

**OFFICE OF PERSONNEL
MANAGEMENT****5 CFR Part 591**

RIN 3206-AK67

**Cost-of-Living Allowances (Nonforeign
Areas); COLA Rate Changes****AGENCY:** Office of Personnel
Management.**ACTION:** Final rule.

SUMMARY: The Office of Personnel Management is issuing final regulations to change the cost-of-living allowance rates received by certain white-collar Federal and U.S. Postal Service employees in Alaska, Hawaii, Guam and the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands. The changes are the result of living-cost surveys conducted in 2002, 2003, and 2004.

DATES: *Effective date:* September 1, 2006. *Implementation date:* First day of the first pay period beginning on or after September 1, 2006.

FOR FURTHER INFORMATION CONTACT: Donald L. Paquin, (202) 606-2838; fax: (202) 606-4264; or e-mail: COLA@opm.gov.

SUPPLEMENTARY INFORMATION: Section 5941 of title 5, United States Code, authorizes Federal agencies to pay cost-of-living allowances (COLAs) to white-collar Federal and U.S. Postal Service employees stationed in Alaska, Hawaii, Guam and the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands. Executive Order 10000, as amended, delegates to the Office of Personnel Management (OPM) the authority to administer nonforeign area COLAs and prescribes certain operational features of the program. OPM conducts living-cost surveys in each allowance area and in the Washington, DC, area to determine whether, and to what degree, COLA area living costs are higher than those in the DC area. OPM sets the COLA rate for each area based on the results of these surveys.

Background

The 2002 Caribbean surveys were the first OPM conducted using the new

methodology we adopted pursuant to the stipulation of settlement in *Caraballo et al. v. United States*, No. 1997-0027 (D.V.I), August 17, 2000. *Caraballo* was a class-action lawsuit in which the plaintiffs contested the methodology OPM used to determine COLA rates. In the *Caraballo* settlement, the parties agreed that if the Government adopted and maintained certain changes in the COLA program, the plaintiffs would be barred from bringing suit over these issues. The complete stipulation for settlement is on OPM's Web site at <http://www.opm.gov/oca/cola/settlement.asp>.

Before the settlement, the parties entered into a memorandum of understanding under which they engaged in a cooperative process to study living-cost and compensation issues. The research was exhaustive and covered essentially all aspects of the COLA program. A summary of that research is available on OPM's Web site at <http://www.opm.gov/oca/cola/research.asp>.

Exhibit A of the *Caraballo* settlement agreement lists 26 "Safe Harbor Principles" that outline the changes to which the parties agreed. These principles formed the basis for a new COLA methodology, which OPM incorporated into its regulations. In developing these regulations, OPM consulted with the Survey Implementation Committee (SIC), which was established under the *Caraballo* settlement and is composed of representatives of the parties in *Caraballo*. The SIC in turn consulted with the Technical Advisory Committee (TAC), which was also established under the *Caraballo* settlement and is composed of three economists with expertise in living-cost comparisons. OPM published proposed regulations incorporating the new methodology in the **Federal Register** for notice and comment on November 9, 2001, at 66 FR 56741, and a final rule on May 3, 2002, at 67 FR 22339. The SIC and the TAC also worked closely with OPM in preparing for and implementing the 2002, 2003, and 2004 COLA surveys.

COLA Surveys

In 2002, OPM surveyed Puerto Rico, the U.S. Virgin Islands, and the Washington, DC, area. We published the results of these Caribbean surveys in the **Federal Register** on February 9, 2004, at 69 FR 6020. In 2003, OPM surveyed Anchorage, Fairbanks, and Juneau, Alaska, and the Washington, DC, area. We published the results of these Alaska surveys on March 12, 2004, at 69 FR 12002. In 2004, OPM surveyed Honolulu County, Kailua Kona, Hilo, Kauai County, Maui County, Guam, and the Washington, DC, area. We published the results of these Pacific surveys on August 4, 2005, at 70 FR 44989. OPM also published the results of new shelter (rent) price analyses for the 2002 Caribbean surveys and the 2003 Alaska surveys in a **Federal Register** notice dated August 4, 2005, at 70 FR 44978.

COLA Rate Changes

As described in the survey reports, OPM compared the results of each of the COLA area surveys with the results of the DC area survey to derive a living-cost index for each of the COLA areas. We then added adjustment factors as provided in 5 CFR 591.227. The final results indicate an increase in the COLA rates for the U.S. Virgin Islands and Kauai County, Maui County, and Hawaii County, HI; no change in the COLA rates for the Rest of the State of Alaska, Guam and the Northern Mariana Islands, and Honolulu County, HI; and a reduction in the COLA rates for Puerto Rico and Anchorage, Fairbanks, and Juneau, Alaska.

Table 1 shows the old and new COLA rates and the survey living-cost indexes for each area. Under 5 CFR 591.228(c), COLA rate reductions are limited to no more than 1 percentage point per year. The living-cost indexes OPM previously published at 70 FR 44979 and 70 FR 44990 have been amended based on changes we implemented in response to comments we received. These changes are described in the section of this notice on *Hedonic Regressions*. OPM is publishing the new living-cost indexes in a **Federal Register** notice that accompanies this final rule.

TABLE 1.—COLA RATES AND LIVING-COST INDEXES

| Allowance area/category | Old COLA rates (percent) | Previously published living-cost indexes | Revised living-cost indexes | New COLA rates (percent) |
|---------------------------|--------------------------|--|-----------------------------|--------------------------|
| Puerto Rico | 11.5 | 105.10 | 103.04 | 10.5 |
| U.S. Virgin Islands | 22.5 | 122.84 | 122.53 | 23.0 |
| Anchorage, Alaska | 25.0 | 113.79 | 113.64 | 24.0 |
| Fairbanks, Alaska | 25.0 | 115.61 | 115.62 | 24.0 |

TABLE 1.—COLA RATES AND LIVING-COST INDEXES—Continued

| Allowance area/category | Old COLA rates (percent) | Previously published living-cost indexes | Revised living-cost indexes | New COLA rates (percent) |
|---|--------------------------|--|-----------------------------|--------------------------|
| Juneau, Alaska | 25.0 | 118.03 | 118.09 | 24.0 |
| Rest of the State of Alaska | 25.0 | 136.00 | 135.84 | 25.0 |
| Honolulu County, Hawaii | 25.0 | 127.78 | 125.80 | 25.0 |
| Hawaii County, Hawaii | 16.5 | 119.11 | 117.25 | 17.0 ¹ |
| Kauai County, Hawaii | 23.25 | 130.58 | 127.63 | 25.0 |
| Maui County, Hawaii | 23.75 | 134.49 | 131.50 | 25.0 |
| Guam and the Northern Mariana Islands | 25.0 | 127.65 | 127.40 | 25.0 |

The 2004 Pacific survey report indicated a COLA rate increase for Hawaii County, HI, from 16.5 percent to 19 percent. OPM, however, refined the rental survey hedonic regressions after taking into consideration comments received. The refined methodology results in a 17 percent COLA rate for Hawaii County. The refinements OPM adopted pursuant to comments are discussed in the section on *Hedonic Regressions*.

OPM published a proposed rule in the **Federal Register** on August 4, 2005, at 70 FR 44976, inviting comments on the COLA rate changes. Approximately 2,400 commenters responded to the proposed rule. Most of the comments were from Federal employees or unions representing Federal employees. Many of the commenters expressed opposition, without further comment, to the planned COLA rate reductions. Other commenters addressed specific issues and concerns with the COLA surveys. One agency and two commenters concurred with the rate changes. We summarize and evaluate the substantive comments in the “Discussion of Comments” section that follows.

Discussion of Comments

Rising Living Costs

Many of the commenters said OPM should not reduce COLA rates because their living costs were increasing. A number of commenters provided or referred to publications showing rising costs in their COLA area. By law, OPM must compare costs in the COLA areas with costs in the Washington, DC, area and adjust COLA rates according to the relative difference. Therefore, if living costs rise faster in the COLA area than in the DC area, we increase the COLA rate subject to the statutory maximum. If living costs rise faster in the DC area than in the COLA area, we reduce the COLA rate, but by no more than 1 percentage point per year, as provided by 5 CFR 591.228(c).

Numerous commenters noted that certain costs have increased since OPM conducted the survey in their COLA area and that the survey data were outdated. Many commenters requested that OPM survey again. They cited the cost of gasoline, housing, utilities, grocery items, medical needs, various fees and taxes, and other items. OPM recognizes that prices for various items will increase in the COLA areas and/or

the DC area between surveys. We collect prices in each survey area every 3 years on a rotating basis according to a schedule agreed upon by the parties in the *Caraballo* settlement. Beginning with the publication of the 2005 Caribbean and DC COLA survey results, OPM will adjust price indexes for areas not surveyed based on the relative change in the Consumer Price Index (CPI) for the COLA area compared with the CPI for the Washington, DC, area. Pursuant to the *Caraballo* settlement, we are not implementing CPI adjustments at this time.

Several commenters said their current living costs are considerably higher than living costs at their previous duty station in the lower 48 States. By law, OPM must compare the cost of living in the COLA areas with the cost of living in the Washington, DC, area.

Consumer Goods

Several commenters noted that some goods available in the contiguous States are not available in their COLA area. Other commenters said certain items, such as water softeners, are necessary in their COLA area, but not in the DC area. Two commenters said they pay for certain services, such as garbage collection, that are covered by taxes in some other areas. Issues such as these were discussed extensively during the COLA litigation. As a result of the *Caraballo* settlement and as provided by 5 CFR 591.227, OPM adds an adjustment factor to the price index for each COLA area to reflect differences in need, access to and availability of goods and services, and quality of life in the COLA area relative to the DC area. With regard to the above comments, we note that several water softener companies do business in the DC area and assume this reflects a need for some DC area residents to have water softeners. We also note that residents in several communities in the DC area pay directly for garbage collection.

One commenter compared prices for a number of items at a department store in Puerto Rico with mainland prices listed on the store’s Internet site, showing the prices for these items in Puerto Rico to be higher. The same commenter also remarked on the high cost of vehicles, including shipping, in Puerto Rico. Other commenters also noted that many consumer goods must be shipped to COLA areas at high cost. In each of the annual surveys, OPM contacted over 900 outlets and collected more than 4,600 prices on over 240 items representing typical consumer purchases. We surveyed the final cost to the consumer of services or items, including automobiles. The final cost includes any overhead, transportation and shipping costs, taxes, competition, and other price influences. Additionally, OPM surveyed catalog prices for a number of items and included in the price the costs for shipping, sales tax, and excise tax, which are often higher in the COLA area relative to the Washington, DC, area.

Inequity Among Areas

Many commenters claimed the COLA rate reductions in Puerto Rico were discriminatory but did not elaborate. Some commenters, however, noted that Puerto Rico historically has had the lowest COLA rate of all of the COLA areas.

OPM conducts COLA surveys using the same methodology in all areas. For many years, OPM’s surveys have indicated that COLA rates should be lower in several COLA areas. However, litigation and legislation barred OPM from implementing COLA rate reductions. The bars have now expired, and we are implementing rate reductions in certain areas. In the future, it is possible that there may be more differentiation among COLA rates than there is today.

Several commenters questioned the data collectors’ familiarity with Puerto

Rico and knowledge of the Spanish language. OPM used data collectors in Puerto Rico who spoke Spanish and had formerly resided in Puerto Rico. In addition, the two non-rental OPM data collectors were accompanied by observers from the Puerto Rico COLA Advisory Committee (CAC), which is composed of current Federal employees who live in Puerto Rico and speak Spanish.

Before each survey, OPM establishes a CAC in each of the survey areas. As described in 5 CFR 591.243, each CAC is composed of approximately 12 agency and employee representatives from the survey area and two representatives from OPM. To help OPM prepare for the COLA surveys, OPM and the CACs held 3-day meetings in each area to be surveyed to plan the COLA surveys. During the survey, the CAC members assisted OPM staff in collecting non-rental data, and after the survey the CAC members had the opportunity to review all of the survey results, including the results of the rental survey. Although CAC members helped plan the rental survey and had the opportunity to review the rental survey results in detail, CAC members did not participate in the rental data collection as observers.

A local union in Puerto Rico stated that in the rental survey, OPM treated Puerto Rico COLA employees in a disparate fashion because of national origin and without regard to unique linguistic and cultural differences. The union cited misspellings in the rental data as evidence that the data collectors encountered a serious language barrier. The OPM contractor that surveyed rental properties in Puerto Rico also employed Spanish-speaking data collectors, some of whom were or are residents of Puerto Rico. Although there may have been misspellings in business names and street addresses, we believe the overall quality of the rental data was good and reflected the COLA survey's specifications for rental prices in Puerto Rico.

Rental Surveys

OPM also received from the local union in Puerto Rico extensive comments on the Caribbean and DC area rental surveys. A large number of commenters wrote in support of the union's comments, made similar comments, or addressed other issues relating to the rental surveys. Many of the comments addressed 2005 survey issues based on pre-publication rental data OPM provided to the Puerto Rico CAC for review. Because we have not yet published the 2005 survey results and because the Puerto Rico rate

reduction is based on the 2002 Caribbean survey results, we are responding in this final rule to the comments as they apply to the 2002 survey.

The union and other commenters asserted that the rental survey did not accurately reflect the areas or the types of housing units where Federal employees live in Puerto Rico, was conducted in a careless and negligent manner, and was conducted differently in Puerto Rico than in the DC area and the U.S. Virgin Islands. Other commenters in Puerto Rico charged that the rental survey was inaccurate, unfair, and discriminatory, and many challenged the veracity, reliability, and adequateness of the rental data.

OPM hired an experienced contractor to collect rental data in each area, and the data were collected in essentially the same manner in all areas. In Puerto Rico, we directed the contractor to collect in the San Juan/Caguas area and in areas east of San Juan, including the Roosevelt Roads area. We selected these areas based on the results of the 1992/93 Federal Employee Housing and Living Patterns Survey, which provided information on where Federal employees live. As described in the survey report, OPM collected over 80 housing characteristics on more than 400 rental observations throughout this area of Puerto Rico and over 900 observations in the Washington, DC, area. The housing characteristics were described in Appendix 4 of the survey report (69 FR 6047).

Pursuant to the *Caraballo* settlement, OPM used hedonic regression analysis, which is a type of statistical analysis, to compare rents in the COLA areas with rents in the DC area. The use of hedonic regressions allows OPM to hold quantity and quality of housing constant to make rental rate comparisons. The hedonic regressions are described in the survey notice at 69 FR 6029 and Appendix 5 at 69 FR 6048. (As described in the notice of August 4, 2005, at 70 FR 44798, OPM revised these hedonic regressions and published new rent indexes.) Therefore, we believe the rental surveys and analyses were conducted in a fair and professional manner in all of the COLA areas.

The union also noted that a high percentage of the Puerto Rico observations were gathered from "drive by" listing sources. The contractor collects information from five types of sources: local newspaper/publication, Internet, agent/broker, drive-by/sign posted, and other. The contractor collected data from all types except "other" in both Puerto Rico and the DC area, but the distribution of observations

by listing source type varied by area. To determine whether listing source influenced rental rates, OPM added listing source as a variable in the hedonic regression analysis. We found that the variable was statistically significant, but that it raised the standard error of the survey area parameter estimates. Therefore, we are not using listing source as a variable in the final hedonic regression. (See the section of this notice on *Hedonic Regressions*.)

The union also stated that a considerable percentage of the rental observations were from individuals who refused to provide some or all self-identifying information (*i.e.*, the individual's name and/or his/her home or business address). Approximately 30 percent of the rental observations in Puerto Rico were from such individuals, and approximately 4 percent of the observations in the DC area were from such individuals. As with listing sources, OPM added self-identification refusal as a variable to the hedonic regression analysis. We found that self-identification refusal was not a statistically significant variable and are not using it in the final hedonic regression.

The union and a number of other commenters believe OPM should have allowed observers to accompany the contractor on the rental surveys in Puerto Rico. The contract did not provide for rental data collection observers to accompany contractor data collectors, and we determined that a contract modification to allow observers would increase contract costs significantly. We are currently exploring with the contractor how rental data collection observers might be involved in future COLA surveys.

Various commenters noted expenses that affect the cost of shelter in their area. A number of commenters said employees in Puerto Rico pay more for living in gated communities or incur costs for security systems because of the high crime rate. One commenter remarked on higher mortgage rates in Puerto Rico. A commenter from Alaska noted that some properties require water wells. To the extent that these necessities influence the rental rate for a property, they are captured by the rental survey. The rental survey also captures any separate security fees added to rents.

One commenter asked why the COLA survey did not compare homeowner data. Under the *Caraballo* settlement, the parties agreed to adopt a rental equivalence approach similar to the one the Bureau of Labor Statistics uses for the Consumer Price Index. Rental

equivalence compares the shelter value (rental value) of owned homes, rather than total owner costs, because the latter are influenced by the investment value of the home (*i.e.*, what homeowners hope to realize as a profit when they sell their homes). As a rule, living-cost surveys do not compare how consumers invest their money.

The same commenter said one of the apartment units surveyed in the 2003 Juneau survey was listed as 960 square feet, but she said the property was actually 690 square feet. OPM asked the contractor to verify the information. The contractor found that the units in this apartment complex varied in size and that some are 690 square feet, while others are 960 square feet. The unit in the Juneau rental database was correctly identified at 960 square feet.

The same commenter also objected to assigning all two-bedroom apartments to the same class. For the purposes of drawing the rental survey sample, OPM classifies rental units by location into six broad categories. The six categories are as follows: Class A—four bedroom, single family unit not to exceed 3200 square feet; Class B—three bedroom, single family unit not to exceed 2600 square feet; Class C—two bedroom, single family unit not to exceed 2200 square feet; Class D—three bedroom apartment unit not to exceed 2000 square feet; Class E—two bedroom apartment unit not to exceed 1800 square feet; and Class F—one bedroom apartment unit not to exceed 1400 square feet. OPM uses this information only to draw the survey sample. During the survey, OPM obtains information on more than 80 housing characteristics, including type, actual square footage, number of bedrooms and bathrooms, and other characteristics of each rental unit. Instead of comparing houses within each of the six broad classes, we use the detailed characteristics of each rental unit and hedonic regressions as described below to hold these characteristics constant between the COLA and Washington, DC, area to make rental price comparisons.

One commenter asserted that OPM's contractor determined most square-footage measurements without visiting the property. OPM's contractor visited every property and used, where appropriate, special equipment to estimate the square footage of living space. The contractor also used living-space information provided by brokers, realtors, owners, property tax records, and other reliable sources.

Hedonic Regressions

As described in the previous section, OPM received several comments

concerning the rental survey, some of which led us to revisit the hedonic regression analyses we use to compute rental indexes. As described at 69 FR 6029 and Appendix 1 at 70 FR 44979, OPM used hedonic regression analysis, which is a type of multiple linear regression analysis, to compare rents in the COLA areas with rents in the DC area. Multiple linear regression is used to determine how the dependent variable (in this case, rent) is influenced by one or more independent variables (in this case, the characteristics of the rental unit including some aspects of the neighborhood). As is common in this type of analysis and as was done in the research leading to the *Caraballo* settlement, OPM used semi-logarithmic regressions. The regression produces parameter estimates for each independent variable, including survey area. A parameter estimate is an estimate of the influence of rental characteristics or variables on rent of a dwelling unit. Variables may be continuous—like square footage, number of bedrooms, or number of bathrooms—or class variables, like external condition (good, fair, etc.), availability of air conditioning (yes, no), or the particular COLA survey area in which the rental unit is located. For example, “Puerto Rico,” “St. Croix,” and “St. Thomas/St. John” are the Caribbean COLA survey area class variables for which parameter estimates are computed.

COLA survey area parameter estimates are of greatest interest in the COLA rental model because, once converted, they become the survey area rent index holding all of the other rental characteristics in the regression constant. In other words, the exponent of the survey area parameter estimate (*i.e.*, after the estimate is converted from natural logarithms with a correction for a slight bias caused by the use of logarithms) multiplied by 100 is the survey area's rent index. This index reflects the difference in rents for the COLA survey area relative to the Washington, DC, area, while (in effect) holding other significant housing characteristics constant.

To select the variables to use in the model, OPM adopted a methodology developed by the TAC and OPM, in consultation with the SIC. The methodology OPM used to produce the rent indexes published in the notices (70 FR 44978 and 70 FR 44989) that accompanied the proposed rule was an objective, multi-step process by which OPM eliminated variables that were not statistically significant. After reviewing the results of hedonic regressions OPM performed in response to comments we

received on the rental survey, the TAC recommended that we refine the methodology to also eliminate variables that decreased the precision of the rent index. Therefore, OPM modified the variable selection process to eliminate variables that are not statistically significant and/or decrease the precision of the rent index. The refined methodology produces an improved hedonic regression model with somewhat different rent indexes than those shown in the survey notices. (See notice that accompanies this rule.)

A commenter from Puerto Rico supported in general the use of hedonic techniques, but was critical of the variables in the OPM regression model. The commenter noted a number of characteristics he thought OPM should have included. OPM collected most of the characteristics the commenter suggested. (See Appendix 4 at 69 FR 6047.) We then processed the characteristics using the methodology described above and included many of them (*e.g.*, square footage, number of bedrooms and bathrooms) in the final hedonic regression analysis. Therefore, although OPM collects more than 80 rental unit characteristics, the multi-step process described above produces a hedonic regression model with fewer characteristics, *i.e.*, those that are statistically most important and increase precision in terms of the rent indexes.

OPM does not collect some of the variables (*e.g.*, occupancy ratio) noted by the commenter. These variables are often included in studies related to the appraised value of properties, particularly apartment complexes, because they might be important to a prospective commercial buyer. We do not collect information such as occupancy ratios, however, because they are not important for renters of single units within a complex.

The commenter noted that location is an important variable and recommended collecting information on neighborhoods and “distance to major employment centers.” OPM added distance as a variable in the hedonic regression analysis by computing the distance from each rental observation to the major Federal building or intersection in each survey area. We then treated distance as any other variable in the model and examined its significance and its impact. As it turned out, distance did not enter as a variable in any of the final models because it either was not significant or decreased the precision of the rent index.

With regard to neighborhoods, as shown in Appendix 4 at 69 FR 6047, OPM already collects information that reflects the quality of the neighborhood.

We use information from the Bureau of the Census to introduce additional variables to the hedonic regressions that may reflect the quality of the neighborhood. To do this, we identify the census tract within which each rental observation is found and then add variables, such as median income, percent school age persons, and percent of people in the area with B.A. degrees or higher, to the hedonic regressions. We process these characteristics using the methodology described above and those that are statistically significant and increase precision are used in the final hedonic regression analysis.

OPM was not able to add census tract data to the 2002 survey. We did not have longitude and latitude coordinates for the 2002 rental observations, and we are not aware of any software product that could provide this information using Puerto Rico and U.S. Virgin Islands addresses. We note, however, that we collected longitude and latitude information in the 2005 Caribbean survey, and we anticipate using census tract data in the analysis of the rental survey results.

The commenter described a type of logit model that appraisers find useful in distinguishing "atypical" apartment complexes—possibly an important tool in the appraisal field. Further, the logit model is useful when the dependent variable is limited in range (*e.g.*, the probability of buying an apartment building of given characteristics) but is not appropriate for a continuous variable, like rents for similar accommodation across cities, which is the goal of OPM analysis.

The commenter said OPM did not say which statistical package it used and did not describe its analyses. As stated at 70 FR 44978, OPM used SAS, which is a common proprietary statistical package. Appendices 1 and 2 at 70 FR 44979 show the details of the regression models OPM used and the results of the regressions.

The commenter also said OPM should provide the statistical procedures used for the hedonic regressions to the CACs for review. OPM provides the CACs with COLA survey materials that explain regression analysis, contain graphs and charts, and provide the same details about the rental survey and hedonic regressions OPM publishes in its **Federal Register** notices. In addition, OPM staff meets with the CACs to explain the procedures used, go over the hedonic regression results, and answer questions.

Locality Pay and Retirement

Numerous commenters said Federal employees in the COLA areas should

receive locality pay. Several requested that OPM replace the COLA rate with locality pay or take DC area locality pay into consideration when setting COLA rates. Two commenters noted that the Rest of U.S. (RUS) locality pay rate is higher than the COLA rate in Puerto Rico. One commenter said OPM should set the lowest COLA rate to be equivalent to the RUS locality pay rate. Several commenters noted that locality pay is included in base pay for retirement purposes, while COLAs are not included. One commenter said that not considering COLAs in retirement calculations creates a disincentive to retire in a COLA area. Another commenter said that employees in the COLA areas have to save more for retirement.

The Federal Employees Pay Comparability Act of 1990 (FEPCA) authorizes locality pay only for Federal employees in the contiguous 48 States and Washington, DC. OPM cannot consider DC area locality pay or set COLA rates at certain locality pay levels because doing so would be tantamount to implementing locality pay outside the 48 States. Additionally, OPM cannot credit COLAs in the retirement calculation because 5 U.S.C. 8331(3) and 8401(4) exclude allowances from base pay for Federal retirement purposes. Changes in law would be required to extend locality payments to Federal employees in the COLA areas or to include COLAs in base pay for Federal retirement purposes.

Recruitment and Retention

Many commenters believe COLA reductions would cause recruitment and retention problems. OPM is concerned about the Government's ability to recruit and retain a well-qualified workforce and notes that the Government has several pay authorities that are available to address recruitment and retention problems. Among these are special salary rates and recruitment, retention, and relocation incentives.

Financial Effect

Many commenters were concerned about the impact of COLA reductions on personal financial commitments, such as mortgages, and other financial obligations. Several commenters stated that the reductions would have an adverse effect on the local economy of the COLA area. As noted above, OPM's authority to set COLA rates is established in 5 U.S.C. 5941. However, our regulations provide that COLA rates may be reduced by no more than 1 percentage point in any 12-month period, which serves to minimize the

financial impact of COLA rate reductions.

Utility Costs

Several commenters remarked that water, electricity, and other utility costs are high in Alaska and Puerto Rico. One commenter noted that increasing energy costs also affect costs for shelter, transportation, and consumer goods. OPM surveyed utility costs and included these costs in the price comparisons. We also surveyed costs for shelter, transportation, and consumer goods and services. The prices of goods and services include any energy and/or local transportation costs associated with making these items available for sale.

Some commenters reported that water utility prices have or are going to increase significantly in Puerto Rico. To the extent that such increases occur, they will be reflected in the results of the 2005 survey or in subsequent surveys and/or adjustments.

Transportation

Several commenters noted the cost of long distance travel from the COLA areas to areas in the continental United States. The commenters requested that OPM consider time, distance, and excessive travel expenses in setting COLA rates. Two other commenters noted higher air transportation costs in Juneau because of the lack of airline competition.

The COLA methodology takes travel expenses into account in two ways. First, OPM compares the cost of air travel from the various COLA areas to common destinations in the contiguous States with the cost of air travel from the DC area to those same destinations. This would capture any higher ticket prices that result from reduced competition. Second, as provided in 5 CFR 591.227, OPM adds to the overall price index for the COLA area an adjustment factor that reflects differences in need, access to and availability of goods and services, and quality of life in the COLA area relative to the DC area. This adjustment factor is designed to address such considerations as the difficulty of traveling long distances.

Medical Services

Several commenters believe the survey underestimated the cost and restricted availability of medical services in Alaska. They also noted that doctor visits and dental care are more expensive in the COLA areas. One commenter said none of the Federal health benefit plans in Juneau offer supplemental dental coverage. Another commenter felt that medical care in

Juneau was limited, resulting in higher health care costs and inferior health care. Several commenters said there was a need for costly travel outside the area to obtain some medical services.

OPM surveys the prices of several medical services (including dental services) and items in each COLA area and in the DC area. The medical services index reflects any relatively higher local prices. The availability of medical services is not something OPM prices or quantifies. Instead, it is part of the adjustment factor OPM adds to the price index to reflect differences in need, access to, and availability of goods and services, and quality of life in the COLA areas relative to the Washington, DC, area.

One commenter noted that there were no Health Maintenance Organizations (HMOs) in Juneau. As described at 69 FR 12005, OPM compared average health insurance premium costs in the COLA area with average health insurance premium costs in the DC area. Therefore, the health insurance premium index reflects higher local costs to the extent that an area has only higher cost plans available (i.e., to the extent HMOs are not available).

Quality of Life

A number of commenters stated that the COLA reductions would affect their quality of life. One commenter from Alaska said the COLA is an incentive that helps with the isolation, extreme climate, support issues, and darkness. As noted under the *Transportation* section, OPM adds adjustment points in part to compensate for differences in quality of life.

Taxes

Several commenters mentioned increased sales, excise, and local taxes in Puerto Rico. Another commenter noted that Federal employees in North Pole, Alaska, must pay a sales tax. OPM adds sales tax and, where applicable, excise and other taxes to the prices it collects. In Puerto Rico, excise taxes paid by importers and distributors are part of the price for the item. In the case of catalog items, OPM adds such taxes as applicable. To the extent any recent tax increases in Puerto Rico have occurred, they will be reflected in the results of the 2005 survey or in subsequent surveys and/or adjustments.

Local Conditions

Several commenters from Puerto Rico noted additional costs faced by Federal employees on the island because of hurricanes and blackouts. Among the costs mentioned were generators, special water tanks, storm shutters,

bottled water, road damage, electrical equipment repair, and higher property insurance. OPM discusses property insurance under the heading *Insurance*. As noted under the *Transportation* section, OPM adds adjustment points pursuant to 5 CFR 591.227 in part to compensate for differences in quality of life.

A number of commenters also remarked on weather conditions in Alaska. They noted additional costs, such as four-wheel drive, studded tires, winter clothes, high electric and heating bills, and vehicle maintenance, because of the long winters, icy roads, and temperatures that sometimes extend to 40 degrees or more below zero. As described in Appendix 3 at 69 FR 12027, OPM priced in Alaska a four-wheel drive vehicle with an engine block heater and regular and studded tires. We also priced parkas, boots, and other cold weather items. The utility model we use reflects Alaska's higher home energy costs.

Insurance

Several commenters noted high property insurance rates as a result of escalating housing prices, hurricanes, or property located in flood zones. OPM uses a rental equivalence approach to determine shelter costs. The rental equivalence approach compares the rental values of homes. Home insurance is implicit in these values. Therefore, we do not survey any type of homeowner insurance, but we do survey renter insurance. In doing so, we include the price of any special riders necessary to cover hurricane or typhoon damage.

Education

Several commenters cited the necessity for placing children in private schools in Puerto Rico. The commenters noted language, quality, and danger issues with the public schools. One commenter said that the quality of Puerto Rico public schools is poor, while the DC area has some of the best public schools in the nation. Another commenter said employees in Puerto Rico who want to compete for employment opportunities in the mainland must place their children in costly English language private schools. Several commenters remarked on the high cost of private school tuition, school supplies, and various school fees in Puerto Rico. Other commenters said the Department of Defense school in San Juan is not available to many Federal employees, so they must pay for private schools. One commenter from the island of Hawaii said school choices and day care facilities there are limited, and the

only private school for high school students is in Waimea. Another commenter said private schools in Juneau are limited, increasing costs for those who must use out-of-state private schools.

OPM surveyed K–12 private education in the COLA and DC areas and computed an average tuition price that reflected all grade levels. Because not everyone sends children to private school, we made an additional special adjustment for K–12 education by applying “use factors.” These use factors reflect the relative extent to which Federal employees make use of private education in the COLA and DC areas. OPM described the process used for K–12 private education in the Caribbean region at 69 FR 6030, in Alaska at 69 FR 12007, and in the Pacific region at 70 FR 44995.

Two commenters said many Federal employees in Puerto Rico send their children to colleges in the continental United States. A commenter from Alaska said there were limited colleges and universities in Alaska, so many employees send their children to colleges in the lower 48 States and incur extra costs for non-resident tuition and transportation. Another commenter said tuition at the University of Puerto Rico will be increasing. Two commenters said Federal employees and their families are not eligible for student grants in Puerto Rico.

OPM does not measure the price of college and university education because where employees send their dependents to school is often a matter of personal preference. For example, many Federal employees in the Washington, DC, area send their children to colleges and universities outside the DC area. To the extent OPM leaves an item, such as college education, out of the COLA model, the effect is as if OPM included it in the model at the overall price index for the area. Therefore, if prices are generally higher in a COLA area relative to the DC area, the implicit assumption is that college and university prices are higher to the same extent. Any additional costs would be reflected in the adjustment points added pursuant to 5 CFR 591.227.

Geographic Coverage

One commenter said there should be separate COLA rates for the east (Kona) and west (Hilo) sides of the island of Hawaii because prices are not equal. OPM does not plan to split Hawaii County into separate areas at this time, but OPM may reconsider that decision after additional surveys have been completed using the methodology

adopted pursuant to the *Caraballo* settlement.

One commenter requested that OPM consider Eielson Air Force Base as part of the Rest of Alaska COLA area. The commenter noted that Eielson is 26 miles from Fairbanks and that it is dangerous to drive that distance for groceries, the hospital, or the airport during the winter months. The commenter suggested changing the distance parameter for Fairbanks to 20 miles. As stated in 5 CFR 591.206(b), the head of a department or agency must submit a request to OPM to initiate any reconsideration of the definition of a COLA area. We note that North Pole, AK, is only 8 miles from Eielson, and that North Pole is part of the Fairbanks survey area. OPM surveys a supermarket and other businesses in North Pole and includes these in the calculation of the Fairbanks living-cost index. We do not believe it would be appropriate to change the definition of the Fairbanks, AK, COLA area.

Another commenter said the cost of living in Girdwood, AK, which is 40 miles outside of Anchorage, is significantly higher than in Anchorage. The commenter asked that OPM consider the effect of the COLA reduction on employees living and working in outlying communities of Anchorage. As noted above, the head of a department or agency must submit a request to OPM to initiate any reconsideration of the definition of a COLA area.

One commenter noted that 5 U.S.C. 5941 states that COLAs are based on "living costs substantially higher than in the District of Columbia." The commenter said the area OPM uses for comparison includes areas in addition to the District of Columbia. The commenter referred also to Executive Order 10000, which uses the term "Washington, DC, area" but precedes it with the phrase "subject to applicable law." The commenter requests that OPM survey only the District of Columbia. The President directs OPM in Executive Order 10000 to designate nonforeign areas at locations in which living costs are substantially higher than in the *Washington, DC, area* and set COLA rates for such areas based on these higher living costs. OPM does not plan to limit the scope of the Washington, DC, area survey to the District of Columbia.

Survey Rates

An agency and one other commenter requested that OPM address the total anticipated COLA rate reductions projected by the area surveys. OPM conducts COLA surveys once every 3

years and will adjust COLA rates pursuant to 5 CFR 591.224, beginning with the publication of the results of the 2005 Caribbean survey. Therefore, we cannot predict what COLA rates will be in future years. However, with each survey notice OPM does publish final living-cost indexes that can easily be converted to hypothetical COLA rates (prior to the 1 percentage point limitation on COLA rate reductions) with the application of 5 CFR 591.228(a). This essentially involves converting the living-cost index to a percentage and rounding the result to the nearest whole percentage point. Table 1 includes the indexes that can be used for this purpose. However, it should be noted that future surveys and adjustments will likely produce different results.

Employee Involvement

Several commenters believe employees from their area were not involved in the COLA surveys. As noted above, OPM established and worked with local COLA Advisory Committees (CACs) in each survey area.

One commenter asked who represented Juneau on the CAC. The Juneau CAC was composed of representatives from the Juneau Federal Executive Association, the Juneau COLA Defense Committee, the National Federation of Federal Employees, the Indian Educators Federation-American Federation of Teachers, the National Weather Service Employees Organization, Professional Airways Systems Specialists, the Department of Agriculture, the Department of Commerce, the Department of the Interior, the Department of Transportation, and OPM.

The same commenter wanted to know more about Federal employee input into the COLA survey, units of measure, and formulas used in analyzing the data. Federal employees serve on both the SIC and the CAC. As explained in the *Background* section, the SIC worked closely with OPM as we developed new COLA regulations pursuant to the *Caraballo* settlement. The composition of the SIC is described in the *Caraballo* stipulation for settlement, which is available on OPM's Web site at <http://www.opm.gov/oca/cola/settlement>. The regulations we adopted describe the methodology and formulas used to analyze the survey data. These regulations can be found on OPM's Web site at <http://www.opm.gov/oca/cola/RegsRpts.asp>.

As also explained in this final rule OPM worked closely with the CACs to plan, conduct, and review the results of the COLA surveys. The CACs are

described in OPM regulations at 5 CFR 591.240 to 591.244. Additional information about the surveys and analyses used may be found in the survey reports, which are on OPM's Web site at <http://www.opm.gov/oca/cola/index.asp>.

Military COLA

Several commenters thought the reductions in the proposed regulation applied to the military COLA. These reductions apply only to the COLA rates paid to certain civilian white-collar Federal employees paid under the General Schedule and similar pay plans. Three commenters remarked on the discrepancy between the civilian and military COLAs. The Department of Defense sets the military COLA using a different methodology as authorized under separate law. The methodology for the civilian nonforeign area COLA derives from 5 U.S.C. 5941, Executive Order 10000, and the *Caraballo* settlement.

Military Post Privileges

One commenter said all Federal employees should be allowed to shop at military commissaries/exchanges. The Department of Defense operates commissaries and exchanges. OPM does not have authority to regulate commissary/exchange access.

Federal Wage System Employees

One employee felt Federal Wage System (FWS) employees should receive the nonforeign area COLA. The law that authorizes nonforeign area COLAs (5 U.S.C. 5941) allows payment of COLAs to employees whose rates of pay are set by statute. When the COLA law was enacted, FWS pay was set administratively according to local prevailing rates, rather than by statute. Currently, FWS rates of pay are not set by statute, and OPM cannot extend COLAs to FWS employees.

Communication of Changes

Three commenters thought OPM did not properly communicate the COLA reductions to Federal employees. The Administrative Procedure Act requires agencies to publish regulations in the **Federal Register** as a means of notifying the public of rule changes. In addition to publishing the proposed regulation in the **Federal Register**, OPM distributed the regulation to agencies with a notice to be posted on employee bulletin boards. OPM also summarized and linked to the regulations on its Web site at <http://www.opm.gov/fedregis/html/aug05.asp> and provided copies to COLA Advisory Committee members in each area. As noted above, OPM received

more than 2,000 responses from COLA area employees during the public comment period on the proposed regulations.

Correction

One commenter pointed out an error in the shelter index for Kauai in Appendix 7 of the 2004 Survey Report. This error was made in typesetting the survey notice. The “1” that precedes the PEG index belongs to the previous column, so that the PEG Weight should show “89.01” and the PEG Index should show “118.21.” Because it was a typesetting error, it does not affect OPM’s calculations for Kauai.

Executive Order 12866, Regulatory Review

This rule has been reviewed by the Office of Management and Budget in accordance with Executive Order 12866.

Regulatory Flexibility Act

I certify that this regulation will not have a significant economic impact on a substantial number of small entities because it will affect only Federal agencies and employees.

List of Subjects in 5 CFR Part 591

Government employees, Travel and transportation expenses, Wages.

Office of Personnel Management.

Linda M. Springer,

Director.

■ Accordingly, the Office of Personnel Management amends subpart B of 5 CFR part 591 as follows:

PART 591—ALLOWANCES AND DIFFERENTIALS

Subpart B—Cost-of-Living Allowance and Post Differential—Nonforeign Areas

■ 1. The authority citation for subpart B of 5 CFR part 591 continues to read as follows:

Authority: 5 U.S.C. 5941; E.O. 10000, 3 CFR, 1943–1948 Comp., p. 792; and E.O. 12510, 3 CFR, 1985 Comp., p. 338.

■ 2. Revise appendix A of subpart B to read as follows:

Appendix A to Subpart B of Part 591—Places and Rates at Which Allowances are Paid

This appendix lists the places approved for a cost-of-living allowance and shows the authorized allowance rate for each area. The allowance percentage rate shown is paid as a percentage of an employee’s rate of basic pay. The rates are subject to change based on the results of future surveys.

| Geographic coverage | Allowance Rate (percent) |
|--|--------------------------|
| State of Alaska: | |
| City of Anchorage and 80-kilometer (50-mile) radius by road | 24.0 |
| City of Fairbanks and 80-kilometer (50-mile) radius by road | 24.0 |
| City of Juneau and 80-kilometer (50-mile) radius by road | 24.0 |
| Rest of the State | 25.0 |
| State of Hawaii: | |
| City and County of Honolulu | 25.0 |
| Hawaii County, Hawaii | 17.0 |
| County of Kauai | 25.0 |
| County of Maui and County of Kalawao | 25.0 |
| Territory of Guam and Commonwealth of the Northern Mariana Islands | 25.0 |
| Commonwealth of Puerto Rico | 10.5 |
| U.S. Virgin Islands | 23.0 |

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