



# Federal Register

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**Thursday,  
April 14, 2005**

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**Part III**

## **Department of Housing and Urban Development**

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**24 CFR Part 990  
Revisions to the Public Housing  
Operating Fund Program; Proposed Rule**

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

[Docket No. FR-4874-P-07, HUD-2005-0005]

RIN 2577-AC51

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

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

**ACTION:** Proposed rule.

**SUMMARY:** This proposed rule would revise the regulations for the Public Housing Operating Fund Program (Operating Fund Program). Through the Operating Fund Program, HUD determines the allocation of operating subsidies to public housing agencies (PHAs). HUD developed the proposed 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 reflect the recommendations made by the negotiated rulemaking committee, with some modifications, on ways to 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.

**DATES:** *Comments Due Date:* June 13, 2005.

**ADDRESSES:** Interested persons are invited to submit comments regarding this rule to the Regulations Division, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-0500. Electronic comments may be submitted through either:

- The Federal Rulemaking Portal: at <http://www.regulations.gov>; or
- The HUD electronic Web site at: <http://www.epa.gov/feddoctet>. Follow the link entitled View Open HUD Dockets." Commenters should follow the instructions provided on that site to submit comments electronically.

Facsimile (FAX) comments are not acceptable. In all cases, communications must refer to the docket number and title. All comments and communications submitted will be available, without revision, for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above

address. Copies are also available for inspection and downloading at <http://www.epa.gov/feddoctet>.

**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 20024; 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 establishes an Operating Fund for the purpose of making assistance available to public housing agencies (PHAs) for the operation and management of public housing. Section 9 of the 1937 Act also requires 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 for an 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—Public Housing Authorities Directors Association (PHADA), Council of Large Public Housing Authorities (CLPHA) and National Association of Housing and Redevelopment Officials (NAHRO). The negotiated rulemaking committee concluded with a proposed rule, published 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 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 negotiated rulemaking to make changes to the Operating Fund formula. Specifically, section 222 of the administrative provisions for the HUD appropriations provides for HUD to conduct negotiated rulemaking with representatives from interested parties for purposes of any changes to the Operating Fund, and that a final rule be issued no later than July 1, 2004.

In response to this statutory language, HUD published a notice on January 28, 2004 (69 FR 4212), announcing its intent to establish an advisory committee to provide advice and recommendations on developing a rule for effectuating changes to the Operating Fund Program in response to the Harvard Cost Study. The January 28, 2004, notice solicited public comments on the proposed membership of the committee, and explained how persons could be nominated for membership. On March 10, 2004 (69 FR 11349), HUD

published a notice in the **Federal Register** announcing both the establishment of its negotiated rulemaking advisory committee on the Operating Fund (Committee) and the final list of Committee members.

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. All of the 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.

### III. Changes to Committee Recommendations

This proposed rule is based primarily on the recommendations made by the Committee on ways to improve the current Operating Fund regulations. HUD developed a draft proposed rule based on those 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. As a result of those review processes, certain Committee recommendations have been revised. These changes have been made to better reflect a comparison with subsidized market-based units and Administration policies and budgetary priorities. HUD believes that these changes to the recommendations advance the goals of the Committee to implement an improved and more accurate Operating Fund formula.

The overall proposed rule sets forth a formula that is comparable with subsidized market-based units; however, differences between public housing units and subsidized market-based units makes certain comparisons difficult. In acknowledgment of these difficulties, certain add-ons were included that went beyond the Harvard Cost Study recommendations and provide additional incentives in some cases (for example, the freezing of rental income for three years). With these changes, the proposed rule would provide PHAs more flexibility to augment the operating subsidy appropriations with additional revenue. In total, the Department believes the changes contained in the proposed rule and the flexibility provided is sufficient to provide for the operation and maintenance of public housing.

This section of the preamble describes those situations where the recommendations submitted by the Committee have been revised, and the rationale for the changes.

#### A. Public Entity Fee

The calculation of the Project Expense Level (PEL) would not include a \$2 per unit month (PUM) public entity fee. The Committee recommended that a public entity fee of \$2 PUM should be added to the initial PELs. After careful review of the proposal, it was determined that the expenses to be covered by the additional subsidy from this public entity fee were already adequately addressed through other means in the proposed rule.

#### B. Operating Subsidy for Vacant Units

Under the proposed rule, PHAs would receive subsidy for occupied dwelling units and dwelling units with an approved vacancy. The Committee recommended that PHAs also receive operating subsidy for a limited number of vacancies if the annualized rate is less than or equal to three percent. It is true that there are special circumstances that may preclude PHAs from attaining full occupancy and, therefore, HUD will continue to pay subsidy for dwelling units meeting these circumstances (*e.g.*, units undergoing modernization, special use units, etc). However, payment of subsidy for vacancies of up to three percent or for five units if the PHA has 100 or fewer units is contradictory to the goals of subsidized housing and asset management and comparability with subsidized market-based units. Accordingly, the proposed rule does not provide for such additional subsidy.

#### C. PEL Inflation Factor

The annual inflation factor used to adjust the PEL would continue to be the applicable local inflation factor used to adjust the Allowable Expense Level (AEL) used under the current Operating Fund Program regulations. The Committee recommended that the inflation factor should be based on information published by the Department of Labor Bureau of Labor Statistics (BLS). The Committee further recommended that the adjustment factor should reflect a weight of 40 percent for increases in cost of living as shown for such annual period by the BLS U.S. Cities Average All Items Consumer Price Index, and 60 percent for increases in wages, salaries and benefits for an annualized period as shown in the BLS Employment Cost Index. The Committee based its recommendation on the fact that the BLS data is readily available to the public. Upon further consideration,

the Department has concluded that the purpose of the inflation factor is better served by using the existing inflation factor. Retaining the current inflation factor will provide PHAs with continuity and an inflation factor that has adequately served to adjust the AEL for many years.

The current inflation factor has a 60 percent wage and 40 percent non-wage structure in keeping with the Committee's recommendation. Additionally, the current inflation factor better reflects wages because it uses Bureau of Labor Statistics wage data generated from county level government wages, which is then averaged to the metropolitan and non-metropolitan level for each state. For the 40 percent non-wage inflation factor, the current formula uses the Producer Price Index (PPI) instead of the Consumer Price Index (CPI). The PPI more accurately reflects the actual costs associated with the production of non-food and non-energy goods.

#### D. Nonprofit Ownership Coefficient

The PEL for a given property consists of the sum of nine variable coefficients added to a formula constant. The exponent of that sum is then multiplied by a percentage, to reflect the nonprofit ownership of the property. This proposed rule provides for a nonprofit coefficient of four percent. The Committee recommended that the nonprofit coefficient be ten percent. The Department believes that PHAs have strong characteristics of both profit and non-profit entities, and agrees with the Cost Study's inclusion of a coefficient. However, the ten percent differential between the costs associated with for-profit and non-profit entities also reflects inefficiencies that currently exist in the delivery of housing services that should not be supported in the formula. Accordingly, the coefficient has been reduced to account for these current inefficiencies.

#### E. Phase-In of Operating Subsidy Gains

For PHAs that would experience a gain in their operating subsidy, the proposed rule provides that the gain will be phased in over a four-year period. The Committee recommended that such increases be phased in over a two-year period. HUD recognizes that PHAs should receive the full benefit of increases to their operating subsidy allocation, but also believes that this period of time should be more closely aligned with the five-year phase in period for those PHAs that would have their subsidy decreased as a result of the proposed regulatory changes.

#### *F. Discontinuation of Subsidy Reduction Through Demonstration of Successful Conversion to Asset Management*

PHAs that experience a reduction in their operating subsidy will not be able to discontinue the reduction at the PHA's next subsidy calculation by demonstrating a successful conversion to asset management. The Committee recommended that HUD should discontinue subsidy reductions for a PHA that can demonstrate a successful conversion to asset management. It was concluded that the Cost Study methodology should be equally applied to all PHAs, and that providing for discontinuation of subsidy reductions would weaken implementation of the Cost Study. However, the proposed rule continues to phase in the reduction of subsidy over the five-year period and by the percentages recommended by the Committee. Further, in accordance with the Committee recommendations, the proposed rule allows PHAs to substitute independent cost data for use as a basis of subsidy funding through an appeals process.

#### *G. Adjustment Based on Committee Recommendations for Certain PHAs*

The proposed rule would provide an "add on" for certain PHAs that would experience a reduction in its operating subsidy between the formula in the current Operating Fund Program regulations and the formula contained in the proposed rule. Specifically, if such a PHA would instead experience an operating subsidy increase if the four factors listed below were applied to the formula in the proposed rule, the PHA will receive an add on to its subsidy allocation. The Department recognizes that many PHAs, especially those that would have experienced an operating subsidy reduction, may have already begun initial conversion steps to asset management. The Department believes that a reduction in subsidy from the current regulations for those PHAs that were expecting to receive an increase in subsidy jeopardizes their timely and successful conversion to asset management. The amount of the add-on would be equal to the difference between the PHA's operating subsidy calculated under the formula in the proposed rule and the amount of the PHA's operating subsidy under the proposed rule with the application of the four factors listed below. The amount of the increased funding would be determined using FY 2004 data and would be subject to the transition policies and requirements contained in the proposed rule. The four factors used for purposes of this calculation reflect

certain Committee recommendations that, as discussed above, were not adopted in the proposed rule. Specifically, the four factors would be: (1) A \$2 PUM public entity fee; (2) a ten percent nonprofit coefficient; (3) payment of operating subsidy on a limited number of vacancies if the annualized rate is less than or equal to three percent; and (4) an annual inflation factor based on the most recent annual data published by the BLS.

#### *H. Subsidy for Vacant Units*

PHAs that appeal to receive higher subsidy on vacant units due to changing market conditions would be required to submit, with their appeal, a plan to end the higher subsidy within two years. In addition, a PHA shall only be granted one such appeal and shall only receive the higher subsidy for a maximum period of two years. The Committee recommendations did not provide for the submission of a plan to end the higher subsidy, nor did the recommendations provide for a limit on the number of appeals or the term a PHA would be permitted receive this higher subsidy. HUD recognizes that when units are vacant due to changing market conditions, receipt of additional subsidy may be necessary. However, the Department believes that continuing to support vacant units is not sound fiscal policy and a two year period is a sufficient time in which to implement a plan to lease these vacant units.

#### *I. Sanctions for Failure To Convert to Asset-Based Management*

The proposed rule provides that HUD shall impose sanctions as deemed necessary, and otherwise provided by law, for those PHAs that are not in compliance with asset management by FY2011. These sanctions may include the imposition of a daily monetary fine until the PHA converts to asset management. The Committee sessions did not make a recommendation regarding sanctions for PHAs not in compliance with asset management. HUD believes that such a provision is necessary to help ensure enforcement of the asset management requirements contained in the proposed rule.

### **IV. This Proposed Rule**

The proposed rule reflects the recommendations made by the Committee, with some modifications, on ways to improve and clarify the current regulations governing the Operating Fund Program, and takes into consideration the recommendations contained in the Cost Study. The most significant features of the proposed rule are described below.

#### *A. Implementation of Cost Study*

The Committee used the Cost Study as the basis for developing the interim regulatory changes. For example, the proposed rule would implement the recommendation made by the Cost Study to replace the current factor known as the Allowable Expense Level (AEL) with a new Project Expense Level (PEL). The proposed rule also adopts the recommendation of the Cost Study to redirect the focus of the public housing program from an "agency-centric" to a "property-based" management model, as is the case generally with multifamily rental housing management.

However, the Committee recognized that asset management reflects a significant change in the direction and methods employed by many PHAs and by HUD, and will require a longer implementation period because there are many aspects to this change. Such changes will include the creation of new goals, a conversion to project-based accounting, the establishment of a different operational approach, and the implementation of additional organizational and regulatory changes beyond those included in this rule. The regulatory changes made by this rule are a significant initial step in the direction of asset management.

#### *B. Other Regulatory Goals*

In addition to implementing the recommendations of the Cost Study, the changes contained in this proposed rule improve and clarify the existing requirements for the Operating Fund Program. As more fully described below, the proposed rule: (1) Provides more explicit guidance on the expected outcomes contained in the operating subsidy formula; (2) streamlines and simplifies the operating subsidy calculation to determine appropriate subsidy amounts for each PHA by project and to distribute those correct amounts timely and accurately, to use effective administrative control of funds; to reduce reporting errors and facilitate more efficient and robust data collection; and (3) improves the operating subsidy estimation process by placing more emphasis on actual or historical data rather than on forecasted information.

1. *Streamlined calculation.* The proposed rule re-organizes part 990 to describe and simplify the operating subsidy calculation. The rule clearly defines the major components of the formula (such as the new Project Expense Level, Utilities Expense Level, Other Formula Expenses (Add-ons), and Formula Income) and notes the

relationships of these various components.

Consistent with the Committee's decision to streamline the operating subsidy calculation, the proposed rule would not codify certain secondary elements that will be used in the revised Operating Fund Formula. These elements include the coefficients used to adjust the variables for calculating the new PEL, the units of measurement and round-off conventions that will be used in the formula, and the determination of the geographic variable used in the PEL calculation. Regulatory codification of these formula elements would require the use of notice and comment rulemaking for future amendments and, thus, potentially delay HUD's ability to update the formula as new and more accurate data becomes available. After careful consideration, the Committee determined that these details should more appropriately be provided in non-codified guidance that may be more quickly revised, such as a Handbook, **Federal Register** notice, or other non-regulatory means. Following publication of the final rule for this proposed rule, HUD will issue guidance providing the information described above, as well as other guidance regarding the revised operating subsidy calculation.

In furtherance of this goal, the Committee also elected to streamline regulatory text concerning statutory and other cross-cutting federal requirements that apply to the Operating Fund Program (for example, the environmental review procedures of the National Environmental Policy Act of 1969 (42 U.S.C. 4321) and the implementing regulations at 24 CFR parts 50 and 58 currently referenced at § 990.111). This regulatory streamlining would not reflect any change in the timing and applicability of the requirements of part 58 as currently described in § 990.111(c), including the need to obtain approval of a request for release of funds, HUD environmental approval, or a responsible entity's determination of exemption before the funding of non-routine maintenance and capital expenditure activities may be incorporated into a PHA's initial operating budget and before the PHA may commit any funds to such activities. HUD will issue non-regulatory guidance providing further instructions on the applicability of these requirements.

**2. Increased focus on actual or historical data.** The typical budget cycle results in an 18-month lag between the time HUD formulates the Operating Fund budget request and the actual budget year. In the past, HUD has based its budget request to Congress on

forecasted information. The proposed rule seeks to provide more accurate reporting and improve HUD's ability to estimate budget requirements by relying more on historical data. For example, HUD will develop a PHA's formula income from a PHA's year-end financial information provided by the PHA through HUD's information systems.

**3. Funding period.** In this proposed rule, a PHA's fiscal year-end is no longer tied to the formula and funding process. Under this proposed rule, HUD will run the formula and obligate funds for all PHAs at the same time during the fiscal year. This is a change from prior practice where HUD based the funding on a limited number of actual current year subsidy calculations submissions and estimates of the remaining outstanding subsidy calculations. This change will result in a one-time transition of obligating funds based on a PHA's fiscal year-end to a calendar year. It is also HUD's intent to use the data, where available from its systems, to populate the formula and to eliminate duplicate data reporting.

#### *C. New Information Systems*

As noted in this preamble and the proposed regulatory text, the changes to the Operating Fund Formula will require that PHAs maintain and report data not required under the current operating subsidy calculation process. Further, HUD will be required to update its automated information systems to accommodate the new data collections required by the rule. HUD has begun the process of updating its systems, and will notify each PHA when HUD has the automated systems capacity to receive the information required by the rule.

#### **V. Overview of Revised Part 990**

The proposed rule re-organizes the regulations in 24 CFR part 990 for purposes of clarity and to reflect the recommendations of the Cost Study. The proposed rule establishes ten subparts (A through J) in part 990, with each subpart addressing a specific aspect of the Operating Fund. This section of the preamble summarizes the requirements of each subpart. Further guidance will be provided in a transition notice and through annual notices provided at the beginning of each funding cycle.

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

Subpart A contains the definitions applicable to the Operating Fund and also describes the Operating Fund Formula along with its applicability to various HUD programs. The proposed

rule revises the current regulations by removing the discussion of those provisions that pertain to the Virgin Islands, Puerto Rico, Guam, and Alaska PHAs. These PHAs had previously received operating subsidy funding outside of the Operating Fund formula but are now included within the formula.

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

Subpart B 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 the PHA will be calculated from July 1 to June 30 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 unit 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.

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

New subpart C describes how formula expenses will be calculated under the revised Operating Fund Formula. The rule provides a detailed description with respect to the computation of the PEL. The PEL replaces the existing AEL methodology pursuant to the recommendations contained in the Cost Study. As more fully detailed in the proposed regulatory text, the specific PEL for a given property consists of the sum of nine variable coefficients added to a formula constant. The exponent of that sum is then multiplied by a percentage, to reflect the nonprofit ownership of the property and an annual inflation factor is then applied to the resulting PEL. This nonprofit ownership adjustment is based on the conclusions contained in the Cost Study. The Cost Study found three basic property ownership types were available for benchmarking—nonprofit, for profit, and limited dividends. The Cost Study designated PHAs as nonprofit, upon concluding that this classification related closest to the ownership and operation of public housing properties.

This subpart also describes the Utilities Expense Level (UEL), including the computation of the current

consumption level and the rolling base consumption level. 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. In addition, this subpart describes add-ons to the subsidy calculation (e.g., funding of resident participation activities, information technology, asset repositioning, and asset management).

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

Subpart D describes the calculation of formula income, which will be derived from a PHA's year-end audited financial information contained in HUD's information systems. Formula income is an estimate of a PHA's non-operating subsidy revenue and is calculated by multiplying the per unit month (PUM) income amount by the eligible unit months (EUMs), as defined in the rule. The rule provides for different PHA fiscal year-ends within 2004. After a PHA's formula income is calculated, it will not be recalculated nor inflated for fiscal years 2006 through 2008, unless a PHA can show a severe local economic hardship affecting its ability to maintain some aspect of its formula income. No later than FY 2008, HUD will analyze the effects of freezing formula income and, based on that analysis, determine whether to extend the applicability of this provision for future fiscal years or to modify the income component of the formula. HUD will issue this policy determination through handbook, **Federal Register** notice, or other non-regulatory means, and offer the public an opportunity to comment before the policy determination takes effect.

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

Subpart E describes, among other things, the amount of operating subsidy for which a PHA is eligible, as well as the procedures HUD will follow to make operating subsidy payments to PHAs. Subpart E also addresses the fungibility of operating subsidy between projects. Specifically, the proposed rule provides that operating subsidy will remain fully fungible between Annual Contribution Contract (ACC) projects until operating subsidy is calculated by HUD at a project level. After subsidy is calculated at a project level, operating subsidy can only be transferred to another ACC project if a project's financial information reveals excess cash flow and only in the amount up to those excess cash flows. Under the rule, the PHA shall submit timely data to ensure accurate calculation under the formula.

Failure to do so may result in sanctions. Also, if HUD determines that a PHA is not in compliance with all of the income reexamination requirements, HUD shall withhold payments to which the PHA may be entitled.

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

Because of the elimination of AEL, the introduction of the PEL, and other formula differences, many PHAs will experience changes in the calculation of their operating subsidies. This subpart provides policies on such transitions.

For PHAs that will experience a reduction in their operating subsidy calculated under the current regulations, such reductions will occur over a five year period. In the first year of the effect of this rule, the decrease will be limited to 24 percent of the difference between the two funding levels. The decrease will be limited to 43 percent of the difference in the second year, 62 percent of the difference in the third year, and 81 percent of the difference in the fourth year. The full amount of the reduction in the operating subsidy shall be realized in the fifth year of the effect of this rule.

For PHAs that will experience a subsidy increase in their operating subsidy, such increases will occur over a four year period. In the first year of the effect of this rule, the increase will be limited to 20 percent of the difference between the two levels. The increase will be limited to 40 percent in the second year of effect of this rule, and 60 percent in the third year. The full increase in subsidy will be realized in the fourth year of the effect of this rule.

#### *Subpart G—Appeals*

Among other changes to the Operating Fund Formula, the revised formula procedures will involve new methods for determining formula expenses and require the asset-based management of PHA properties. Given the significant changes to the current Operating Fund Formula, the Committee determined that it would be appropriate to provide PHAs with the opportunity to appeal subsidy amounts under certain specified circumstances. These appeals procedures will assist PHAs to transition to the new methods for calculating operating subsidies, and help ensure that accurate data is used in the new formula calculations.

Subpart G describes the different types of appeals available to PHAs, and the requirements applicable for each appeal. HUD will provide up to a two percent hold-back of Operating Fund appropriations for FY2006 and FY2007 to fund appeals that are filed during

each of these two fiscal years. Hold-back funds not utilized will be added back to the formula within each of the affected fiscal years. Appeals are voluntary and must cover an entire portfolio, not single properties. However, the Assistant Secretary for Public and Indian Housing has the discretion to accept appeals of less than an entire portfolio for PHAs with greater than 5,000 units.

#### *Subpart H—Asset Management*

This rule states that PHAs shall manage their properties according to an asset management model, consistent with management norms in the broader multifamily management industry. PHAs shall also implement project-based management, project-based budgeting, and project-based accounting, defined in the rule, which are essential components of asset management. The rule provides that PHAs that own and operate 250 or more dwelling rental units are required to operate using an asset management model consistent with this subpart. PHAs that own and operate fewer than 250 dwelling rental units may treat their entire portfolio as a single project, but will not receive the add-on for the asset management fee. Similarly, PHAs with only one project will not be eligible for an asset management fee. The rule further provides that a PHA is considered in compliance with asset management requirements if it can demonstrate that it is managing substantially in accordance with this subpart H. This subpart also provides that HUD may impose sanctions for PHAs that are not in compliance with asset management by FY 2011.

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

This subpart describes how the operating subsidy will be calculated for RMCs including direct-funded RMCs, and lists several factors that will affect the calculation of the subsidy, including changes in inflation, utility rates and consumption, and changes in the number of units in the resident management project. The rule indicates other factors and exclusions and inclusions that will affect the amounts to be provided a project managed by an RMC. Subpart I also contains detailed provisions regarding the preparation of an RMC's operating budget and the retention of excess revenues.

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

Subpart J describes requirements regarding financial management

systems, as well as on the monitoring of PHA program and financial performance. These requirements are mostly unchanged from the current regulatory provisions.

## VI. Findings and Certifications

### *Information Collection Requirements*

The information collection requirements contained in this proposed rule have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) and assigned OMB Control Numbers 2577–0026, 2577–0029, 2577–0066, and 2577–0072. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number

### *Environmental Impact*

A Finding of No Significant Impact with respect to the environment for this rule has been made 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 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, Room 10276, 451 Seventh Street, SW., 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, who 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. Notwithstanding HUD’s determination that this rule will not have a significant effect on a substantial number of small entities, HUD specifically invites comments regarding any less burdensome alternatives to this rule that will meet HUD’s objectives as described in this preamble.

### *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 the 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. Any changes made to this proposed rule as a result of that review are identified in the docket file, which is available for public inspection between 8 a.m. and 5 p.m. weekdays in the Office of Legislation and Regulations, Office of the General Counsel, Room 10276, 451 Seventh Street, SW., Washington, DC 20410–0500.

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>. A summary of the findings contained in Economic Analysis follows.

*A. Rulemaking Goals and Focus of Economic Analysis.* As noted above, the proposed regulatory changes contained in this proposed rule reflect the recommendations made by the Committee on ways to improve and clarify the current regulations governing the Operating Fund Program, and take into consideration the recommendations of the Cost Study on the cost of operating well-run public housing. The proposed rule would make some modifications to the Committee recommendations to more accurately compare the costs of operating public housing and subsidized market-based units, as well as to better reflect Administration policies and budgetary priorities. More specifically, the rule attempts to achieve three objectives:

1. Provide more explicit guidance on the expected outcomes contained in the operating subsidy formula.

2. Streamline and simplify the operating subsidy calculation to: (i) Determine appropriate subsidy amounts for each PHA by project; (ii) distribute those amounts in a timely and accurate manner; (iii) use effective administrative control of funds; and (iv) reduce reporting errors and facilitate more efficient and robust data collection.

3. Improve the operating subsidy estimation process by placing more emphasis on actual or historical data rather than on forecasted information.

The Economic Analysis discusses the economic impact of the implementation of the proposed rule.

*B. Basis for Economically Significant Determination Under E.O. 12866.* HUD determined that the proposed rule would be an economically significant rule under E.O. 12866 because the rule would result in transfers of funding levels to and among PHAs of more than \$100 million a year.

*C. Findings.* This Economic Analysis finds that, with more efficient transfers through better incentives, there will be a net increase in societal benefits. The net increase was not quantified. The Economic Analysis also finds that the full implementation cost of the proposed rule is approximately \$74 million in 2003 dollars in increased operating subsidy eligibility. The transition funding provisions, which are intended to provide a transition period for PHAs with subsidy changes, would result in varying costs over a five year period when compared to the fully phased in subsidy change, which would occur in year 5 of rule implementation. The proposed rule would alter the flow



of transfers to PHAs, as such, would have a direct financial consequence on the federal budget and on individual PHAs and their tenants.

The Economic Analysis concludes that the two immediate consequences of the proposed rule would be as follows:

1. Using FY 2003 dollars and assuming funding at 100 percent of eligibility, public housing program funding eligibility for operating subsidies would increase by \$83 million over the 5-year period and by about \$74 million a year in 2003 dollars when fully implemented.

2. Changes in operating subsidy allocations resulting from the proposed rule would be phased in over four years for PHAs having subsidy eligibility increases and over five years for those with subsidy eligibility decreases; thus the increase in Operating Fund eligibility and the change in distribution of funds will be less during the transition than in the full implementation of the proposed rule in the fifth year.

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

This rule is a "major rule" as defined in Chapter 8 of 5 U.S.C. At the final rule stage, the rule will be 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 stated in the preamble, HUD proposes to amend 24 CFR part 990 as follows:

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

1. Revise 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.
- 990.155 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.
- 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 a 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 Fund payments previously, but are eligible for such payments 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 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 Operating Fund 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 Fund equal to its most recent actual audit cost.

(3) Operating Fund 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 contribution contract (ACC)* is a contract in the form 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 property management as well as long term and strategic planning.

*Current consumption level* is the amount of each utility consumed at a project during the one-year 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 the Operating Fund according to the Operating Fund Formula.

*Operating fund* is the account/program authorized by section 9 of the 1937 Act for making assistance available to PHAs for the operation and managements of public housing.

*Operating fund formula (Formula)* means the data and calculations used under this part to determine a PHA's amount of the 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 month (PUM)* is an expression of Project Expense Level, Utility Expense Level and formula income. It describes a cost or an amount on a monthly basis per unit.

*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 are 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 per unit per month 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 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 per unit month dollar amount.

*Utility rate (rate)* means the actual average rate for any given utility for the latest 12 months 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 one-year period ending June 30.

#### § 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 one-year 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; and

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

#### § 990.130 Ineligible units.

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

(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 eligible unit months will be calculated for the 12-month period from July 1 to June 30 that is prior to the first day of the applicable funding period, and will consist of eligible units as defined in § 990.140 and § 990.145.

(b)(1) The determination of whether a public housing unit satisfies the requirements of § 990.140 or § 990.145 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, 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 they 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 they are under 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 accounting 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).

#### § 990.155 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, PHA 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 eligible unit months' 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 eligible unit month 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 § 990.175(h) are not to be included in the calculation of eligible unit months. 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 unique to PHAs are titled other formula expenses (add-ons) and are expressed in a yearly 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 eligible unit months 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 five adjustments to the PEL. The adjustments are:

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

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

(3) Application of a four percent reduction for any PEL calculated over \$325, with the reduction limited to \$325; and

(4) The reduction of audit costs as reported for FFY 2003 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 nine variables' coefficients (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 out of model 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 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 (Public Law 104-134, approved April 26, 1996) shall receive an operating subsidy as provided in Attachment A of their MTW Agreements executed prior to the effective date of this rule. 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 [insert effective date of final rule], 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) or such other authority or protocol determined appropriate. 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 latest 12 months that ended June 30. 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 respective time periods.

(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(b), 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 twelve-month period ending June 30.

(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 one-year period ending June 30 that is six 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 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 one-year period ending June 30. 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:

Year 1 = July 1, 2001 through June 30, 2002

Year 2 = July 1, 2002 through July 30, 2003

Year 3 = July 1, 2003 through June 30, 2004

**Note:** 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. The 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. For a PHA to qualify for these incentives, the PHA must obtain HUD approval. Approval shall be based upon 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.

(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 fund 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, 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 during the term of the contract subject to the provisions of this paragraph (b)(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 is 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 only be extended 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 FY2011. The meeting shall be convened in accordance with the Federal Advisory Committee Act (5 U.S.C. Appendix) (FACA) or such other authority or protocol determined appropriate. 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 of the Operating Fund 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, 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 FY2011 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 eligible unit month 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.

*Example:* A PHA has HUD's approval to demolish (or dispose of) a 100-unit project from its 1,000 EUM inventory. On January 12, 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 1. (This date is calculated as follows: January 12 + six months = July 12. The first day of the next quarter is October 1.)

Although payment of the asset repositioning fee will not begin until October 1, the PHA will receive its full operating subsidy based on the 1,000 EUMs through September 30. On October 1 the PHA will begin its 3-year phase down of operating subsidy in accordance with paragraph (h) (3) of this section for the 100 units approved for *demolition*. (Phase down requirements for projects approved for *disposition* are found in paragraph (h)(4) of this section.) On October 1, the PHA's EUMs will be 900.

(i) *Adjustment for certain PHAs.* A PHA that will experience a reduction in its operating subsidy between calculations using the formula in effect prior to [insert effective date of final rule] and the formula in this part, but would experience an increase in its operating subsidy between calculations using the formula in effect prior to [insert effective date of final rule] and the formula in this part with application of the four factors listed in paragraphs (i)(1) through (i)(4) of this section, will receive an add on to its subsidy. The amount of the add-on will be equal to

the difference between the PHA's operating subsidy calculated under the formula in this part and the amount of the PHA's operating subsidy calculated by applying the four factors to the formula in this part. The amount of the add-on will be determined using FY 2004 data and will be subject to the transition policies and requirements contained in § 990.235 of subpart F of this part. The four factors that will be used for purposes of this calculation are:

(1) A \$2 PUM public entity fee;

(2) A ten percent nonprofit coefficient;

(3) Payment of operating subsidy on a limited number of vacancies if the annualized rate is less than or equal to three percent or for five units if the PHA has 100 or fewer units; and

(4) An annual inflation factor based on the most recent annual data published by the Department of Labor Bureau of Labor Statistics (BLS) for the lowest geographic area with statistically valid data at the time the annual inflation adjustment is calculated. The adjustment will reflect a weight of:

(i) 40 percent for increases in cost of living as shown for such annual period by the BLS U.S. Cities Average All Items Consumer Price Index; and

(ii) 60 percent for increases in wages, salaries and benefits for an annualized period as shown in the BLS Employment Cost Index, which annual adjustment shall reflect the most recently published annual data and the lowest geographic area with statistically valid data available from BLS at the time the annual inflation adjustment is calculated.

(j) *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, in 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.* 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: April 1, 2003 through

March 31, 2004, July 1, 2003 through June 30, 2004, October 1, 2003 through September 30, 2004, and January 1, 2004 through December 31, 2004. For the purpose of the Operating Fund Formula, formula income is equal to the amount of rent charged to tenants divided by the respective unit months leased, and is therefore expressed in terms of PUM.

(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 informational system errors that affect any of the data elements used in the calculation of the Formula.

(d) HUD shall impose sanctions as deemed necessary, and otherwise provided by law, for those PHAs that do not report accurate and timely data, as required under this section.

**§ 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. PHA requests 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 upon the amount of the PHA's previous year's formula or such other amount as 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 it is in compliance with the annual income reexamination requirements and that rents 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 twelve 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 [insert effective date of final rule]. The difference will be calculated using FY 2004 data. When actual data are not available for one of the formula components needed to calculate the Operating Fund formula of this rule for FY 2004, HUD will use alternate data as a substitute (e.g., unit months available for eligible unit months, phase-down funding for asset repositioning fee, 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 [insert effective date of final rule];

(2) 43 percent of the difference between the two funding levels in the second year following [insert effective date of final rule];

(3) 62 percent of the difference between the two levels in the third year following [insert effective date of final rule]; and

(4) 81 percent of the difference between the two levels in the fourth year following [insert effective date of final rule].

(b) The full amount of the reduction in the operating subsidy level shall be realized in the fifth year following [insert effective date of final rule].

(c) For example, a PHA has a subsidy reduction from \$1,000,000 under the formula in effect prior to [insert effective date of final rule] to \$900,000 under the formula used for operating subsidy under this part using FY 2004 data. The difference would be calculated at \$100,000 (\$1,000,000 - \$900,000 = \$100,000). In the first year, the subsidy reduction would be limited to \$24,000, (24 percent of the difference). Thus, in this example 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) The schedule for a PHA whose subsidy would be reduced is reflected in the table below.

Funding period	Reduction limited to
Year 1 .....	24 percent of the difference.
Year 2 .....	43 percent of the difference.
Year 3 .....	62 percent of the difference.
Year 4 .....	81 percent of the difference.
Year 5 .....	Full reduction reached.

**§ 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:

(1) 20 percent of the difference between the two funding levels in the first year following [insert effective date of final rule];

(2) 40 percent of the difference between the two funding levels in the second year following [insert effective date of final rule]; and

(3) 60 percent of the difference between the two funding levels in the third year following [insert effective date of final rule].

(b) The full amount of the increase in the operating subsidy level shall be realized in the fourth year following [insert effective date of final rule].

(c) For example, a PHA's subsidy increased from \$900,000 under the formula in effect prior to [insert effective date of final rule] to \$1,000,000 under the formula used to calculate operating subsidy under this part using FY 2004 data. The difference would be calculated at \$100,000 (\$1,000,000—\$900,000 = \$100,000). In the first year, the subsidy increase would be limited to \$20,000 (20 percent of the difference). Thus, in this example the PHA will receive the PEL-derived subsidy amount of this rule minus a transition funding amount of \$80,000 (the \$100,000 difference between the two subsidy amounts minus the \$20,000 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 .....	20 percent of the difference.
Year 2 .....	40 percent of the difference.
Year 3 .....	60 percent of the difference.
Year 4 .....	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 that is located in an area experiencing population loss or economic dislocations that faces a lack of demand for housing in the foreseeable future. A PHA's appeal must contain a plan to end the higher subsidy within two years. This exemption shall only be granted one time and for a maximum term of two years.

(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 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 his 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 will 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 otherwise consistent with the PHA's ACC responsibilities, as appropriate.

#### § 990.275 Project-based management.

Project-based management (PBM) is the provision of property-based management services that are 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 (i.e., 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 formula 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 shall also 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 only be charged 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) below, 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 or his 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.

(e) HUD may impose sanctions as deemed necessary, and otherwise provided by law, for those PHAs that are not in compliance with asset management by FY 2011. These sanctions may include the imposition of a daily monetary fine until the PHA converts to asset management.

#### **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 funds 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, and changes in the number of units in the resident management 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 each submit a separate operating budget to HUD for approval, including the calculation of operating subsidy eligibility in accordance with § 990.200 for the project managed by an RMC. 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 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 only be used 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 on 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.**

Required documentation:

(a) 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.

(b) 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.

(c) If HUD finds that an operating budget is incomplete, inaccurate, includes illegal or ineligible expenditures, mathematical errors, errors in the application of accounting procedures, or is otherwise unacceptable, HUD may, at any time, require the PHA to submit more 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 operating subsidy for a period of five fiscal years after the fiscal year in which the funds were received.

Dated: March 18, 2005.

**Michael Liu,**

*Assistant Secretary for Public and Indian Housing.*

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