility rate because natural gas and heating oil prices tend to be higher during winter when usage is higher, and lower in the summer when usage is reduced. Conversely, electricity prices will tend to be lower in winter and higher in summer. Thus, in order to capture the true rate over a 12-month period, a weighted average would more accurately take into account seasonal usage and rates in use at that time.

*HUD Response.* HUD has not adopted the suggestion made by the commenters. The Committee discussed various ways to calculate the UEL and it was determined that an actual average rate, not a weighted average, was the most appropriate means to capture utility rates for the past year. The final rule states that funding for utility expenses will be based on the most recent 12-month period, which includes both a heating and cooling season and will

include an inflation/deflation factor. Furthermore, by shifting the funding to a calendar cycle and standardizing the rolling base to a July 1st to June 30th cycle, all PHAs will be funded for utilities on the same cycle.

*Comment: HUD should not prorate the incentives for energy conservation improvements.* One commenter wrote that PHAs may be reluctant to undertake energy conservation measures because the incentives are subject to proration, and PHAs will be unable to realize the full amount of the subsidy associated with the incentives. The commenter suggested that the incentives for energy conservation improvements not be subject to proration.

*HUD Response.* HUD has not adopted the suggestion made by the commenters. The Department believes that it would be inequitable to the approximately 3,200 PHAs nationwide to provide special treatment for any one component of the formula. Because HUD regards all components of the Operating Fund formula to be of equal importance, HUD believes that it is more equitable when there is a proration to uniformly prorate operating subsidy eligibility based on all components.

*Comment: HUD should allow PHAs to substitute "future approved rates" as the basis for calculating a PHA's utility subsidy.* One commenter wrote that basing utility subsidy on the "most recent 12-month period that ended the June 30th prior to the beginning of the applicable funding period" may not adequately address near-term changes in utility costs. Specifically, the commenter wrote that rates used in the utility subsidy calculation may be at least nine months old at the time of calculation and over 12 months old at the beginning of the new fiscal year. The commenter suggested that language applicable to the current Operating Fund formula be added. The current formula language allows "future approved rates" to be used as the basis for utility subsidy calculation when these rate changes have been approved and published prior to the due date of the operating subsidy eligibility calculation to HUD.

*HUD Response.* HUD has not adopted the suggestion made by the commenter. During the negotiated rulemaking sessions, the Committee recognized that the utility subsidy calculation time frame as specified in the rule might not adequately address near-term changes in utility rates. To address this concern, the Committee provided for the inclusion of an inflation/deflation factor in each PHA utility calculation.

*Comment: HUD should provide for large utility rate increases.* One

commenter requested that the PHAs that experience large utility rate increases that are greater than the inflation factor be given consideration in the calculation of the utility subsidy.

*HUD Response.* In the negotiations, the Committee acknowledged and discussed that utility rate spikes above the rate of inflation have occurred in past fiscal years and could occur again. However, the Committee agreed that since year-end adjustments to the utility funding could no longer be processed due to congressional appropriation language, the new system of funding utilities under this final rule (based on the actual average rate from the last twelve months that ended on June 30 of the year prior to the funding year to be adjusted by an inflation/deflation factor) was the most reasonable and consistent way to fund utilities for all PHAs. If utility rates spike during the course of a PHA's fiscal year, that increase will be picked up in the calculation of the UEL during the next fiscal year.

*Comment: Increases in utility costs lower rental income to PHAs with resident-paid utilities.* One commenter wrote that when utility costs increase, PHAs with resident-paid utilities must increase utility allowances, thus lowering rental income to the PHA. The commenter wrote that since formula income will be frozen at the 2004 level, the PHA will have no recourse but to request a waiver for an adjustment to rental income.

*HUD Response.* Section 990.170(e) addresses this issue in providing that, with regard to resident-paid utilities, increases/decreases in tenant utility allowances shall result in a commensurate increase/decrease in operating subsidy. HUD will issue guidance regarding the implementation of this language.

*Comment: HUD should provide incentives for PHAs that achieve energy efficiency programs.* One commenter made this suggestion.

*HUD Response:* HUD has retained the current incentives for energy efficiency programs, which are contained in § 990.185.

#### *Comments Regarding Subpart C—Add-ons*

*Comment: HUD should clarify which "coordinators" are funded under the self-sufficiency add-on.* Several commenters asked for clarification as to which program coordinators are included under § 990.190(a) and also whether additional coordinators could be funded.

*HUD Response.* Section 990.190(a) provides that the self-sufficiency add-on will be "in accordance with HUD's self-



sufficiency program regulations and notices.” HUD has issued guidance indicating that the Operating Fund will provide subsidy for elderly and disabled service coordinators for those PHAs that previously received funding under the Resident Opportunities and Self Sufficiency (ROSS) program, and at the levels they received funding under the ROSS program. This guidance may change to reflect program objectives; however, at present, there is no additional funding for these activities.

*Comment: HUD should provide PHAs with additional operating subsidy for Family Self-Sufficiency (FSS) coordinators.* One commenter wrote that in FY 2004, HUD began to fund the cost of the FSS Coordinator program from the ROSS program, which led to the loss of FSS funding for many PHAs because ROSS is a competitive grant program. To compensate for this loss, the commenter recommended that every PHA with at least 25 public housing FSS slots approved in its FSS action plan receive operating subsidy for the full cost of one coordinator. Costs for other coordinators would fall outside the Operating Fund Program.

*HUD Response.* At this time, in accordance with recent HUD guidance, funding for FSS coordinators is available only through the ROSS program. However, funding self-sufficiency coordinators is an eligible activity under the Operating Fund and, although no additional funds will be provided, PHAs can spend their operating subsidy on this type of activity.

*Comment: HUD should exclude FSS escrow deposits from calculation of formula income.* One commenter wrote that under HUD’s current procedures, a PHA excludes FSS escrow deposits from the tenant income that are reported to HUD. The commenter expressed concern that under the new formula, which would freeze tenant income based on data from the audited financial statements for the purposes of determining operating subsidy, that FSS escrow deposits would no longer continue to be excluded from the formula income calculation.

*HUD Response.* The rental income amount collected on PHA’s financial statements already excludes amounts from FSS escrow deposits. Thus, HUD will continue to exclude FSS escrow deposits when calculating the formula income component.

*Comment: HUD should provide PHAs with operating subsidy for contributions to FSS escrow accounts.* One commenter wrote that the cost of contributions to the FSS escrow accounts should be included as an add-on to operating

subsidy. The commenter indicated that HUD had in the past paid for the costs of the FSS escrow accounts by allowing PHAs to deduct contributions to the FSS escrow account from the rent roll reported to HUD for calculating operating subsidy.

*HUD Response.* HUD has not adopted the suggestion made by the commenter to provide an add-on for PHA contributions to the FSS escrow account. HUD does not believe that a separate add-on is needed. As stated above, HUD will continue to exclude the FSS escrow deposits in the calculation of the formula income component.

*Comment: Other HUD grant programs for self-sufficiency activities should not be eliminated.* One commenter asked if, with implementation of this final rule, other grant programs will be eliminated and whether PHAs will have to request and fund program coordinators through the use of operating subsidy.

*HUD Response.* This final rule applies only to the Operating Fund Program. The final rule does not establish a new requirement, or remove or alter any existing requirement for the ROSS Program.

*Comment: HUD should provide additional funding through the Operating Fund formula to well-managed PHAs for resident services.* One commenter made this suggestion.

*HUD Response.* HUD has not adopted the suggestion of the commenter. While operating subsidy may be used to provide resident services (*i.e.*, that is an eligible use of funds), HUD disagrees that additional funding should be provided outside the add-ons that already exist for self-sufficiency, as described in § 990.190(a), and resident participation, as described in § 990.190(e).

*Comment: HUD should clarify whether PHAs will receive the add-on for payment in lieu of taxes (PILOT) in circumstances when the PILOT payment to the local municipality is waived.* One commenter posed this question regarding the PILOT add-on described in § 990.190(i).

*HUD Response.* The final rule provides that the add-on is based on a PHA’s “cooperation agreement or latest actual PILOT payment.” Providing that a cooperation agreement is in place, HUD will provide funding for PILOT regardless of whether the local government waives payment.

*Comment: HUD should clarify which activities can be funded with the add-on for resident participation.* One commenter posed this question regarding the add-on described in § 990.190(e).

*HUD Response.* The final rule provides that the add-on is for the funding of “resident participation activities, including but not limited to those described in 24 CFR part 964.” The intent of this language was to allow resident participation funds to be used for a broader range of activities than outlined in 24 CFR part 964, including resident services.

*Comment: There may be an error in the example on the repositioning fee in § 990.190(h)(4).* One commenter submitted this observation.

*HUD Response.* The language in § 990.190(h)(4) should have referenced a PHA with a 1,000 unit inventory, not a 1,000 EUM inventory. The language in this rule has been changed accordingly, and the calculation is now correct.

*Comment: HUD should provide an add-on to cover the cost of employee benefits.* Several commenters wrote that because their PHA is part of the state retirement system and because much of their work force is unionized, the costs associated with employee benefits including retirement, health, and dental benefits have increased dramatically. The commenters wrote that these costs are not reflected in the FHA cost structure or in other PHAs. The commenters suggested that HUD provide an add-on to cover the costs associated with employee benefits.

*HUD Response.* HUD has not adopted the suggestion made by the commenters. As the commenters acknowledged, their PHAs may be somewhat unique in that they belong to a state pension system, which is not the case for most PHAs. To provide such an add-on would be unfair to other PHAs. The new Operating Fund formula takes a “benchmark” approach. It represents what essentially other non-profit operators would spend on housing in the same market with similar characteristics. The model does not attempt to reimburse PHAs for requirements imposed uniquely on them by state or local governments. Rather, the formula represents a reasonable amount that other housing operators would incur to run the properties.

*Comment: HUD should use interim rulemaking to issue procedures for changes in subsidy due to changes in laws, regulations, or the economy.* Section 990.190(i) provides that in the event that HUD determines that enactment of a Federal law or revision in HUD or other Federal regulations has caused or will cause a significant change in expenditures of a continuing nature above the PEL and UEL, HUD may, at its sole discretion, decide to prescribe a procedure under which the PHA may apply for or may receive an

adjustment in operating subsidy. One commenter suggested that HUD should use interim rulemaking to establish such procedures. The commenter wrote that this would ensure that the relevant factors have been considered and that adequate procedures are provided.

**HUD Response.** HUD has not revised the rule in response to this comment. The language referred to by the commenter, which was agreed to by the Committee, grants HUD the necessary authority to determine the process under which PHAs may apply for subsidy adjustments. Where appropriate, HUD will issue an interim rule to establish these procedures. However, interim rulemaking may not be the best choice in all circumstances, and HUD does not believe it would be appropriate to limit the available options as suggested by the commenter.

#### *Comments Regarding Subpart D—Formula Income*

**Comment:** HUD should provide for regulatory review in determining changes to the formula income component after FY 2008. Several commenters objected to the preamble language of the April 14, 2005, proposed rule indicating that HUD, after FY 2008, will determine how PHA income is to be treated through non-regulatory means. The commenter suggested that HUD clarify that the determination of changes to PHA income post-FY 2008 be accomplished through regulatory means so that the public can comment.

**HUD Response.** HUD has not revised the rule in response to these comments. However, HUD does agree that residents, organizations representing residents, and other interested parties should have an opportunity to submit comments. To that end, the preamble to the April 14, 2005, proposed rule explicitly stated that the public will have an opportunity to comment before HUD makes the post-2008 policy determination on the income component of the formula (see 70 FR 19858 at 19862, first column).

#### *Comments Regarding Subpart E—Determination and Payment of Operating Subsidy*

**Comment:** Clarify the phrase “two funding levels.” One commenter wrote that it is not clear what is meant by the phrase “two funding levels” in § 990.230(a). The commenter wrote that neither funding level is explained clearly or referenced.

**HUD Response.** The phrase “two funding levels” refers to the funding level under the current formula and the funding level under the new formula established by this final rule, as

explained in § 990.225, which describes how HUD will determine the amount of a PHA’s increase or decrease in subsidy.

**Comment:** The application of the inflation factor each year will result in a higher PEL during the phase-in of subsidy reductions. One commenter wrote that the application of the inflation factor each year will result in an increase in the PEL, thereby changing the dollar amounts of the subsidy reductions that will occur each year during the five-year phase-in of reductions.

**HUD Response.** As provided in § 990.225, HUD will calculate the amount of a PHA’s reduction or gain in operating subsidy only one time after the effective date of the final rule. The calculation will be made in terms of 2004 dollars. The resulting dollar amount of the loss or gain is the amount that all reductions or gains will be built on during the respective phase-in periods. Thus, the inflation factor will not impact the calculation of the PEL each year for purposes of the amount of loss or gain.

**Comment:** Objection to calendar funding when PHAs have different fiscal year ends. One commenter wrote that HUD should consider the impact that calendar year funding will have on PHAs whose fiscal years are not calendar years. The commenter wrote that, when PHAs receive subsidy from two different federal fiscal years, they would experience operating budget and reporting issues that HUD should address.

**HUD Response.** Congress directed HUD to change from funding the operating subsidy on a fiscal year basis to funding it on a calendar year basis in HUD’s 2005 appropriations. HUD has implemented this change without requiring PHAs to change their fiscal year ends and will issue guidance to assist PHAs in this change in the funding cycle. When completing operating budgets and financial reports, PHAs will use procedures similar to those that they currently use for capital fund, ROSS, and Section 8, which HUD does not fund on a PHA fiscal year basis.

#### *Comments Regarding Subpart F—Transition Policy and Transition Funding*

**Comment:** When calculating transition funding, HUD should take into account changes in a PHA’s inventory. One commenter wrote that the rule does not address how transition funding is calculated if a PHA’s property inventory changes during the transition period, which would result in a different subsidy calculation. The

commenter suggested that this section be rewritten to take into account changes in a PHA’s property inventory during the transition period.

**HUD Response.** HUD has not adopted the suggestion made by the commenter. The Committee addressed this matter during the negotiated rulemaking sessions. The Committee decided that, overall, it would be unnecessarily complicated and administratively burdensome to recalculate the five-year transition funding for “decliners” and two-year transition funding for “gainers” on an annual basis. Instead, the rule provides that the transition funding will be calculated in the first year based on FY 2004 data and is unchanged during the transition funding period. That said, the commenter’s suggestion is addressed through the PEL calculation, which provides that as properties leave or enter the PHA’s inventory, these changes will be reflected in the annual PEL calculation.

**Comment:** The reductions in subsidy should be phased in differently. One commenter recommended that the reductions in subsidy be phased in differently, with more of the reductions occurring in the later years. Rather than phasing in reductions over five years at 24 percent the first year, 43 percent the second year, 62 percent the third year, 81 percent the fourth year, and with the full amount of the reduction being realized in the fifth year, the commenter suggested that the reduction would be managed more prudently by PHAs over five years at 18 percent the first year, 37 percent the second year, 56 percent the third year, 76 percent the fourth year, and with the full amount of the reduction being realized in the fifth year.

**HUD Response.** HUD has not adopted this approach to phasing in the reductions to subsidy. The final rule at § 990.230 retains the five-year phase in schedule that was set forth in the April 14, 2005, proposed rule and agreed to by the Committee. The Committee discussed the phase in of reductions at length and agreed on this schedule as reasonable.

#### *Comments Regarding Subpart G—Appeals*

**Comment:** The Operating Fund formula does not provide adequate funding. A number of commenters wrote that the Operating Fund formula did not provide PHAs with sufficient funding to maintain well-run public housing.

**HUD Response.** HUD has not revised the rule in response to these comments. Subpart G of the final rule provides five

types of appeals for PHAs that feel that their formula amount is inadequate.

*Comment: HUD should allow for appeals of individual property PELs.* Two commenters inquired about the permissibility of PHAs appealing on an individual property PEL rather than on a portfolio basis.

*HUD Response.* HUD has not adopted the suggestion of the commenters. As discussed by the Committee during negotiations, § 990.240(b) provides that appeals must cover an entire portfolio, not single projects, with the exception that the Assistant Secretary for Public and Indian Housing may accept appeals for less than an entire portfolio for PHAs with more than 5,000 public housing units.

*Comment: For appeals under § 990.245(e), HUD should accept information other than actual expenses.* One commenter stated that other information beyond actual expenses should be accepted as part of an appeal, because actual expenses are constrained by actual funding and, therefore, the costs of a PHA that has been underfunded will be understated.

*HUD Response.* HUD has not revised the rule in response to this comment. However, HUD will provide subsequent guidance to clarify the type of data that is indicative of actual project costs and that will be accepted as part of an appeal.

*Comment: PEL calculation does not reflect the unique circumstances of certain PHAs.* Several commenters wrote that the PEL calculations for their PHAs are incorrect. Several commenters wrote that the geographic coefficient applied to their PHA does not take into account the unique geographical location of the PHA and the location of its properties. Higher transportation costs, therefore, translate into higher costs for goods and services.

*HUD Response.* During the negotiated rulemaking sessions, the Committee recognized that it was important that accurate data be used in the new formula calculations. As a result, the Committee determined that it would be appropriate to provide PHAs with the opportunity to appeal subsidy amounts under five different categories. Therefore, PHAs that believe that an Operating Fund formula component has a “blatant and objective flaw” and/or that the model’s predictions are not accurate because of “specific local conditions” can appeal their operating subsidy amount.

*Comment: A PHA cannot determine whether there is variance of ten percent or greater without knowing the factors or variables that can vary or be challenged.* One commenter requested

clarification on the sentence in § 990.245(c) that reads: “To be eligible, the affected PHA must demonstrate a variance of ten percent or greater in its PEL.” The commenter wrote that a PHA cannot know if there is a variance of ten percent or more in order to appeal without knowing the factors or variable that can vary or be challenged.

*HUD Response.* This ground of appeal covers the appeals of specific variables in the formula model that are not reliable for a particular PHA. Thus, any of the ten variables in the PEL calculation may be challenged. While HUD will be issuing more guidance on appeals, an example of an appeal under this paragraph would be when a PHA is physically located in a non-city central metropolitan area, but actually has all of the characteristics of a location in a city central metropolitan area.

*Comment: The independent assessors should be familiar with PHAs.* One commenter urged that the professional who will conduct the independent assessments for appeals and determinations of compliance with asset management be familiar with PHAs, their mission, and how HUD requirements affect their structure and operations.

*HUD Response.* The primary purpose of the appeals is to determine if the cost estimate produced by the formula is valid. Because the Harvard Cost Study was based on a benchmark model, so too will the appeals be based on what other non-profit operators of federally subsidized housing would spend to run the subject properties. Similarly, the asset management assessments would be based on basic principles of asset management for owners of subsidized housing.

#### *Comments Regarding Subpart H—Asset Management*

*Comment: HUD should reconsider the requirement that PHAs with 250 units or more implement project-based budgeting and accounting.* A number of commenters submitted comments on the requirement for project-based accounting and project-based accounting. Some of the commenters wrote that the requirement is unnecessary and a financial and administrative burden, particularly on smaller PHAs. Others commenters proposed different thresholds for applicability of the asset management requirements, such as 500 units and 1,249 units. Another commenter wrote that, based on the number of units in its portfolio and their locations, it would be impossible to be an asset manager.

*HUD Response.* HUD has not adopted the suggestion of the commenters. PHAs

with less than 250 units can treat their entire public housing portfolio as one “project.” Implementation of project-based budgeting and accounting, as well as project-based management, were fundamental elements of both the Cost Study and the Committee Recommendations. HUD remains committed to their implementation.

*Comment: HUD should phase in the implementation of asset management.* A number of commenters suggested that, because of the organizational and other changes required of a PHA to move to asset management, there should be a phase-in approach. One commenter suggested that that phase in be based on PHA size.

*HUD Response.* HUD has not adopted the suggestion of the commenter. The implementation dates in the rule were considered and adopted by the Committee. Different phase-in dates would not only treat different classes of PHAs in a disparate manner, but would also create an administrative burden on HUD and its systems.

*Comment: Central office cost centers are unnecessary.* Many commenters wrote that the establishment of a central office cost center is an unneeded level of accounting. Several commenters wrote that PHAs should be allowed to develop alternative methods of allocating central office costs, consistent with OMB Circular A–87. One commenter proposed distributing the actual costs between the projects based on size or utility consumption or any other method. Another commenter wrote that the fee-for-service system may work for some functions like centralized maintenance, but it may not work for others where it is difficult to determine a fee. Thus, PHAs should be allowed in some instances to allocate their costs, which will result in less cumbersome recordkeeping systems.

*HUD Response.* HUD has not revised the rule in response to these comments. The use of a fee-for-service approach for the treatment of overhead and centrally provided services will ensure that such costs are reasonable and that projects are charged only for services received. These procedures are standard in the multifamily housing industry. As necessary, HUD will provide guidance on the use of a fee-for-service approach consistent with the accounting and management practices of the multifamily housing industry.

*Comment: The requirement to apportion assets, liabilities, and equity is unrealistic.* One commenter wrote that because accounting has previously been maintained only at the “program” level and not at the “property” level, PHAs do not now segregate assets,

liabilities, and equity by project. Hence, efforts to break out these amounts by project will be prone to error. HUD should require only the preparation of project operating statements and therefore not require project balance sheets.

**HUD Response.** HUD has not revised the rule in response to the commenter. However, HUD recognizes that the transition to a project-based accounting system will raise questions and pose certain challenges for PHAs. To assist PHAs in making the transition, HUD will issue guidance, as necessary, on the apportionment of assets, liabilities, and equity. HUD believes that balance sheets will provide important information on each project's financial position, increase PHAs' access to debt financing, and improve monitoring of property performance.

**Comment:** *The 2007 deadline for implementation of project-based budgeting and accounting should be delayed.* Commenters were particularly concerned that guidance has not been provided for PHAs to move forward with the changes they will need to make to their systems as well as other organizational arrangements. One commenter suggested that HUD provide PHAs with a minimum of 24 months to implement project-based systems after the requirement takes effect.

**HUD Response.** HUD has not revised the rule in response to these comments. HUD believes that the change to project-based accounting is feasible within the FY 2007 time frame. HUD plans to make the changes to project-based accounting through the current Financial Assessment Subsystem (FASS-PH), where PHAs already have had experience submitting PHA-level financial data to HUD. As noted above, HUD intends to issue guidance that will assist PHAs in making the transition to project-based budgeting within the targeted time frames.

**Comment:** *PHAs require financial assistance to implement the new accounting, budgeting, and management changes.* Many commenters wrote that HUD should provide PHAs with special transition funds to address the costly changes in technology and other areas required by the rule.

**HUD Response.** The Committee discussed, but did not adopt in the Committee Recommendations, special transition funds. The final rule contains two operating subsidy add-ons that can be used by PHAs toward converting to and maintaining technology to facilitate asset management. The first is the asset management fee described in § 990.190(f) that provides an additional

\$4 PUM to PHAs with 250 or more units and a \$2 PUM to PHAs with less than 250 units that choose to convert (PHAs can charge an even higher asset management fee, provided that the fee is "reasonable" and if the project generates excess cash flow). The second is the information technology fee described in § 990.190(g) that provides an additional \$2 PUM to all PHAs.

**Comment:** *HUD should consult PHAs when establishing guidance.* HUD should establish guidance on converting to asset management in an open manner and consult with PHAs in doing so.

**HUD Response.** As indicated in previous responses to the commenters, HUD will be issuing a variety of guidance and, where appropriate, intends to consult with its constituents in the development of the guidance.

**Comment:** *HUD should provide training on these new asset management requirements.* One commenter asked about the type and quality of training that HUD plans to provide for PHAs, auditors, and field staff to transition to asset management.

**HUD Response.** HUD intends to conduct training shortly following publication of this final rule. This training, in addition to the guidance that will be issued, should assist PHAs, auditors, and field staff in this transition.

**Comment:** *Although other regulatory changes (outside of the Operating Fund Program) are required to complete the conversion to asset management, HUD should take care not to abandon the segment of the population public housing serves.* One commenter wrote that, if asset management is to take advantage of cost savings in the private market, then certain regulations unique to public housing should be removed that restrict PHA movement in that direction. However, these changes should not cause PHAs to abandon the segment of the population that public housing is intended to serve.

**HUD Response.** The Cost Study showed that, while generally similar, there were certain statutory and regulatory requirements that, if modified, would align public housing more closely to the regulatory environment of other multifamily-assisted housing programs. As stated in the preamble to the April 14, 2005, proposed rule, the Committee recognized that, with the conversion to asset management, other changes were necessary. These changes, including deregulation efforts to continue to lessen burdens on PHAs, will be implemented separately and HUD will provide opportunity for input by stakeholders, as appropriate.

**Comment:** *In some cases, centralized services are more efficient.* Several commenters wrote that asset management was not a cost-effective way to run public housing, especially for PHAs that have small to moderate-sized projects for whom centralized or quasi project-based management is superior. Forcing PHAs to decentralize will increase costs, duplicate efforts, and decrease ability to respond to resident needs.

**HUD Response.** Section 990.275 expressly provides that PHAs can continue to maintain centralized property management services. However, consistent with practices in multifamily housing, this section further provides that services must be arranged in accordance with the best interests of the property and that the cost for any centralized service must be reasonable.

**Comment:** *PHAs already run more efficiently than FHA properties and, therefore, asset management is unnecessary.* Several commenters wrote that there was no compelling reason for PHAs to convert to asset management since there is no evidence that conversion will improve efficiency and effectiveness. The Cost Study recommended an increase in subsidy to PHAs based on a comparison between AELs and the FHA benchmark, thereby showing that PHAs administer their properties more efficiently than FHA.

**HUD Response.** The fact that the Cost Study recommended increased funding levels, based on costs in other federally subsidized housing, does not necessarily mean that PHAs operate efficiently. Indeed, the Cost Study's recommendations to move to asset management were related to concerns that program effectiveness could be greatly improved.

**Comment:** *Other institutions similar to PHAs do not perform asset management.* One commenter wrote that, although project-based management is the norm for the multifamily housing industry, it is not the norm for other institutions that are similar to PHAs. Universities, municipal governments, school systems, and hospitals manage multiple properties and do so more similarly to PHAs than the multifamily housing industry.

**HUD Response.** HUD believes that the appropriate peer group in this situation is, indeed, the multifamily housing industry and not entities such as universities, schools, or hospitals. In the multifamily housing industry, project-based budgeting, accounting, and management is the norm.

**Comment:** *HUD should require PHAs to distribute reports to resident organizations and other entities with*

*oversight and monitoring responsibilities.* Several commenters suggested that HUD add language to § 990.285(b) and § 990.315(a) requiring that PHAs provide project-based budgets, year-end statements, and operating budgets to resident organizations and other entities.

**HUD Response.** HUD has not adopted the suggestion of the commenters. While HUD does encourage PHAs to discuss these documents with resident organizations and other entities, HUD believes that this decision should be left to individual PHAs and their PHA Board of Commissioners.

**Comment:** HUD should include responsibilities to resident organizations in the responsibilities of asset management. One commenter suggested that § 990.270 be amended to include language regarding a PHA's responsibility to resident organizations.

The commenter suggested that "responding to and supporting independent resident organizations, consulting with residents and the Resident Advisory Board (RAB) in the development of and any amendments to the PHA's annual and five year plans" be added to the sentence at the end of the section.

**HUD Response.** HUD has not adopted this suggestion. The requirement regarding PHA annual and five-year plans are codified in 24 CFR part 903, including all of the requirements for resident participation and meetings.

## VII. Findings and Certifications

### Information Collection Requirements

The revised information collection requirements contained in this final rule have been submitted to the Office of Management and Budget (OMB) for

review under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number. The information collection requirements for the Operating Fund program have been approved by OMB and assigned OMB Control Number 2577–0029. The revised public reporting burden for this collection of information is estimated to include the time for reviewing the instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Information on the revised estimated public reporting burden is provided in the following table:

HUD form number	Number of respondents	Responses per respondents	Total annual responses	Hours per response	Total hours
HUD–52722 .....	3,141	1	1	.75	2,355.75
HUD–52723 .....	3,141	1	1	.75	2,355.75
HUD–53087 .....	24	1	1	.75	18.00
<b>Total</b> .....					<b>4,729.50</b>

### Environmental Impact

A Finding of No Significant Impact with respect to the environment for this rule was made at the proposed rule stage in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4321 *et seq.*). The Finding of No Significant Impact remains applicable to this final rule and is available for public inspection between 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of the General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410–5000.

### Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*), generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. The entities that would be subject to this rule are public housing agencies that administer public housing. Under the definition of "small governmental jurisdiction" in section 601(5) of the RFA, the

provisions of the RFA are applicable only to those public housing agencies that are part of a political jurisdiction with a population of under 50,000 persons. The number of entities potentially affected by this rule is therefore not substantial. Further, the proposed regulatory changes were developed using negotiated rulemaking procedures and with the active participation of PHAs that will be affected by the revised Operating Fund requirements. The membership of the negotiated rulemaking committee included representatives of smaller PHAs, which expressed the views and concerns of these PHAs during development of the proposed regulatory changes.

Accordingly, the undersigned certifies that this rule will not have a significant economic impact on a substantial number of small entities.

### Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on state and local governments and is not required by statute, or the rule preempts state law, unless the agency meets the consultation and funding requirements

of section 6 of the executive order. This rule does not have federalism implications and will not impose substantial direct compliance costs on State and local governments nor preempt State law within the meaning of the executive order.

### Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments, and on the private sector. This rule does not impose any Federal mandates on any State, local, or tribal government, nor on the private sector, within the meaning of UMRA.

### Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866 ("entitled Regulatory Planning and Review"). This rule was determined to be economically significant under E.O. 12866. The docket file is available for public inspection in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410–0500. Due to

security measures at the HUD Headquarters building, please schedule an appointment to review the docket file by calling the Regulations Division at (202) 708-3055 (this is not a toll-free number). The Economic Analysis prepared for this rule is also available for public inspection at the same location and on HUD's Web site at <http://www.hud.gov>.

#### *Congressional Review of Major Proposed Rules*

This rule is a "major rule" as defined in Chapter 8 of 5 U.S.C. The final rule has been submitted for congressional review in accordance with this chapter.

#### *Catalog of Federal Domestic Assistance*

The Catalog of Federal Domestic Assistance (CFDA) program number is 14.850.

#### **List of Subjects in 24 CFR Part 990**

Accounting, Grant programs-housing and community development, Public housing, Reporting and recordkeeping requirements.

■ Accordingly, for the reasons described in the preamble, HUD revises 24 CFR part 990 to read as follows:

### **PART 990—THE PUBLIC HOUSING OPERATING FUND PROGRAM**

#### **Subpart A—Purpose, Applicability, Formula, and Definitions**

Sec.

- 990.100 Purpose.
- 990.105 Applicability.
- 990.110 Operating fund formula.
- 990.115 Definitions.
- 990.116 Environmental review requirements.

#### **Subpart B—Eligibility for Operating Subsidy; Computation of Eligible Unit Months**

- 990.120 Unit months.
- 990.125 Eligible units.
- 990.130 Ineligible units.
- 990.135 Eligible unit months (EUMs).
- 990.140 Occupied dwelling units.
- 990.145 Dwelling units with approved vacancies.
- 990.150 Limited vacancies.
- 990.155 Addition and deletion of units.

#### **Subpart C—Calculating Formula Expenses**

- 990.160 Overview of calculating formula expenses.
- 990.165 Computation of project expense level (PEL).
- 990.170 Computation of utilities expense level (UEL): Overview.
- 990.175 Utilities expense level: Computation of the current consumption level.
- 990.180 Utilities expense level: Computation of the rolling base consumption level.
- 990.185 Utilities expense level: Incentives for energy conservation/rate reduction.

990.190 Other formula expenses (add-ons).

#### **Subpart D—Calculating Formula Income**

990.195 Calculation of formula income.

#### **Subpart E—Determination and Payment of Operating Subsidy**

- 990.200 Determination of formula amount.
- 990.205 Fungibility of operating subsidy between projects.
- 990.210 Payment of operating subsidy.
- 990.215 Payments of operating subsidy conditioned upon reexamination of income of families in occupancy.

#### **Subpart F—Transition Policy and Transition Funding**

- 990.220 Purpose.
- 990.225 Transition determination.
- 990.230 PHAs that will experience a subsidy reduction.
- 990.235 PHAs that will experience a subsidy increase.

#### **Subpart G—Appeals**

- 990.240 General.
- 990.245 Types of appeals.
- 990.250 Requirements for certain appeals.

#### **Subpart H—Asset Management**

- 990.255 Overview.
- 990.260 Applicability.
- 990.265 Identification of projects.
- 990.270 Asset management.
- 990.275 Project-based management (PBM).
- 990.280 Project-based budgeting and accounting.
- 990.285 Records and reports.
- 990.290 Compliance with asset management requirements.

#### **Subpart I—Operating Subsidy for Properties Managed by Resident Management Corporations (RMCs)**

- 990.295 Resident Management Corporation operating subsidy.
- 990.300 Preparation of operating budget.
- 990.305 Retention of excess revenues.

#### **Subpart J—Financial Management Systems, Monitoring, and Reporting**

- 990.310 Purpose—General policy on financial management, monitoring, and reporting.
- 990.315 Submission and approval of operating budgets.
- 990.320 Audits.
- 990.325 Record retention requirements.

**Authority:** 42 U.S.C. 1437g; 42 U.S.C. 3535(d).

#### **Subpart A—Purpose, Applicability, Formula, and Definitions**

##### **§ 990.100 Purpose.**

This part implements section 9(f) of the United States Housing Act of 1937 (1937 Act), (42 U.S.C. 1437g). Section 9(f) establishes an Operating Fund for the purposes of making assistance available to public housing agencies (PHAs) for the operation and management of public housing. In the case of unsubsidized housing, the total expenses of operating rental housing

should be covered by the operating income, which primarily consists of rental income and, to some degree, investment and non-rental income. In the case of public housing, the Operating Fund provides operating subsidy to assist PHAs to serve low, very low, and extremely low-income families. This part describes the policies and procedures for Operating Fund formula calculations and management under the Operating Fund Program.

##### **§ 990.105 Applicability.**

(a) *Applicability of this part.* (1) With the exception of subpart I of this part, this part is applicable to all PHA rental units under an Annual Contributions Contract (ACC). This includes PHAs that have not received operating subsidy previously, but are eligible for operating subsidy under the Operating Fund Formula.

(2) This part is applicable to all rental units managed by a resident management corporation (RMC), including a direct-funded RMC.

(b) *Inapplicability of this part.* (1) This part is not applicable to Indian Housing, section 5(h) and section 32 homeownership projects, the Housing Choice Voucher Program, the section 23 Leased Housing Program, or the section 8 Housing Assistance Payments Programs.

(2) With the exception of subpart J of this part, this part is not applicable to the Mutual Help Program or the Turnkey III Homeownership Opportunity Program.

##### **§ 990.110 Operating fund formula.**

(a) *General formula.* (1) The amount of annual contributions (operating subsidy) each PHA is eligible to receive under this part shall be determined by a formula.

(2) In general, operating subsidy shall be the difference between formula expense and formula income. If a PHA's formula expense is greater than its formula income, then the PHA is eligible for an operating subsidy.

(3) Formula expense is an estimate of a PHA's operating expense and is determined by the following three components: Project Expense Level (PEL), Utility Expense Level (UEL), and other formula expenses (add-ons). Formula expense and its three components are further described in subpart C of this part. Formula income is an estimate for a PHA's non-operating subsidy revenue and is further described in subpart D of this part.

(4) Certain portions of the operating fund formula (e.g., PEL) are calculated in terms of per unit per month (PUM) amounts and are converted into whole

dollars by multiplying the PUM amount by the number of eligible unit months (EUMs). EUMs are further described in subpart B of this part.

(b) *Specific formula.* (1) A PHA's formula amount shall be the sum of the three formula expense components calculated as follows: {(PEL multiplied by EUM) plus (UEL multiplied by EUM) plus add-ons} minus (formula income multiplied by EUM)}.

(2) A PHA whose formula amount is equal to or less than zero is still eligible to receive operating subsidy equal to its most recent actual audit cost for its Operating Fund Program.

(3) Operating subsidy payments will be limited to the availability of funds as described in § 990.210(c).

(c) *Non-codified formula elements.* This part defines the major components of the Operating Fund Formula and describes the relationships of these various components. However, this part does not codify certain secondary elements that will be used in the revised Operating Fund Formula. HUD will more appropriately provide this information in non-codified guidance, such as a Handbook, **Federal Register** notice, or other non-regulatory means that HUD determines appropriate.

#### § 990.115 Definitions.

The following definitions apply to the Operating Fund program:

*1937 Act* means the United States Housing Act of 1937 (42 U.S.C. 1437 *et seq.*).

*Annual contributions contract (ACC)* is a contract prescribed by HUD for loans and contributions, which may be in the form of operating subsidy, whereby HUD agrees to provide financial assistance and the PHA agrees to comply with HUD requirements for the development and operation of its public housing projects.

*Asset management* is a management model that emphasizes project-based management, as well as long-term and strategic planning.

*Current consumption level* is the amount of each utility consumed at a project during the 12-month period that ended the June 30th prior to the beginning of the applicable funding period.

*Eligible unit months (EUM)* are the actual number of PHA units in eligible categories expressed in months for a specified time frame and for which a PHA receives operating subsidy.

*Formula amount* is the amount of operating subsidy a PHA is eligible to receive, expressed in whole dollars, as determined by the Operating Fund Formula.

*Formula expense* is an estimate of a PHA's operating expense used in the Operating Fund Formula.

*Formula income* is an estimate of a PHA's non-operating subsidy revenue used in the Operating Fund Formula.

*Funding period* is the calendar year for which HUD will distribute operating subsidy according to the Operating Fund Formula.

*Operating Fund* is the account/program authorized by section 9 of the 1937 Act for making operating subsidy available to PHAs for the operation and management of public housing.

*Operating Fund Formula (or Formula)* means the data and calculations used under this part to determine a PHA's amount of operating subsidy for a given period.

*Operating subsidy* is the amount of annual contributions for operations a PHA receives each funding period under section 9 of the 1937 Act as determined by the Operating Fund Formula in this part.

*Other operating costs (add-ons)* means PHA expenses that are recognized as formula expenses but are not included either in the project expense level or in the utility expense level.

*Payable consumption level* is the amount for all utilities consumed at a project that the Formula recognizes in the computation of a PHA's utility expense level at that project.

Per unit per month (PUM) describes a dollar amount on a monthly basis per unit, such as Project Expense Level, Utility Expense Level, and formula income.

*Project* means each PHA project under an ACC to which the Operating Fund Formula is applicable. However, for purposes of asset management, as described in subpart H of this part, projects may be as identified under the ACC or may be a reasonable grouping of projects or portions of a project or projects under the ACC.

*Project-based management* is the provision of property management services that is tailored to the unique needs of each property, given the resources available to that property.

*Project expense level (PEL)* is the amount of estimated expenses for each project (excluding utilities and add-ons) expressed as a PUM cost.

*Project units* means all dwelling units in all of a PHA's projects under an ACC.

*Rolling base consumption level (RBCL)* is the average of the yearly consumption levels for the 36-month period ending on the June 30th that is 18 months prior to the beginning of the applicable funding period.

*Transition funding* is the timing and amount by which a PHA will realize increases and reductions in operating subsidy based on the new funding levels of the Operating Fund Formula.

*Unit months* are the total number of project units in a PHA's inventory expressed in months for a specified time frame.

*Utilities* means electricity, gas, heating fuel, water, and sewerage service.

*Utilities expense level (UEL)* is a product of the utility rate multiplied by the payable consumption level multiplied by the utilities inflation factor expressed as a PUM dollar amount.

*Utility rate (rate)* means the actual average rate for any given utility for the most recent 12-month period that ended the June 30th prior to the beginning of the applicable funding period.

*Yearly consumption level* is the actual amount of each utility consumed at a project during a 12-month period ending June 30th.

#### § 990.116 Environmental review requirements.

The environmental review procedures of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)) and the implementing regulations at 24 CFR parts 50 and 58 are applicable to the Operating Fund Program.

#### Subpart B—Eligibility for Operating Subsidy; Computation of Eligible Unit Months

##### § 990.120 Unit months.

(a) Some of the components of HUD's Operating Fund Formula are based on a measure known as unit months. Unit months represent a PHA's public housing inventory during a specified period of time. The unit months eligible for operating subsidy in a 12-month period are equal to the number of months that the units are in an operating subsidy-eligible category, adjusted for changes in inventory (*e.g.*, units added or removed), as described below.

(b) A PHA is eligible to receive operating subsidy for a unit on the date it is both placed under the ACC and occupied. The date a unit is eligible for operating subsidy does not change the Date of Full Availability (DOFA) or the date of the End of Initial Operating Period (EIOP), nor does this provision place a project into management status.

##### § 990.125 Eligible units.

A PHA is eligible to receive operating subsidy for public housing units under an ACC for:



(a) Occupied dwelling units as defined in § 990.140;

(b) A dwelling unit with an approved vacancy (as defined in § 990.145); and

(c) A limited number of vacancies (as defined in § 990.150).

#### **§ 990.130 Ineligible units.**

(a) Vacant units that do not fall within the definition of § 990.145 or § 990.150 are not eligible for operating subsidy under this part.

(b) Units that are eligible to receive an asset-repositioning fee, as described in § 990.190(h), are not eligible to receive operating subsidy under this subpart.

#### **§ 990.135 Eligible unit months (EUMs).**

(a) A PHA's total number of EUMs will be calculated for the 12-month period from July 1st to June 30th that is prior to the first day of the applicable funding period, and will consist of eligible units as defined in § 990.140, § 990.145, or § 990.150.

(b)(1) The determination of whether a public housing unit satisfies the requirements of § 990.140, § 990.145, or § 990.150 for any unit month shall be based on the unit's status as of either the first or last day of the month, as determined by the PHA.

(2) HUD reserves the right to determine the status of any and all public housing units based on information in its information systems.

(c) The PHA shall maintain and, at HUD's request, shall make available to HUD, specific documentation of the status of all units, including, but not limited to, a listing of the units, street addresses or physical address, and project/management control numbers.

(d) Any unit months that do not meet the requirements of this subpart are not eligible for operating subsidy, and will not be subsidized by the Operating Fund.

#### **§ 990.140 Occupied dwelling units.**

A PHA is eligible to receive operating subsidy for public housing units for each unit month that those units are under an ACC and occupied by a public housing-eligible family under lease.

#### **§ 990.145 Dwelling units with approved vacancies.**

(a) A PHA is eligible to receive operating subsidy for vacant public housing units for each unit month the units are under an ACC and meet one of the following HUD-approved vacancies:

(1) *Units undergoing modernization.* Vacancies resulting from project modernization or unit modernization (such as work necessary to reoccupy vacant units) provided that one of the following conditions is met:

(i) The unit is undergoing modernization (*i.e.*, the modernization contract has been awarded or force account work has started) and must be vacant to perform the work, and the construction is on schedule according to a HUD-approved PHA Annual Plan; or

(ii) The unit must be vacant to perform the work and the treatment of the vacant unit is included in a HUD-approved PHA Annual Plan, but the time period for placing the vacant unit under construction has not yet expired. The PHA shall place the vacant unit under construction within two federal fiscal years (FFYs) after the FFY in which the capital funds are approved.

(2) *Special use units.* Units approved and used for resident services, resident organization offices, and related activities, such as self-sufficiency and anti-crime initiatives.

(b) On a project-by-project basis, subject to prior HUD approval and for the time period agreed to by HUD, a PHA shall receive operating subsidy for the units affected by the following events that are outside the control of the PHA:

(1) *Litigation.* Units that are vacant due to litigation, such as a court order or settlement agreement that is legally enforceable; units that are vacant in order to meet regulatory and statutory requirements to avoid potential litigation (as covered in a HUD-approved PHA Annual Plan); and units under voluntary compliance agreements with HUD or other voluntary compliance agreements acceptable to HUD (*e.g.*, units that are being held vacant as part of a court-order, HUD-approved desegregation plan, or voluntary compliance agreement requiring modifications to the units to make them accessible pursuant to 24 CFR part 8).

(2) *Disasters.* Units that are vacant due to a federally declared, state-declared, or other declared disaster.

(3) *Casualty losses.* Damaged units that remain vacant due to delays in settling insurance claims.

(c) A PHA may appeal to HUD to receive operating subsidy for units that are vacant due to changing market conditions (see subpart G of this part—Appeals).

#### **§ 990.150 Limited vacancies.**

(a) *Operating subsidy for a limited number of vacancies.* HUD shall pay operating subsidy for a limited number of vacant units under an ACC if the annualized vacancy rate is less than or equal to:

(1) Three percent of the PHA's total unit inventory (not to exceed 100 percent of the unit months under an

ACC) for the period July 1, 2004, to June 30, 2005, and

(2) Three percent of the total units on a project-by-project basis based on the definition of a project under subpart H of this part, beginning July 1, 2005.

(b) *Exception for PHAs with 100 or fewer units.* Notwithstanding paragraph (a) of this section, a PHA with 100 or fewer units will be paid operating subsidy for up to five vacant units not to exceed 100 percent of the unit months under an ACC. For example, a PHA with an inventory of 100 units and four vacancies during its fiscal year will be eligible for operating subsidy for all 100 units. A PHA with an inventory of 50 units with seven vacancies during its fiscal year will be eligible for operating subsidy for 48 units.

#### **§ 990.155 Addition and deletion of units.**

(a) *Changes in public housing unit inventory.* To generate a change to its formula amount within each one-year funding period, PHAs shall periodically (*e.g.*, quarterly) report the following information to HUD, during the funding period:

(1) New units that were added to the ACC, and occupied by a public housing-eligible family during the prior reporting period for the one-year funding period, but have not been included in the previous EUMs' data; and

(2) Projects, or entire buildings in a project, that are eligible to receive an asset repositioning fee in accordance with the provisions in § 990.190(h).

(b) *Revised EUM calculation.* (1) For new units, the revised calculation shall assume that all such units will be fully occupied for the balance of that funding period. The actual occupancy/vacancy status of these units will be included to calculate the PHA's operating subsidy in the subsequent funding period after these units have one full year of a reporting cycle.

(2) Projects, or entire buildings in a project, that are eligible to receive an asset repositioning fee in accordance with § 990.190(h) are not to be included in the calculation of EUMs. Funding for these units is provided under the conditions described in § 990.190(h).

### **Subpart C—Calculating Formula Expenses**

#### **§ 990.160 Overview of calculating formula expenses.**

(a) *General.* Formula expenses represent the costs of services and materials needed by a well-run PHA to sustain the project. These costs include items such as administration, maintenance, and utilities. HUD also

determines a PHA's formula expenses at a project level. HUD uses the following three factors to determine the overall formula expense level for each project:

(1) The project expense level (PEL) (calculated in accordance with § 990.165);

(2) The utilities expense level (UEL) (calculated in accordance with §§ 990.170, 990.175, 990.180, and 990.185); and

(3) Other formula expenses (add-ons) (calculated in accordance with § 990.190).

(b) *PEL, UEL, and Add-ons.* Each project of a PHA has a unique PEL and UEL. The PEL for each project is based on ten characteristics and certain adjustments described in § 990.165. The PEL represents the normal expenses of operating public housing projects, such as maintenance and administration costs. The UEL for each project represents utility expenses. Utility expense levels are based on an incentive system aimed at reducing utility expenses. Both the PEL and UEL are expressed in PUM costs. The expenses not included in these expense levels and which are unique to PHAs are titled "other formula expenses (add-ons)" and are expressed in a dollar amount.

(c) *Calculating project formula expense.* The formula expense of any one project is the sum of the project's PEL and the UEL, multiplied by the total EUMs specific to the project, plus the add-ons.

#### **§ 990.165 Computation of project expense level (PEL).**

(a) *Computation of PEL.* The PEL is calculated in terms of PUM cost and represents the costs associated with the project, except for utility and add-on costs. Costs associated with the PEL are administration, management fees, maintenance, protective services, leasing, occupancy, staffing, and other expenses, such as project insurance. HUD will calculate the PEL using regression analysis and benchmarking for the actual costs of Federal Housing Administration (FHA) projects to estimate costs for public housing projects. HUD will use the ten variables described in paragraph (b) of this section and their associated coefficient (*i.e.*, values that are expressed in percentage terms) to produce a PEL.

(b) *Variables.* The ten variables are:

- (1) Size of project (number of units);
- (2) Age of property (Date of Full Availability (DOFA));
- (3) Bedroom mix;
- (4) Building type;
- (5) Occupancy type (family or senior);
- (6) Location (an indicator of the type of community in which a property is

located; location types include rural, city central metropolitan, and non-city central metropolitan (suburban) areas);

(7) Neighborhood poverty rate;

(8) Percent of households assisted;

(9) Ownership type (profit, non-profit, or limited dividend); and

(10) Geographic.

(c) *Cost adjustments.* HUD will apply four adjustments to the PEL. The adjustments are:

(1) Application of a \$200 PUM floor for any senior property and a \$215 PUM floor for any family property;

(2) Application of a \$420 PUM ceiling for any property except for New York City Housing Authority projects, which have a \$480 PUM ceiling;

(3) Application of a four percent reduction for any PEL calculated over \$325 PUM, with the reduction limited so that a PEL will not be reduced to less than \$325; and

(4) The reduction of audit costs as reported for FFY 2003 in a PUM amount.

(d) *Annual inflation factor.* The PEL for each project shall be adjusted annually, beginning in 2005, by the local inflation factor. The local inflation factor shall be the HUD-determined weighted average percentage increase in local government wages and salaries for the area in which the PHA is located, and non-wage expenses.

(e) *Calculating a PEL.* To calculate a specific PEL for a given property, the sum of the coefficients for nine variables (all variables except ownership type) shall be added to a formula constant. The exponent of that sum shall be multiplied by a percentage to reflect the non-profit ownership type, which will produce an unadjusted PEL. For the calculation of the initial PEL, the cost adjustments described in paragraphs (c)(1), (c)(2), and (c)(3) of this section will be applied. After these initial adjustments are applied, the audit adjustment described in paragraph (c)(4) of this section will be applied to arrive at the PEL in year 2000 dollars. After the PEL in year 2000 dollars is created, the annual inflation factor as described in paragraph (d) of this section will be applied cumulatively to this number through 2004 to yield an initial PEL in terms of current dollars.

(f) *Calculation of the PEL for Moving to Work PHAs.* PHAs participating in the Moving to Work (MTW) Demonstration authorized under section 204 of the Omnibus Consolidated Rescissions and Appropriations Act of 1996 (Pub. L. 104-134, approved April 26, 1996) shall receive an operating subsidy as provided in Attachment A of their MTW Agreements executed prior to November 18, 2005. PHAs with an

MTW Agreement will continue to have the right to request extensions of or modifications to their MTW Agreements.

(g) *Calculation of the PELs for mixed-finance developments.* If, prior to November 18, 2005, a PHA has either a mixed-finance arrangement that has closed or has filed documents in accordance with 24 CFR 941.606 for a mixed-finance transaction, then the project covered by the mixed-finance transaction will receive funding based on the higher of its former Allowable Expense Level or the new computed PEL.

(h) *Calculation of PELs when data are inadequate or unavailable.* When sufficient data are unavailable for the calculation of a PEL, HUD may calculate a PEL using an alternative methodology. The characteristics may be used from similarly situated properties.

(i) *Review of PEL methodology by advisory committee.* In 2009, HUD will convene a meeting with representation of appropriate stakeholders, to review the methodology to evaluate the PEL based on actual cost data. The meeting shall be convened in accordance with the Federal Advisory Committee Act (5 U.S.C. Appendix) (FACA). HUD may determine appropriate funding levels for each project to be effective in FY 2011 after following appropriate rulemaking procedures.

#### **§ 990.170 Computation of utilities expense level (UEL): Overview.**

(a) *General.* The UEL for each PHA is based on its consumption for each utility, the applicable rates for each utility, and an applicable inflation factor. The UEL for a given funding period is the product of the utility rate multiplied by the payable consumption level multiplied by the inflation factor. The UEL is expressed in terms of PUM costs.

(b) *Utility rate.* The utility rate for each type of utility will be the actual average rate from the most recent 12-month period that ended June 30th prior to the beginning of the applicable funding period. The rate will be calculated by dividing the actual utility cost by the actual utility consumption, with consideration for pass-through costs (*e.g.*, state and local utility taxes, tariffs) for the time period specified in this paragraph.

(c) *Payable consumption level.* The payable consumption level is based on the current consumption level adjusted by a utility consumption incentive. The incentive shall be computed by comparing current consumption levels of each utility to the rolling base consumption level. If the comparison

reflects a decrease in the consumption of a utility, the PHA shall retain 75 percent of this decrease. Alternately, if the comparison reflects an increase in the consumption of a utility, the PHA shall absorb 75 percent of this increase.

(d) *Inflation factor for utilities.* The UEL shall be adjusted annually by an inflation/deflation factor based upon the fuels and utilities component of the United States Department of Labor, Bureau of Labor Statistics (BLS) Consumer Price Index for All Urban Consumers (CPI-U). The annual adjustment to the UEL shall reflect the most recently published and localized data available from BLS at the time the annual adjustment is calculated.

(e) *Increases in tenant utility allowances.* Increases in tenant utility allowances, as a component of the formula income, as described in § 990.195, shall result in a commensurate increase of operating subsidy. Decreases in such utility allowances shall result in a commensurate decrease in operating subsidy.

(f) *Records and reporting.* (1) Appropriate utility records, satisfactory to HUD, shall be developed and maintained, so that consumption and rate data can be determined.

(2) All records shall be kept by utility and by project for each 12-month period ending June 30th.

(3) HUD will notify each PHA when HUD has the automated systems capacity to receive such information. Each PHA then will be obligated to provide consumption and cost data to HUD for all utilities for each project.

(4) If a PHA has not maintained or cannot recapture utility data from its records for a particular utility, the PHA shall compute the UEL by:

(i) Using actual consumption data for the last complete year(s) of available data or data of comparable project(s) that have comparable utility delivery systems and occupancy, in accordance with a method prescribed by HUD; or

(ii) Requesting field office approval to use actual PUM utility expenses for its UEL in accordance with a method prescribed by HUD when the PHA cannot obtain necessary data to calculate the UEL in accordance with paragraph (f)(4)(i) of this section.

**§ 990.175 Utilities expense level: Computation of the current consumption level.**

The current consumption level shall be the actual amount of each utility consumed during the 12-month period ending June 30th that is 6 months prior to the first day of the applicable funding period.

**§ 990.180 Utilities expense level: Computation of the rolling base consumption level.**

(a) *General.* (1) The rolling base consumption level (RBCL) shall be equal to the average of yearly consumption levels for the 36-month period ending on the June 30th that is 18 months prior to the first day of the applicable funding period.

(2) The yearly consumption level is the actual amount of each utility consumed during a 12-month period ending June 30th. For example, for the funding period January 1, 2006, through December 31, 2006, the RBCL will be the average of the following yearly consumption levels:

(i) Year 1 = July 1, 2001, through June 30, 2002.

(ii) Year 2 = July 1, 2002, through June 30, 2003.

(iii) Year 3 = July 1, 2003, through June 30, 2004.

**Note to paragraph (a)(2):** In this example, the current year's consumption level will be July 1, 2004, through June 30, 2005.

(b) *Distortions to rolling base consumption level.* The PHA shall have its RBCL determined so as not to distort the rolling base period in accordance with a method prescribed by HUD if:

(1) A project has not been in operation during at least 12 months of the rolling base period;

(2) A project enters or exits management after the rolling base period and prior to the end of the applicable funding period; or

(3) A project has experienced a conversion from one energy source to another, switched from PHA-supplied to resident-purchased utilities during or after the rolling base period, or for any other reason that would cause the RBCL not to be comparable to the current year's consumption level.

(c) *Financial incentives.* The three-year rolling base for all relevant utilities will be adjusted to reflect any financial incentives to the PHA to reduce consumption as described in § 990.185.

**§ 990.185 Utilities expense level: Incentives for energy conservation/rate reduction.**

(a) *General/consumption reduction.* If a PHA undertakes energy conservation measures that are financed by an entity other than HUD, the PHA may qualify for the incentives available under this section. For a PHA to qualify for these incentives, the PHA must obtain HUD approval. Approval shall be based on a determination that payments under the contract can be funded from the reasonably anticipated energy cost savings. The contract period shall not

exceed 12 years. The energy conservation measures may include, but are not limited to: Physical improvements financed by a loan from a bank, utility, or governmental entity; management of costs under a performance contract; or a shared savings agreement with a private energy service company.

(1) *Frozen rolling base.* (i) If a PHA undertakes energy conservation measures that are approved by HUD, the RBCL for the project and the utilities involved may be frozen during the contract period. Before the RBCL is frozen, it must be adjusted to reflect any energy savings resulting from the use of any HUD funding. The RBCL also may be adjusted to reflect systems repaired to meet applicable building and safety codes as well as to reflect adjustments for occupancy rates increased by rehabilitation. The RBCL shall be frozen at the level calculated for the year during which the conservation measures initially shall be implemented.

(ii) The PHA operating subsidy eligibility shall reflect the retention of 100 percent of the savings from decreased consumption until the term of the financing agreement is complete. The PHA must use at least 75 percent of the cost savings to pay off the debt, e.g., pay off the contractor or bank loan. If less than 75 percent of the cost savings is used for debt payment, however, HUD shall retain the difference between the actual percentage of cost savings used to pay off the debt and 75 percent of the cost savings. If at least 75 percent of the cost savings is paid to the contractor or bank, the PHA may use the full amount of the remaining cost savings for any eligible operating expense.

(iii) The annual three-year rolling base procedures for computing the RBCL shall be reactivated after the PHA satisfies the conditions of the contract. The three years of consumption data to be used in calculating the RBCL after the end of the contract period shall be the yearly consumption levels for the final three years of the contract.

(2) PHAs undertaking energy conservation measures that are financed by an entity other than HUD may include resident-paid utilities under the consumption reduction incentive, using the following methodology:

(i) The PHA reviews and updates all utility allowances to ascertain that residents are receiving the proper allowances before energy savings measures are begun;

(ii) The PHA makes future calculations of rental income for purposes of the calculation of operating subsidy eligibility based on these

baseline allowances. In effect, HUD will freeze the baseline allowances for the duration of the contract;

(iii) After implementation of the energy conservation measures, the PHA updates the utility allowances in accordance with provisions in 24 CFR part 965, subpart E. The new allowance should be lower than baseline allowances;

(iv) The PHA uses at least 75 percent of the savings for paying the cost of the improvement (the PHA will be permitted to retain 100 percent of the difference between the baseline allowances and revised allowances);

(v) After the completion of the contract period, the PHA begins using the revised allowances in calculating its operating subsidy eligibility; and

(vi) The PHA may exclude from its calculation of rental income the increased rental income due to the difference between the baseline allowances and the revised allowances of the projects involved, for the duration of the contract period.

(3) *Subsidy add-on.* (i) If a PHA qualifies for this incentive (i.e., the subsidy add-on, in accordance with the provisions of paragraph (a) of this section), then the PHA is eligible for additional operating subsidy each year of the contract to amortize the cost of the loan for the energy conservation measures and other direct costs related to the energy project under the contract during the term of the contract subject to the provisions of this paragraph (a)(3) of this section. The PHA's operating subsidy for the current funding year will continue to be calculated in accordance with paragraphs (a), (b), and (c) of § 990.170 (i.e., the rolling base is not frozen). The PHA will be able to retain part of the cost savings in accordance with § 990.170(c).

(ii) The actual cost of energy (of the type affected by the energy conservation measure) after implementation of the energy conservation measure will be subtracted from the expected energy cost, to produce the energy cost savings for the year.

(iii) If the cost savings for any year during the contract period are less than the amount of operating subsidy to be made available under this paragraph to pay for the energy conservation measure in that year, the deficiency will be offset against the PHA's operating subsidy eligibility for the PHA's next fiscal year.

(iv) If energy cost savings are less than the amount necessary to meet amortization payments specified in a contract, the contract term may be extended (up to the 12-year limit) if HUD determines that the shortfall is the result of changed circumstances rather

than a miscalculation or misrepresentation of projected energy savings by the contractor or PHA. The contract term may be extended only to accommodate payment to the contractor and associated direct costs.

(b) *Rate reduction.* If a PHA takes action beyond normal public participation in rate-making proceedings, such as well-head purchase of natural gas, administrative appeals, or legal action to reduce the rate it pays for utilities, then the PHA will be permitted to retain one-half the annual savings realized from these actions.

(c) *Utility benchmarking.* HUD will pursue benchmarking utility consumption at the project level as part of the transition to asset management. HUD intends to establish benchmarks by collecting utility consumption and cost information on a project-by-project basis. In 2009, after conducting a feasibility study, HUD will convene a meeting with representation of appropriate stakeholders to review utility benchmarking options so that HUD may determine whether or how to implement utility benchmarking to be effective in FY 2011. The meeting shall be convened in accordance with the Federal Advisory Committee Act (5 U.S.C. Appendix) (FACA). The HUD study shall take into account typical levels of utilities consumption at public housing developments based upon factors such as building and unit type and size, temperature zones, age and construction of building, and other relevant factors.

#### **§ 990.190 Other formula expenses (add-ons).**

In addition to calculating operating subsidy based on the PEL and UEL, a PHA's eligible formula expenses shall be increased by add-ons. The allowed add-ons are:

(a) *Self-sufficiency.* A PHA may request operating subsidy for the reasonable cost of program coordinator(s) and associated costs in accordance with HUD's self-sufficiency program regulations and notices.

(b) *Energy loan amortization.* A PHA may qualify for operating subsidy for payments of principal and interest cost for energy conservation measures described in § 990.185(a)(3).

(c) *Payments in lieu of taxes (PILOT).* Each PHA will receive an amount for PILOT in accordance with section 6(d) of the 1937 Act, based on its cooperation agreement or its latest actual PILOT payment.

(d) *Cost of independent audits.* A PHA is eligible to receive operating subsidy equal to its most recent actual

audit costs for the Operating Fund Program when an audit is required by the Single Audit Act (31 U.S.C. 7501–7507) (see 24 CFR part 85) or when a PHA elects to prepare and submit such an audit to HUD. For the purpose of this rule, the most recent actual audit costs include the associated costs of an audit for the Operating Fund Program only. A PHA whose operating subsidy is determined to be zero based on the formula is still eligible to receive operating subsidy equal to its most recent actual audit costs. The most recent actual audit costs are used as a proxy to cover the cost of the next audit. If a PHA does not have a recent actual audit cost, the PHA working with HUD may establish an audit cost. A PHA that requests funding for an audit shall complete an audit. The results of the audit shall be transmitted in a time and manner prescribed by HUD.

(e) *Funding for resident participation activities.* Each PHA's operating subsidy calculation shall include \$25 per occupied unit per year for resident participation activities, including, but not limited to, those described in 24 CFR part 964. For purposes of this section, a unit is eligible to receive resident participation funding if it is occupied by a public housing resident or it is occupied by a PHA employee, or a police officer or other security personnel who is not otherwise eligible for public housing. In any fiscal year, if appropriations are not sufficient to meet all funding requirements under this part, then the resident participation component of the formula will be adjusted accordingly.

(f) *Asset management fee.* Each PHA with at least 250 units shall receive a \$4 PUM asset management fee. PHAs with fewer than 250 units that elect to transition to asset management shall receive an asset management fee of \$2 PUM. PHAs with fewer than 250 units that elect to have their entire portfolio treated and considered as a single project as described in § 990.260(b) or PHAs with only one project will not be eligible for an asset management fee. For all PHAs eligible to receive the asset management fee, the fee will be based on the total number of ACC units. PHAs that are not in compliance with asset management as described in subpart H of this part by FY 2011 will forfeit this fee.

(g) *Information technology fee.* Each PHA's operating subsidy calculation shall include \$2 PUM for costs attributable to information technology. For all PHAs, this fee will be based on the total number of ACC units.

(h) *Asset repositioning fee.* (1) A PHA that transitions projects or entire

buildings of a project out of its inventory is eligible for an asset-repositioning fee. This fee supplements the costs associated with administration and management of demolition or disposition, tenant relocation, and minimum protection and service associated with such efforts. The asset-repositioning fee is not intended for individual units within a multi-unit building undergoing similar activities.

(2) Projects covered by applications approved for demolition or disposition shall be eligible for an asset repositioning fee on the first day of the next quarter six months after the date the first unit becomes vacant after the relocation date included in the approved relocation plan. When this condition is met, the project and all associated units are no longer considered an EUM as described in § 990.155. Each PHA is responsible for accurately applying and maintaining supporting documentation on the start date of this transition period or is subject to forfeiture of this add-on.

(3) Units categorized for demolition and which are eligible for an asset repositioning fee are eligible for operating subsidy at the rate of 75 percent PEL per unit for the first twelve months, 50 percent PEL per unit for the next twelve months, and 25 percent PEL per unit for the next twelve months.

(4) Units categorized for disposition and which are eligible for an asset repositioning fee are eligible for operating subsidy at the rate of 75 percent PEL per unit for the first twelve months and 50 percent PEL per unit for the next twelve months.

(5) The following is an example of how eligibility for an asset-repositioning fee is determined:

(i) A PHA has HUD's approval to demolish (or dispose of) a 100-unit project from its 1,000 unit inventory. On January 12th, in conjunction with the PHA's approved Relocation Plan, a unit in that project becomes vacant. Accordingly, the demolition/disposition-approved project is eligible for an asset-repositioning fee on October 1st. (This date is calculated as follows: January 12th + six months = July 12th. The first day of the next quarter is October 1st.)

(ii) Although payment of the asset-repositioning fee will not begin until October 1st, the PHA will receive its full operating subsidy based on the 1,000 units through September 30th. On October 1st the PHA will begin to receive the 36-month asset-repositioning fee in accordance with paragraph (h)(3) of this section for the 100 units approved for demolition. (Asset repositioning fee requirements for

projects approved for disposition are found in paragraph (h)(4) of this section.) On October 1st, the PHA's units will be 900.

(i) *Costs attributable to changes in Federal law, regulation, or economy.* In the event that HUD determines that enactment of a Federal law or revision in HUD or other Federal regulations has caused or will cause a significant change in expenditures of a continuing nature above the PEL and UEL, HUD may, at HUD's sole discretion, decide to prescribe a procedure under which the PHA may apply for or may receive an adjustment in operating subsidy.

#### Subpart D—Calculating Formula Income

##### § 990.195 Calculation of formula income.

(a) *General.* For the purpose of the formula, formula income is equal to the amount of rent charged to tenants divided by the respective unit months leased, and is therefore expressed as a PUM. Formula income will be derived from a PHA's year-end financial information. The financial information used in the formula income computation will be the audited information provided by the PHA through HUD's information systems. The information will be calculated using the following PHA fiscal year-end information:

(1) April 1, 2003, through March 31, 2004;

(2) July 1, 2003, through June 30, 2004;

(3) October 1, 2003, through September 30, 2004; and

(4) January 1, 2004, through December 31, 2004.

(b) *Calculation of formula income.* To calculate formula income in whole dollars, the PUM amount will be multiplied by the EUMs as described in subpart B of this part.

(c) *Frozen at 2004 level.* After a PHA's formula income is calculated as described in paragraph (a) of this section, it will not be recalculated or inflated for fiscal years 2006 through 2008, unless a PHA can show a severe local economic hardship that is impacting the PHA's ability to maintain some semblance of its formula income (see subpart G of this part—Appeals). A PHA's formula income may be recalculated if the PHA appeals to HUD for an adjustment in its formula.

(d) *Calculation of formula income when data are inadequate or unavailable.* When audited data are unavailable in HUD's information systems for the calculation of formula income, HUD may use an alternative methodology, including, but not limited

to, certifications, hard copy reports, and communications with the respective PHAs.

(e) *Inapplicability of 24 CFR 85.25.* Formula income is not subject to the provisions regarding program income in 24 CFR 85.25.

#### Subpart E—Determination and Payment of Operating Subsidy

##### § 990.200 Determination of formula amount.

(a) *General.* The amount of operating subsidy that a PHA is eligible for is the difference between its formula expenses (as calculated under subpart C of this part) and its formula income (as calculated under subpart D of this part).

(b) *Use of HUD databases to calculate formula amount.* HUD shall utilize its databases to make the formula calculations. HUD's databases are intended to be employed to provide information on all primary factors in determining the operating subsidy amount. Each PHA is responsible for supplying accurate information on the status of each of its units in HUD's databases.

(c) *PHA responsibility to submit timely data.* PHAs shall submit data used in the formula on a regular and timely basis to ensure accurate calculation under the formula. If a PHA fails to provide accurate data, HUD will make a determination as to the PHA's inventory, occupancy, and financial information using available or verified data, which may result in a lower operating subsidy. HUD has the right to adjust any or all formula amounts based on clerical, mathematical, and information system errors that affect any of the data elements used in the calculation of the formula.

##### § 990.205 Fungibility of operating subsidy between projects.

(a) *General.* Operating subsidy shall remain fully fungible between ACC projects until operating subsidy is calculated by HUD at a project level. After subsidy is calculated at a project level, operating subsidy can be transferred as the PHA determines during the PHA's fiscal year to another ACC project(s) if a project's financial information, as described more fully in § 990.280, produces excess cash flow, and only in the amount up to those excess cash flows.

(b) Notwithstanding the provisions of paragraph (a) of this section and subject to all of the other provisions of this part, the New York City Housing Authority's Development Grant Project Amendment Number 180, dated July 13, 1995, to Consolidated Annual Contributions Contract NY-333, remains in effect.

**§ 990.210 Payment of operating subsidy.**

(a) *Payments of operating subsidy under the formula.* HUD shall make monthly payments equal to  $\frac{1}{12}$  of a PHA's total annual operating subsidy under the formula by electronic funds transfers through HUD's automated disbursement system. HUD shall establish thresholds that permit PHAs to request monthly installments. Requests by PHAs that exceed these thresholds will be subject to HUD review. HUD approvals of requests that exceed these thresholds are limited to PHAs that have an unanticipated and immediate need for disbursement.

(b) *Payments procedure.* In the event that the amount of operating subsidy has not been determined by HUD as of the beginning of the funding period, operating subsidy shall be provided monthly, quarterly, or annually based on the amount of the PHA's previous year's formula or another amount that HUD may determine to be appropriate.

(c) *Availability of funds.* In the event that insufficient funds are available, HUD shall have discretion to revise, on a pro rata basis, the amounts of operating subsidy to be paid to PHAs.

**§ 990.215 Payments of operating subsidy conditioned upon reexamination of income of families in occupancy.**

(a) *General.* Each PHA is required to reexamine the income of each family in accordance with the provisions of the ACC, the 1937 Act, and HUD regulations. Income reexaminations shall be performed annually, except as provided in the 1937 Act, in HUD regulations, or in the MTW agreements. A PHA must be in compliance with all reexamination requirements in order to be eligible to receive full operating subsidy. A PHA's calculations of rent and utility allowances shall be accurate and timely.

(b) *A PHA in compliance.* A PHA shall submit a certification that states that the PHA is in compliance with the annual income reexamination requirements and its rent and utility allowance calculations have been or will be adjusted in accordance with current HUD requirements and regulations.

(c) *A PHA not in compliance.* Any PHA not in compliance with annual

income reexamination requirements at the time of the submission of the calculation of operating subsidy shall furnish to the responsible HUD field office a copy of the procedures it is using to achieve compliance and a statement of the number of families that have undergone reexamination during the 12 months preceding the current funding cycle. If, on the basis of this submission or any other information, HUD determines that the PHA is not substantially in compliance with all of the annual income reexamination requirements, HUD shall withhold payments to which the PHA may be entitled under this part. Payment may be withheld in an amount equal to HUD's estimate of the loss of rental income to the PHA resulting from its failure to comply with the requirements.

**Subpart F—Transition Policy and Transition Funding****§ 990.220 Purpose.**

This policy is aimed at assisting all PHAs in transitioning to the new funding levels as determined by the formula set forth in this rule. PHAs will be subject to a transition funding policy that will either increase or reduce their total operating subsidy for a given year.

**§ 990.225 Transition determination.**

The determination of the amount and period of the transition funding shall be based on the difference in subsidy levels between the formula set forth in this part and the formula in effect prior to November 18, 2005. The difference in subsidy levels will be calculated using FY 2004 data. When actual data are not available for one of the formula components needed to calculate the formula of this part for FY 2004, HUD will use alternate data as a substitute (e.g., unit months available for eligible unit months, etc.) If the difference between these formulas indicates that a PHA shall have its operating subsidy reduced as a result of this formula, the PHA will be subject to a transition policy as indicated in § 990.230. If the difference between these formulas indicates that a PHA will have its operating subsidy increased as a result of this formula, the PHA will be subject

to the transition policy as indicated in § 990.235.

**§ 990.230 PHAs that will experience a subsidy reduction.**

(a) For PHAs that will experience a reduction in their operating subsidy, as determined in § 990.225, such reductions will have a limit of:

(1) 24 percent of the difference between the two funding levels in the first year following November 18, 2005;

(2) 43 percent of the difference between the two funding levels in the second year following November 18, 2005;

(3) 62 percent of the difference between the two levels in the third year following November 18, 2005; and

(4) 81 percent of the difference between the two levels in the fourth year following November 18, 2005.

(b) The full amount of the reduction in the operating subsidy level shall be realized in the fifth year following November 18, 2005.

(c) For example, a PHA has a subsidy reduction from \$1 million under the formula in effect prior to November 18, 2005 to \$900,000 under the formula used for calculating operating subsidy under this part using FY 2004 data. The difference would be calculated at \$100,000 (\$1 million – \$900,000 = \$100,000). In the first year, the subsidy reduction would be limited to \$24,000 (24 percent of the difference). Thus, the PHA will receive an operating subsidy amount of this rule plus a transition-funding amount of \$76,000 (the \$100,000 difference between the two subsidy amounts minus the \$24,000 reduction limit).

(d) If a PHA can demonstrate a successful conversion to the asset management requirements of subpart H of this part, as determined under paragraph (f) of this section, HUD will discontinue the reduction at the PHA's next subsidy calculation following such demonstration, as reflected in the schedule in paragraph (e) of this section, notwithstanding § 990.290(c).

(e) The schedule of reductions for a PHA that will experience a reduction in subsidy is reflected in the table below.

Funding period	Demonstration date by	Reduction limited to
Prior to year 1 .....	October 1, 2005 .....	5 percent of the difference between the two funding levels.
Year 1 .....	October 1, 2006 .....	24 percent of the difference.
Year 2 .....	October 1, 2007 .....	43 percent of the difference.
Year 3 .....	October 1, 2008 .....	62 percent of the difference.
Year 4 .....	October 1, 2009 .....	81 percent of the difference.
Year 5 .....	October 1, 2010 .....	Full reduction reached.

(f)(1) For purposes of this section, compliance with the asset management requirements of subpart H of this part will be based on an independent assessment conducted by a HUD-approved professional familiar with property management practices in the region or state in which the PHA is located.

(2) A PHA must select from a list of HUD-approved professionals to conduct the independent assessment. The professional review and recommendation will then be forwarded to the Assistant Secretary for Public and Indian Housing (or designee) for final determination of compliance with the asset management requirements of subpart H of this part.

(3) Upon completion of the independent assessment, the assessor shall conduct an exit conference with the PHA. In response to the exit conference, the PHA may submit a management response and other pertinent information (including, but not limited to, an additional assessment procured at the PHAs' own expense) within ten working days of the exit conference to be included in the report submitted to HUD.

(4) In the event that HUD is unable to produce a list of independent assessors on a timely basis, the PHA may submit its own demonstration of a successful conversion to asset management directly to HUD for determination of compliance.

(5) The Assistant Secretary for Public and Indian Housing (or designee) shall consider all information submitted and respond with a final determination of compliance within 60 days of the independent assessor's report being submitted to HUD.

#### **§ 990.235 PHAs that will experience a subsidy increase.**

(a) For PHAs that will experience a gain in their operating subsidy, as determined in § 990.225, such increases will have a limit of 50 percent of the difference between the two funding levels in the first year following November 18, 2005.

(b) The full amount of the increase in the operating subsidy level shall be realized in the second year following November 18, 2005.

(c) For example, a PHA's subsidy increased from \$900,000 under the formula in effect prior to November 18, 2005 to \$1 million under the formula used to calculate operating subsidy under this part using FY 2004 data. The difference would be calculated at \$100,000 (\$1 million – \$900,000 = \$100,000). In the first year, the subsidy increase would be limited to \$50,000

(50 percent of the difference). Thus, in this example the PHA will receive the operating subsidy amount of this rule minus a transition-funding amount of \$50,000 (the \$100,000 difference between the two subsidy amounts minus the \$50,000 transition amount).

(d) The schedule for a PHA whose subsidy would be increased is reflected in the table below.

Funding period	Increase limited to
Year 1 .....	50 percent of the difference.
Year 2 .....	Full increase reached.

### **Subpart G—Appeals**

#### **§ 990.240 General.**

(a) PHAs will be provided opportunities for appeals. HUD will provide up to a two percent hold-back of the Operating Fund appropriation for FY 2006 and FY 2007. HUD will use the hold-back amount to fund appeals that are filed during each of these fiscal years. Hold-back funds not utilized will be added back to the formula within each of the affected fiscal years.

(b) Appeals are voluntary and must cover an entire portfolio, not single projects. However, the Assistant Secretary for Public and Indian Housing (or designee) has the discretion to accept appeals of less than an entire portfolio for PHAs with greater than 5,000 public housing units.

#### **§ 990.245 Types of appeals.**

(a) *Streamlined appeal.* This appeal would demonstrate that the application of a specific Operating Fund formula component has a blatant and objective flaw.

(b) *Appeal of formula income for economic hardship.* After a PHA's formula income has been frozen, the PHA can appeal to have its formula income adjusted to reflect a severe local economic hardship that is impacting the PHA's ability to maintain rental and other revenue.

(c) *Appeal for specific local conditions.* This appeal would be based on demonstrations that the model's predictions are not reliable because of specific local conditions. To be eligible, the affected PHA must demonstrate a variance of ten percent or greater in its PEL.

(d) *Appeal for changing market conditions.* A PHA may appeal to receive operating subsidy for vacant units due to changing market conditions, after a PHA has taken aggressive marketing and outreach measures to rent these units. For example, a PHA could appeal if it is

located in an area experiencing population loss or economic dislocations that faces a lack of demand for housing in the foreseeable future.

(e) *Appeal to substitute actual project cost data.* A PHA may appeal its PEL if it can produce actual project cost data derived from actual asset management, as outlined in subpart H of this part, for a period of at least two years.

#### **§ 990.250 Requirements for certain appeals.**

(a) Appeals under § 990.245 (a) and (c) must be submitted once annually. Appeals under § 990.245 (a) and (c) must be submitted for new projects entering a PHA's inventory within one year of the applicable Date of Full Availability (DOFA).

(b) Appeals under § 990.245 (c) and (e) are subject to the following requirements:

(1) The PHA is required to acquire an independent cost assessment of its projects;

(2) The cost of services for the independent cost assessment is to be paid by the appellant PHA;

(3) The assessment is to be reviewed by a professional familiar with property management practices and costs in the region or state in which the appealing PHA is located. This professional is to be procured by HUD. The professional review and recommendation will then be forwarded to the Assistant Secretary for Public and Indian Housing (or designee) for final determination; and

(4) If the appeal is granted, the PHA agrees to be bound to the independent cost assessment regardless of new funding levels.

### **Subpart H—Asset Management**

#### **§ 990.255 Overview.**

(a) PHAs shall manage their properties according to an asset management model, consistent with the management norms in the broader multi-family management industry. PHAs shall also implement project-based management, project-based budgeting, and project-based accounting, which are essential components of asset management. The goals of asset management are to:

(1) Improve the operational efficiency and effectiveness of managing public housing assets;

(2) Better preserve and protect each asset;

(3) Provide appropriate mechanisms for monitoring performance at the property level; and

(4) Facilitate future investment and reinvestment in public housing by public and private sector entities.



(b) HUD recognizes that appropriate changes in its regulatory and monitoring programs may be needed to support PHAs to undertake the goals identified in paragraph (a) of this section.

**§ 990.260 Applicability.**

(a) PHAs that own and operate 250 or more dwelling rental units under title I of the 1937 Act, including units managed by a third-party entity (for example, a resident management corporation) but excluding section 8 units, are required to operate using an asset management model consistent with this subpart.

(b) PHAs that own and operate fewer than 250 dwelling rental units may treat their entire portfolio as a single project. However, if a PHA selects this option, it will not receive the add-on for the asset management fee described in § 990.190(f).

**§ 990.265 Identification of projects.**

For purposes of this subpart, project means a public housing building or set of buildings grouped for the purpose of management. A project may be as identified under the ACC or may be a reasonable grouping of projects or portions of a project under the ACC. HUD shall retain the right to disapprove of a PHA's designation of a project. PHAs may group up to 250 scattered-site dwelling rental units into a single project.

**§ 990.270 Asset management.**

As owners, PHAs have asset management responsibilities that are above and beyond property management activities. These responsibilities include decision-making on topics such as long-term capital planning and allocation, the setting of ceiling or flat rents, review of financial information and physical stock, property management performance, long-term viability of properties, property repositioning and replacement strategies, risk management responsibilities pertaining to regulatory compliance, and those decisions otherwise consistent with the PHA's ACC responsibilities, as appropriate.

**§ 990.275 Project-based management (PBM).**

PBM is the provision of property-based management services that is tailored to the unique needs of each property, given the resources available to that property. These property management services include, but are not limited to, marketing, leasing, resident services, routine and preventive maintenance, lease enforcement, protective services, and other tasks associated with the day-to-day operation of rental housing at the

project level. Under PBM, these property management services are arranged, coordinated, or overseen by management personnel who have been assigned responsibility for the day-to-day operation of that property and who are charged with direct oversight of operations of that property. Property management services may be arranged or provided centrally; however, in those cases in which property management services are arranged or provided centrally, the arrangement or provision of these services must be done in the best interests of the property, considering such factors as cost and responsiveness.

**§ 990.280 Project-based budgeting and accounting.**

(a) All PHAs covered by this subpart shall develop and maintain a system of budgeting and accounting for each project in a manner that allows for analysis of the actual revenues and expenses associated with each property. Project-based budgeting and accounting will be applied to all programs and revenue sources that support projects under an ACC (e.g., the Operating Fund, the Capital Fund, etc.).

(b)(1) Financial information to be budgeted and accounted for at a project level shall include all data needed to complete project-based financial statements in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP), including revenues, expenses, assets, liabilities, and equity data. The PHA shall also maintain all records to support those financial transactions. At the time of conversion to project-based accounting, a PHA shall apportion its assets, liabilities, and equity to its respective projects and HUD-accepted central office cost centers.

(2) Provided that the PHA complies with GAAP and other associated laws and regulations pertaining to financial management (e.g., OMB Circulars), it shall have the maximum amount of responsibility and flexibility in implementing project-based accounting.

(3) Project-specific operating income shall include, but is not limited to, such items as project-specific operating subsidy, dwelling and non-dwelling rental income, excess utilities income, and other PHA or HUD-identified income that is project-specific for management purposes.

(4) Project-specific operating expenses shall include, but are not limited to, direct administrative costs, utilities costs, maintenance costs, tenant services, protective services, general expenses, non-routine or capital

expenses, and other PHA or HUD-identified costs which are project-specific for management purposes. Project-specific operating costs also shall include a property management fee charged to each project that is used to fund operations of the central office. Amounts that can be charged to each project for the property management fee must be reasonable. If the PHA contracts with a private management company to manage a project, the PHA may use the difference between the property management fee paid to the private management company and the fee that is reasonable to fund operations of the central office and other eligible purposes.

(5) If the project has excess cash flow available after meeting all reasonable operating needs of the property, the PHA may use this excess cash flow for the following purposes:

(i) Fungibility between projects as provided for in § 990.205.

(ii) Charging each project a reasonable asset management fee that may also be used to fund operations of the central office. However, this asset management fee may be charged only if the PHA performs all asset management activities described in this subpart (including project-based management, budgeting, and accounting). Asset management fees are considered a direct expense.

(iii) Other eligible purposes.

(c) In addition to project-specific records, PHAs may establish central office cost centers to account for non-project specific costs (e.g., human resources, Executive Director's office, etc.). These costs shall be funded from the property-management fees received from each property, and from the asset management fees to the extent these are available.

(d) In the case where a PHA chooses to centralize functions that directly support a project (e.g., central maintenance), it must charge each project using a fee-for-service approach. Each project shall be charged for the actual services received and only to the extent that such amounts are reasonable.

**§ 990.285 Records and reports.**

(a) Each PHA shall maintain project-based budgets and fiscal year-end financial statements prepared in accordance with GAAP and shall make these budgets and financial statements available for review upon request by interested members of the public.

(b) Each PHA shall distribute the project-based budgets and year-end financial statements to the Chairman and to each member of the PHA Board of Commissioners, and to such other

state and local public officials as HUD may specify.

(c) Some or all of the project-based budgets and financial statements and information shall be required to be submitted to HUD in a manner and time prescribed by HUD.

**§ 990.290 Compliance with asset management requirements.**

(a) A PHA is considered in compliance with asset management requirements if it can demonstrate substantially, as described in paragraph (b) of this section, that it is managing according to this subpart.

(b) Demonstration of compliance with asset management will be based on an independent assessment.

(1) The assessment is to be conducted by a professional familiar with property management practices and costs in the region or state in which the PHA is located. This professional is to be procured by HUD.

(2) The professional review and recommendation will then be forwarded to the Assistant Secretary for Public and Indian Housing (or designee) for final determination of compliance to asset management.

(c) Upon HUD's determination of successful compliance with asset management, PHAs will then be funded based on this information pursuant to § 990.165(i).

(d) PHAs must be in compliance with the project-based accounting and budgeting requirements in this subpart by FY 2007. PHAs must be in compliance with the remainder of the components of asset management by FY 2011.

**Subpart I—Operating Subsidy for Properties Managed by Resident Management Corporations (RMCs)**

**§ 990.295 Resident Management Corporation operating subsidy.**

(a) *General.* This part applies to all projects managed by a Resident Management Corporation (RMC), including a direct funded RMC.

(b) *Operating subsidy.* Subject to paragraphs (c) and (d) of this section, the amount of operating subsidy that a PHA or HUD provides a project managed by an RMC shall not be reduced during the three-year period beginning on the date the RMC first assumes management responsibility for the project.

(c) *Change factors.* The operating subsidy for an RMC-managed project shall reflect changes in inflation, utility rates, and consumption, as well as changes in the number of units in the resident managed project.

(d) *Exclusion of increased income.*

Any increased income directly generated by activities by the RMC or facilities operated by the RMC shall be excluded from the calculation of the operating subsidy.

(e) *Exclusion of technical assistance.*

Any technical assistance the PHA provides to the RMC will not be included for purposes of determining the amount of funds provided to a project under paragraph (b) of this section.

(f) The following conditions may not affect the amounts to be provided under this part to a project managed by an RMC:

(1) *Income reduction.* Any reduction in the subsidy or total income of a PHA that occurs as a result of fraud, waste, or mismanagement by the PHA; and

(2) *Change in total income.* Any change in the total income of a PHA that occurs as a result of project-specific characteristics when these characteristics are not shared by the project managed by the RMC.

(g) *Other project income.* In addition to the operating subsidy calculated in accordance with this part and the amount of income derived from the project (from sources such as rents and charges), the management contract between the PHA and the RMC may specify that income be provided to the project from other legally available sources of PHA income.

**§ 990.300 Preparation of operating budget.**

(a) The RMC and the PHA must submit operating budgets and calculations of operating subsidy to HUD for approval in accordance with § 990.200. The budget will reflect all project expenditures and will identify the expenditures related to the responsibilities of the RMC and the expenditures that are related to the functions that the PHA will continue to perform.

(b) For each project or part of a project that is operating in accordance with the ACC amendment relating to this subpart and in accordance with a contract vesting maintenance responsibilities in the RMC, the PHA will transfer into a sub-account of the operating reserve of the PHA an operating reserve for the RMC project. When all maintenance responsibilities for a resident-managed project are the responsibility of the RMC, the amount of the reserve made available to a project under this subpart will be the per-unit cost amount available to the PHA operating reserve, excluding all inventories, prepaids, and receivables at the end of the PHA fiscal year preceding implementation, multiplied by the number of units in the

project operated. When some, but not all, maintenance responsibilities are vested in the RMC, the management contract between the PHA and RMC may provide for an appropriately reduced portion of the operating reserve to be transferred into the RMC's sub-account.

(c) The RMC's use of the operating reserve is subject to all administrative procedures applicable to the conventionally owned public housing program. Any expenditure of funds from the reserve must be for eligible expenditures that are incorporated into an operating budget subject to approval by HUD.

(d) Investment of funds held in the reserve will be in accordance with HUD regulations and guidance.

**§ 990.305 Retention of excess revenues.**

(a) Any income generated by an RMC that exceeds the income estimated for the income categories specified in the RMC's management contract must be excluded in subsequent years in calculating:

(1) The operating subsidy provided to a PHA under this part; and

(2) The funds the PHA provides to the RMC.

(b) The RMC's management contract must specify the amount of income that is expected to be derived from the project (from sources such as rents and charges) and the amount of income to be provided to the project from the other sources of income of the PHA (such as operating subsidy under this part, interest income, administrative fees, and rents). These income estimates must be calculated consistent with HUD's administrative instructions. Income estimates may provide for adjustment of anticipated project income between the RMC and the PHA, based upon the management and other project-associated responsibilities (if any) that are to be retained by the PHA under the management contract.

(c) Any revenues retained by an RMC under this section may be used only for purposes of improving the maintenance and operation of the project, establishing business enterprises that employ residents of public housing, or acquiring additional dwelling units for lower income families. Units acquired by the RMC will not be eligible for payment of operating subsidy.

**Subpart J—Financial Management Systems, Monitoring, and Reporting**

**§ 990.310 Purpose—General policy on financial management, monitoring and reporting.**

All PHA financial management systems, reporting, and monitoring of

program performance and financial reporting shall be in compliance with the requirements of 24 CFR 85.20, 85.40, and 85.41. Certain HUD requirements provide exceptions for additional specialized procedures that are determined by HUD to be necessary for the proper management of the program in accordance with the requirements of the 1937 Act and the ACC between each PHA and HUD.

**§ 990.315 Submission and approval of operating budgets.**

(a) Required documentation:

(1) Prior to the beginning of its fiscal year, a PHA shall prepare an operating budget in a manner prescribed by HUD. The PHA's Board of Commissioners shall review and approve the budget by resolution. Each fiscal year, the PHA shall submit to HUD, in a time and manner prescribed by HUD, the approved Board resolution.

(2) HUD may direct the PHA to submit its complete operating budget with detailed supporting information and the Board resolution if the PHA has breached the ACC contract, or for other reasons, which, in HUD's determination, threaten the PHA's future serviceability, efficiency, economy, or stability. When the PHA no longer is operating in a manner that threatens the future serviceability, efficiency, economy, or stability of the housing it operates, HUD will notify the PHA that it no longer is required to submit a complete operating budget with detailed supporting information to HUD for review and approval.

(b) If HUD finds that an operating budget is incomplete, inaccurate, includes illegal or ineligible expenditures, contains mathematical errors or errors in the application of accounting procedures, or is otherwise unacceptable, HUD may, at any time,

require the PHA to submit additional or revised information regarding the budget or revised budget.

**§ 990.320 Audits.**

All PHAs that receive financial assistance under this part shall submit an acceptable audit and comply with the audit requirements in 24 CFR 85.26.

**§ 990.325 Record retention requirements.**

The PHA shall retain all documents related to all financial management and activities funded under the Operating Fund for a period of five fiscal years after the fiscal year in which the funds were received.

Dated: September 12, 2005.

**Paula O. Blunt,**

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