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24 CFR Part 990

Allocation of Operating Subsidies Under the Operating Fund Formula; Proposed Rule

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 990

[Docket No. FR–4425–P–11]

RIN: 2577–AB88

Allocation of Operating Subsidies Under the Operating Fund Formula

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

ACTION: Proposed rule.

SUMMARY: This proposed rule is the first stage in HUD's rulemaking process to implement an interim Operating Fund Formula for determining the payment of operating subsidies to public housing agencies (PHAs). As required by statute, this proposed rule was developed through negotiated rulemaking procedures. The policies and procedures described in this proposed rule would govern the determination of funding distributions to PHAs under the Operating Fund until a final rule, reflecting the results of a congressionally requested public housing cost study, is developed and published. Pending the completion of the cost study and the issuance of superseding rules based on the study, HUD will proceed to consider the public comments received on this proposed rule and to issue, in the next stage of this rulemaking process, an interim rule based on this proposed rule and the public comments received on the proposed rule.

DATES: *Comments Due Date:* August 9, 2000.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Rules Docket Clerk, Room 10276, Office of General Counsel, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410. Comments should refer to the above docket number and title. A copy of each comment submitted will be available for public inspection and copying during regular business hours at the above address. Facsimile (FAX) comments are not acceptable.

FOR FURTHER INFORMATION CONTACT: Steve Sprague, Funding and Financial Management Division, Office of Public and Indian Housing, Room 4216, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410; telephone (202) 708–1872 (this telephone number is not toll-free). Hearing or speech-impaired individuals may access this number via TTY by calling the toll-free Federal Information Relay Service at 1–800–877–8339.

SUPPLEMENTARY INFORMATION:

I. Background

A. The Performance Funding System (PFS)

HUD currently uses a formula approach called the Performance Funding System (PFS) to distribute operating subsidies to public housing agencies (PHAs). HUD's regulations implementing the PFS can be found at 24 CFR part 990. Generally, the amount of operating subsidy received by a PHA is the difference between projected expenses and projected income, with the PFS regulations detailing how these projections will be made. PHAs calculate their PFS eligibility annually and submit a request for funding as part of their budget process. While the amount varies, this subsidy represents a substantial amount of revenue to a PHA. For example, in 1999, HUD distributed approximately $2.9 billion in operating subsidies to PHAs.

The United States Housing Act of 1937 (42 U.S.C. 1437 *et seq.*) (referred to as the ''1937 Act'') establishes the statutory framework for HUD's public housing programs. The 1937 Act limits eligibility to public housing to low income families, and caps public housing rents at 30 percent of a family's income. PHAs must therefore rely on the HUD operating subsidies (rather than rental income) to cover a significant amount of the costs associated with the operation of their public housing units.

B. Public Housing Reform

On October 21, 1998, the Congress enacted the Quality Housing and Work Responsibility Act of 1998 (Public Law 105–276, approved October 21, 1998) (referred to as the ''Public Housing Reform Act''). The Public Housing Reform Act makes sweeping changes to HUD's public and assisted housing programs. Among other changes, section 519 of the Public Housing Reform Act amended section 9 of the 1937 Act (42 U.S.C. 1437g). Amended section 9 establishes an Operating Fund for the purpose of making assistance available to PHAs for the operation and management of public housing. Section 9(f) of the 1937 Act, as amended by the Public Housing Reform Act, requires that the assistance to be made available from that fund be determined using a formula developed through negotiated rule-making procedures as set forth in subchapter III of chapter 5 of title 5, United States Code (5 U.S.C. 561 *et. seq.*), commonly referred to as the Negotiated Rulemaking Act of 1990.

II. Negotiated Rulemaking

A. The Convening Report

Negotiated rulemaking, or ''neg-reg,'' is a relatively new process for HUD. The basic concept of neg-reg is to have the agency that is considering drafting a rule bring together representatives of affected interests for face-to-face negotiations that are open to the public. The give-and-take of the negotiation process is expected to foster constructive, creative and acceptable solutions to difficult problems.

In anticipation of possible congressional action, HUD entered into an interagency agreement in June 1998 with the Federal Mediation and Conciliation Service (FMCS) for convening and facilitation services associated with a negotiated rulemaking regarding a possible operating fund proposed rule. FMCS submitted its Convening Report in November 1998. The report provided a list of individual PHAs and organizations, representing a wide range of interests, that were willing and able to work within a consensus framework on a new Operating Fund formula.

B. HUD's Negotiated Rulemaking Committee on Operating Fund Allocation

On February 3, 1999 (64 FR 5570), HUD published a notice announcing its intent to establish a negotiated rulemaking committee for the Operating Fund. This notice identified a list of possible interested individuals and organizations to serve on the negotiated rulemaking committee. The list of possible interested individuals and organizations included PHAs, national organizations representing PHAs, residents organizations, advocates for low-income housing, and other housing experts.

On March 16, 1999 (64 FR 12920), HUD published a notice announcing the establishment of its Negotiated Rulemaking Committee on Operating Fund Allocation (the ''Committee''). The notice also provided the list of Committee members and announced its first set of meetings. The members participating in the negotiated rulemaking procedure for the Operating Fund are:

- Large Housing Authorities
  1. Atlanta Housing Authority, Atlanta, GA
  2. Chicago Housing Authority, Chicago, IL
  3. New York City Housing Authority, NYC, NY

4. Pittsburgh Housing Authority, Pittsburgh, PA
5. Seattle Housing Authority, Seattle, WA

- Medium Housing Authorities
  1. Akron Metro Housing Authority, Akron, OH
  2. Athens Housing Authority, Athens, GA
  3. Indianapolis Housing Agency, Indianapolis, IN
  4. Oakland Housing Authority, Oakland, CA
  5. Reno Housing Authority, Reno, NV
- Small Housing Authorities
  1. Marble Falls Housing Authority, Marble Falls, TX
  2. Meade County Housing and Redevelopment Commission, Sturgis, SD
  3. York Housing Authority, York, NE
- Non-PFS Housing Authority
  1. Puerto Rico Public Housing Administration, San Juan, PR
- Resident Organizations
  1. Massachusetts Union of Public Housing Tenants, Dorchester MA
  2. New Jersey Association of Public and Subsidized Housing Residents, Inc., Newark, NJ
- Public Interest Groups
  1. National Low Income Housing Coalition, Washington, DC
  2. Housing and Development Law Institute, Washington, DC
  3. Center for Community Change, Washington, DC
  4. National Organization of African-Americans in Housing (NOAAH)
- National PHA Associations
  1. Public Housing Authorities Directors Association (PHADA)
  2. National Association of Housing and Redevelopment Officials (NAHRO)
  3. Council of Large Public Housing Authorities (CLPHA)
- Federal Government
  1. U.S. Department of Housing and Urban Development

Additionally, two FMCS representatives served as facilitators. The Committee first convened on March 23–24, 1999. Additional Committee meetings were held on April 13–14, May 13–14, June 15–16, July 7–8, September 14–15, November 30–December 2, 1999; February 16–17, 2000; and March 7–8, 2000. All Committee meetings were held in the Washington, DC metro area. The Committee meetings were announced in the **Federal Register**. Members of the public were invited to attend the meetings and to submit their views and recommendations.

III. This Proposed Rule

This proposed rule is the product of the Committee's successful negotiations, and reflects the consensus decisions reached over nearly a year's worth of deliberations. The proposed rule is the first stage in the rulemaking process that will establish an Operating Fund formula, to replace the current PFS regulations located in 24 CFR part 990. The rule thus represents a partnership among HUD, the PHAs, public housing residents, and advocates of public housing. The policies and procedures described in this proposed rule would govern the determination of funding distributions to PHAs under the Interim Operating Fund Formula until a final rule, reflecting the results of a Congressionally requested public housing cost study, is developed and published (see Section XIII. of this preamble for further information regarding the cost study).

It became apparent to the Committee during its deliberations that sufficient data were not available to either establish the true costs of operating public housing or to develop final modifications to the existing PFS regulations without an unacceptable degree of unpredictability. The Committee determined, therefore, to recommend that a comprehensive cost study be undertaken to provide data and recommendations necessary for finalizing an Operating Fund Formula. A consensus also became apparent that, pending the results of the housing cost study, there exist urgent needs and tangible benefits from implementing the proposed Interim Operating Fund Formula. Accordingly, the Interim Operating Fund Formula that would be established by this proposed rule is largely based on the policies and procedures that have heretofore governed the PFS. The Committee has decided to recommend several important modifications to the existing PFS regulations. These modifications would address, to the extent feasible under data presently available to the public, five specific proposals considered important by members of the Committee.

The proposed rule would: (1) Modify the method by which ''small PHAs'' are funded in order to assure an adequate minimum level funding, based on nationally averaged operating costs for multifamily housing projects insured by the Federal Housing Administration (FHA), adjusted for unit size differences and locational cost differences; (2) implement statutory changes permitting PHAs to retain certain rental and non-rental income without offset against operating subsidy; (3) retain the current method of estimating utility expenses, but would eliminate year-end adjustments, for the costs of utilities, reflecting the adjustments instead, in the PHA's operating subsidy calculation for the second PHA fiscal year following the year being adjusted, and in order to encourage energy efficiency, it would replace the current 50–50 split of savings or increase in cost due to changes in utilities consumption to a 75–25 split between PHAs and HUD, respectively; (4) require each PHA to include in its operating subsidy calculation, $25 per occupied unit per year for resident participation activities as an add on expense component for subsidy eligibility; and (5) include flood insurance costs in the computation of the Allowable Expense Level (AEL) by permitting a one-time permanent adjustment to reflect this cost. The proposed rule would also make several clarifying and technical changes to the PFS regulations and would remove several obsolete provisions.

The most significant amendments made by this proposed rule to the current part 990 regulations are described in the following sections of this preamble. For the convenience of readers, this proposed rule republishes the text of subpart A of the part 990 regulations in its entirety. Except for the changes identified in this preamble, no additional revisions would be made to 24 CFR part 990.

IV. FHA-Based AEL (FHAEL) Adjustment for Small PHAs (§ 990.105(e))

The proposed rule would modify how non-utility Allowable Expense Levels (AELs) are calculated. AELs were initially set in 1975 for most PHAs and have subsequently been updated only for inflation. In 1992, PHAs with AELs that fell significantly below a statistical regression-based formula were allowed to receive increases up to 85% of the formula value. Many of those familiar with public housing have argued that the original AEL determinations had the effect of freezing into place whatever funding inequities then existed, and that the 1992 revisions did little to correct this problem because the formula was based on an analysis of the existing distribution of AELs. The most common concerns relate to small PHAs.

The Committee sought a proxy measure of the adequacy of small PHA funding; one not based upon public housing operating expense data since such data fails to provide an objective measure as to whether small PHA funding is adequate, inadequate, or excessive. The most readily accessible proxy information comes from HUD's Real Estate Management data system. This data system contains detailed time-series financial statements and project characteristics for approximately 11,000 multifamily housing projects insured by the FHA and/or assisted by HUD, of which approximately 90% have some form of housing subsidies.

In reviewing applications for multifamily housing insurance, FHA requires that an applicant submit detailed budget estimates that demonstrate that the proposed project is financially feasible. Operating expense levels are normally required to be close to industry norms for similar projects in the area. This is done to reduce FHA's insurance risk—under-estimating operating expenses increases the risk that a project will go into default. Available data suggest that there is limited variability in normal operating expense levels for similar projects in similar locations.

The Committee adopted an approach that used a national FHA-based operating cost average (referred to as the ''FHAEL'') for a two-bedroom public housing unit based on line-item expenses for non-utility operating costs that excluded property taxes. This figure was then used to calculate a PHA-specific equivalent factor by adjusting for average unit size differences and for locational cost differences. The unit size differential was calculated using Fair Market Rent (FMR) cost relationships (*e.g.,* a one-bedroom costs 85% of a two-bedroom and a three-bedroom costs 125% of a two-bedroom). The location differential was based on the R.S. Means construction cost index, which effectively measures wage and material price differentials for a constant quality product. The R.S. Means and bedroom size adjustments had a high correlation with actual FHA operating expense differentials and a significant but lower unit-weighted correlation (83%) with PHA AELs.

The FHA operating cost data used in the comparisons of FHA and public housing operating costs consisted of all FHA multifamily insured or subsidized projects for which audited operating expense data for fiscal year (FY) 1996 were available. Data for 1996 were selected because they had been extensively tested and used for other purposes (*e.g.,* to develop operating cost standards and factors for FHA-managed properties). Comparisons with other years were made to eliminate projects which appeared to have atypical annual expenditures. A total of 8,651 projects were used for most analyses. Most of the projects for which all needed variables were available were assisted by some form of HUD subsidy.

In practice, it was found that the AEL/FHA cost ratio was 101% for the public housing program as a whole, but that many small PHAs had AELs significantly below estimated FHA-based operating cost averages. Conceptually, there is no reason to expect a PHA to be able to provide maintenance levels typical of private market projects with significantly less funding. Therefore, this proposed rule would establish a one-time adjustment to AELs for certain PHAs with less than 500 units.

AELs for small PHAs would be set at the higher of a small PHA's current AEL or 70% of the FHAEL, and the AEL would be increased to the higher of their current AEL or 85% of the FHAEL for PHAs under 250 units. The cost of these increases would be achieved by reducing the AELs of PHAs with more than 500 units. The proposed rule would provide an exception to this determination for small PHAs with AELs that are greater than 120% of the FHAEL, in which case the small PHAs will use an AEL equivalent to 120% of the FHAEL.

PHAs with more than 500 units and AELs in excess of 85% of their FHAEL will use 98.64% of the FY 2000 AEL (which represents a 1.36% reduction in the FY 2000 AEL value) for purposes of calculating their FY 2001 subsidy determinations. This reduction offsets the cost of establishing minimum AELs for PHAs with less than 250 units at 85% of the value of the FHAEL, and of establishing minimum AELs for PHAs with 250–499 units at 70% of their FHAEL values.

V. Treatment of Revenues (§§ 990.102, 990.109, 990.110, and 990.116)

A. Treatment of Non-Rental Income—Exclusion of Investment Income and Revised Definition of ''Other Income'' (§§ 990.102, 990.109 and 990.110)

As noted above, the amount of operating subsidy received by a PHA is generally calculated by determining the difference between projected expenses and projected income. Projected income is categorized as being either dwelling rental income, investment income, or ''other income.'' This proposed rule would revise the definition of other income (for purposes of calculating subsidy) to only include income from: (1) Rents billed for dwelling units rented for non-dwelling purposes; and (2) charges to residents for excess utility consumption of PHA supplied utilities.

Under the proposed definition, investment income would not be used to determine operating subsidy eligibility. Accordingly, the proposed rule would make a conforming amendment to § 990.109, which governs the calculation of projected operating income levels. Specifically, the proposed rule would remove paragraph (e)(1) of that section, which regards a PHA's estimate of investment income for purposes of the operating subsidy calculation. The proposed rule would also remove the provisions dealing with adjustments for investment income located at § 990.110(b). This regulatory change would codify HUD's revised policy regarding the treatment of non-rental income for FY 2000 and beyond, which was announced through an earlier issued Public and Indian Housing (PIH) Notice 2000–04 (HA), issued on February 3, 2000.

B. Computation of Projected Monthly Dwelling Rental Income (§ 990.109)

The proposed rule would amend § 990.109 to revise the method for calculating projected monthly dwelling rental income. Under the proposed rule, a PHA would determine its average monthly dwelling charge for the month that is six months before the start of its budget year (the ''current year average'') as well as the average monthly charge for the comparable month of its two previous years. An average would be computed for these three amounts (the ''three year average'') and compared with the current year average.

If the current year average is not higher than the three year average, rental income has not increased and the current year average will be used to calculate projected rental income.

If the current year average is higher than the three year average, the PHA shall be allowed to retain 50% of any increases in dwelling rental income, so long as the PHA uses the increased revenue for the provision of resident-related improvements and services as described in new § 990.116 (see Section V.C. of this preamble below). The retained income will not be recognized in the PHA's calculation under the Interim Operating Fund Formula. The projected dwelling rental income for PHAs with increased rental income will be based on the three year average plus 50% of the increase.

A change factor of 3% will then be applied. HUD intends to revise the 3% adjustment factor, for the duration of the interim rule, beginning in FY 2002, to more accurately reflect the inflationary pressure on the projection of monthly dwelling rental income. In determining such a factor for FY 2002, HUD will also take into consideration any negative impacts on incentives for PHAs to increase resident earned income, relevant and available indices of rental income inflation, historical trends in rental income changes, and the proportion and amount of increased income retained by PHAs using the rolling base method. There will be consultation with the appropriate stakeholders regarding the methodology for determining change factors to be used by HUD followed by publication of written notice and an opportunity for public comment.

The PHA must adjust the rent rolls used for purposes of these calculations to reflect any change from PHA-paid utilities to resident-paid utilities, or vice versa, between the rent roll date and the projected budget year.

C. Use of Increases in Dwelling Rental Income (§ 990.116)

The proposed rule would replace the current § 990.116 (which concerns three year incentive adjustments) with a new section concerning the eligible uses of increases in dwelling rental income, as calculated under § 990.109 (see Section V.B. of this preamble above). The uses of the retained income must be described in the PHA's Plan submissions under 24 CFR part 903. The uses for the retained income must be developed with front end resident participation and ongoing input, and shall be made part of the PHA Plan submission. The proposed rule provides several examples of eligible uses for the retained income, including, but not limited to:

1. Physical and management improvements that benefit residents;
2. Resident self-sufficiency services;
3. Maintenance operations;
4. Resident employment and training services;
5. Resident safety and security improvements and services; and
6. Optional earned income exclusions.

VI. Utility Adjustments (§§ 990.107 and 990.110)

After consideration of various options for the treatment of utilities, the Committee decided to retain the current methodology for estimating utility expenses (located in § 990.107). However, the proposed rule would make several changes to the regulations concerning utility adjustments (located in § 990.110).

First, the proposed rule would eliminate the so-called ''year-end adjustments.'' Under the current PFS regulations, a PHA must conduct a comparison of the differences between the actual costs and consumption of utilities during the immediate preceding year with the estimates used to determine the allowable utilities expense level for that year. The comparison of actual and estimated utility costs is to be reported to HUD within 45 days after the end of a PHA's fiscal year. Under the proposed rule, a PHA will continue to report its comparison of actual and estimated utility costs within 45 days after the end of the PHA's fiscal year. The adjustment would normally be made in the operating subsidy calculation for the second PHA fiscal year following the year being adjusted. These adjustments would be applicable to PHA fiscal years beginning on or after January 1, 1999.

In order to strengthen the regulatory incentives to conserve energy, the current ''50–50'' sharing of additional costs or savings resulting from changes in consumption levels would be revised to a ''75–25'' split. Under the proposed rule, if actual consumption levels are lower than estimated, PHAs would retain 75% of the savings resulting from decreased consumption. The remaining 25% of the savings would be deducted by HUD when determining future subsidy eligibility. Conversely, if actual consumption levels are higher than anticipated, HUD would allow 25% of the resulting cost. The remaining 75% of the increased consumption cost would be absorbed by the PHA.

The risks associated with utility rates increasing after the estimate of utility costs has been approved will continue to be absorbed by HUD. In return, savings in utility costs due to decreases in rates that occur after the estimate of utility costs has been approved will accrue to HUD.

By permitting PHAs to retain a greater share of the savings from decreased utilities consumption, the Committee expects to encourage energy conservation. PHAs are urged to implement policies and procedures that foster conservation and to reduce energy costs. The savings resulting from such cost reductions can more appropriately be used to improve existing living conditions in public housing. The Committee strongly recommends that energy conservation become a central component of each PHA's Annual and Five Year Plans.

VII. Resident Participation (§ 990.108(e))

In its development of the proposed rule, the Committee discussed at substantial length the importance of resident participation to the success of public housing, including the Interim Operating Fund formula. The Committee noted that the Public Housing Reform Act places value on resident participation by requiring, with certain exceptions, at least one resident on the PHA Board of Commissioners, resident involvement in the PHA Plan process (through Resident Advisory Boards) and additional involvement as reflected in HUD's resident participation regulations (24 CFR part 964). Accordingly, the proposed rule would require each PHA to include, in its operating subsidy eligibility calculation, $25 per occupied unit per year for resident participation activities. These activities include (but are not limited to) those described in 24 CFR part 964. For purposes of this section, a unit may be occupied by a public housing resident, a PHA employee, or a police officer.

The proposed rule would also authorize HUD to approve the use of vacant rental units for resident participation purposes and allow PHAs to receive subsidy support for those units. HUD will approve the use of vacant units for such purposes only if the PHA can demonstrate that safe and suitable space for the resident participation activities is not otherwise readily available. Only one site per public housing development, involving one or more contiguous units, may be used for resident participation activities. Further, the number of units must be the minimum necessary to support the resident participation activities. Any rental income generated as a result of the activity must be reported as income in the operating subsidy calculation.

HUD is also taking various steps to promote resident involvement in creating and maintaining a positive living environment. For example, HUD is developing a proposed rule that will revise the part 964 regulations in their entirety. HUD is committed to developing this proposed rule with the active participation of public housing residents. HUD will solicit resident input through the scheduling of public forums, solicitations for written comments, and/or other appropriate means. HUD's goal in undertaking this rulemaking is to develop a set of easy-to-understand regulations that reflect the meaningful contributions of public housing residents. Accordingly, the proposed rule will not only implement statutory amendments made by the Public Housing Reform Act, but will also streamline and reorganize 24 CFR part 964 to simplify and improve the clarity of HUD's resident participation requirements.

HUD is taking several other steps to increase resident participation in public housing. For example, HUD will conduct training for resident organizations and PHAs on the Public Housing Reform Act.

VIII. Flood Insurance Adjustment to AEL (§ 990.105(f))

To simplify the calculation of operating subsidy, this proposed rule would include flood insurance costs in the AEL computation. Specifically, the proposed rule would require that the AEL be adjusted by adding the flood insurance charge per unit month, as reflected in the last HUD approved subsidy calculation for FY 2000. This adjustment would be a one-time permanent adjustment made only in FY 2001. However, if the flood map is changed at a future date, HUD will adjust the AEL for the affected PHAs to reflect the revised flood insurance charges.

IX. Removal of Obsolete Provisions and Other Streamlining Changes

In addition to the changes discussed above, this proposed rule would make several clarifying and technical changes to part 990. For example, the proposed rule would replace all outdated reference to the PFS with references to the Interim Operating Fund Formula. The proposed rule would also remove several obsolete provisions, which continue to be unnecessarily codified. HUD has also taken this opportunity to re-format or clarify certain other provisions. These proposed changes are not substantive, and do not alter or modify existing requirements. Rather, these changes are designed to make the part 990 regulations easier to comprehend.

X. Treatment of Utility and Waste Management Savings

Amended section 9 of the 1937 Act requires that ''the treatment of utility and waste management costs under the [Operating Fund] formula shall provide that a public housing agency shall receive the full financial benefit from any reduction in the cost of utilities or waste management resulting from any contract with a third party to undertake energy conservation improvements in one or more of its public housing projects'' (42 U.S.C. 1437g(e)(2)(C)).

The proposed rule would address this statutory requirement by retaining the current PFS provisions at § 990.107(f), which describes PHA incentives for non-HUD financed energy conservation improvements. Under this provision, a PHA, whose energy conservation measures have been approved by HUD as satisfying certain regulatory requirements, may retain 100% of the savings from decreased energy consumption after payment of the amount due the contractor until the term of the financing agreement is completed.

With regard to waste management, these costs are treated as a maintenance expense (not a utilities expense) under the PFS and this proposed rule. The Allowable Expense Level (AEL) covers non-utility costs and is not adjusted when costs are reduced. Should a PHA be able to reduce its waste management costs below the amount assumed in its AEL, the PHA would retain all of the savings. This is true under the existing PFS, and would continue to apply under this proposed rule.

XI. Moving To Work PHAs

Moving To Work (MTW) PHAs will continue to be funded under the provisions of their existing MTW agreements. These agreements may be renegotiated in view of the new Interim Operating Fund Formula, as requested by MTW PHAs and as agreed to by HUD. If MTW PHAs choose to be included under the new Interim Operating Fund Formula, then both the redistribution and funding benefits will apply. (See § 990.104(d) of this proposed rule.)

XII. Applicability of the Interim Operating Fund Formula to Non-PFS PHAs

This proposed rule would revise § 990.103 (which concerns the applicability of the Interim Operating Fund Formula) to provide that the amendments described in sections IV. through X. of this preamble would be applicable to housing owned by the PHAs of the Virgin Islands, Puerto Rico, Guam and Alaska (the ''non-PFS PHAs''). Otherwise, the Interim Operating Fund Formula would not be applicable to these PHAs. Operating subsidy payments to these PHAs would continue to be made in accordance with subpart B of 24 CFR part 990. The non-PFS PHAs would not be subject to the AEL reductions necessary to offset the cost of establishing minimum AELs for small PHAs (see Section IV. of this preamble).

XIII. The Operating Fund Cost Study

The Conference Report to the FY 2000 HUD Appropriations Act (Public Law 106–74, approved October 20, 1999) states, in part, that ''. . . before a proposed rule is published in the **Federal Register**, the conferees direct HUD to contract with the Harvard University Graduate School of Design (''Harvard'') to conduct a study of the cost incurred in operating well-run public housing and provide the results to the negotiated rulemaking committee and the appropriate congressional committees. . . .'' (Congressional Record of October 13, 1999, H10007).

HUD has contracted for the study. HUD has also directed Harvard, as the cost-study contractor, to provide public opportunities (such as periodic forums, status reports, and other means) for interested persons and organizations to be informed of the study's research design, methodologies, and progress, and to provide input and feedback for consideration in the development of the study. Harvard, as the contractor for the cost study, will consult with interested individuals and organizations in developing the cost study findings and recommendations.

During the period that the cost study is underway, HUD will proceed to consider the public comments received on this proposed rule and to issue an interim rule based on this proposed rule and the public comments received on the proposed rule. As part of the rulemaking process, HUD will submit the rule to the Office of Management and Budget (OMB) for review and clearance (as required under Executive Order 12866), and to HUD's Congressional committees for 15-day pre-publication review (as required under section 7(o) of the Department of Housing and Urban Development Act (42 U.S.C. 3531 *et seq.*)).

XIV. Development of Final Rule

Following and based upon the findings and recommendations of the completed cost study and the Public Housing Reform Act, HUD will develop the additional rulemaking to finalize the Operating Fund Formula, using the procedures of the Negotiated Rulemaking Act of 1990, subject to compliance with applicable legal requirements prerequisite to the establishment of a negotiated rulemaking committee for such purposes and to the appropriate approvals of any proposed or final rule as referenced in Section XII of this preamble above.

XV. Justification for Reduced Public Comment Period

It is the general practice of the Department to provide a 60-day public comment period on all proposed rules. The Department, however, is reducing its usual 60-day public comment period to 30 days for this proposed rule. In an effort to have an interim Operating Fund Formula in place as close to beginning of FY 2001, and given that the formula was developed through the negotiated rulemaking process, in which representatives of all affected parties participated, the Department believes that a 30-day public comment period is justified under these circumstances.

XVI. Findings and Certifications

Information Collection Requirements

The information collection requirements contained in 24 CFR part 990 have been approved by the Office of Management (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). While this proposed rule would make several modifications to the existing regulatory requirements (described above), the rule would not increase the total reporting and recordkeeping burden related to the payment of operating subsidies to PHAs. The information collection requirements contained in §§ 990.104, 990.105, 990.107, 990.108, 990.110, 990.111, and 990.117 of this proposed rule correspond to information collections contained in HUD's current part 990 regulations. These information collection requirements have been assigned OMB control numbers 2577–0029 (expiration date May 31, 2001), 2577–0026 (expiration date June 30, 2001), and 2577–0066 (expiration date September 30, 2002). In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

Environmental Impact

A Finding of No Significant Impact with respect to the environment 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. 4223). The Finding of No Significant Impact is available for public inspection between the hours of 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC.

Regulatory Planning and Review

The Office of Management and Budget has reviewed this proposed rule under Executive Order 12866 (captioned "Regulatory Planning and Review") and determined that this rule is a "significant regulatory action" as defined in section 3(f) of the Order. Any changes made to this rule as a result of that review are identified in the docket file, which is available for public inspection during regular business hours (7:30 a.m. to 5:30 p.m.) at the Office of the General Counsel, Rules Docket Clerk, Room 10276, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410.

Regulatory Flexibility Act

The Secretary has reviewed this proposed rule before publication and by approving it certifies, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), that this proposed rule would not have a significant economic impact on a substantial number of small entities. The proposed rule would implement a new system for formula allocation of funds to PHAs for their operating needs. The new system is established to provide minimum impact on all PHAs, small and large. Accordingly, the formula will not have a significant economic impact on any PHA. Notwithstanding HUD's determination that this proposed rule would not have a significant economic impact on small entities, HUD specifically invites comments regarding alternatives to this proposed rule that would meet HUD's objectives as described in this preamble.

Federalism Impact

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 proposed rule would not have federalism implications and would not impose substantial direct compliance costs on State and local governments or 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) requires Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and on the private sector. This proposed rule does not impose, within the meaning of the UMRA, any Federal mandates on any State, local, or tribal governments or on the private sector.

Catalog of Federal Domestic Assistance

The Catalog of Federal Domestic Assistance Number for this program is 14.850.

List of Subjects in 24 CFR Part 990

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

For the reasons discussed in the preamble, HUD proposes to amend 24 CFR part 990 as follows:

PART 990—THE PUBLIC HOUSING OPERATING FUND PROGRAM

1. Revise the heading of part 990 to read as set forth above.

2. The authority citation for part 990 is revised to read as follows:

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

3. Subpart A is revised to read as follows:

Subpart A—The Operating Fund Formula

§ 990.101 Purpose.

This subpart implements section 9(f) of the United States Housing Act of 1937 (42 U.S.C. 1437g) (referred to as "the 1937 Act"). 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. The assistance made available from the Operating Fund is determined using a formula developed through negotiated rulemaking procedures. This subpart describes the policies and procedures for operating subsidy calculations under the Operating Fund Formula.

§ 990.102 Definitions.

Allowable Expense Level (AEL). The per unit per month dollar amount of expenses (excluding Utilities and expenses allowed under § 990.108) computed in accordance with § 990.105, which is used to compute the amount of operating subsidy.

Allowable Utilities Consumption Level (AUCL). The amount of utilities expected to be consumed per unit per month by the PHA during the Requested Budget Year, which is equal to the average amount consumed per unit per month during the Rolling Base Period.

Base Year. The PHA's fiscal year immediately preceding its first fiscal year of receipt of operating subsidy under this part (either under the Operating Fund Formula or its predecessor, the Performance Funding System (PFS)).

Base Year Expense Level. The expense level (excluding utilities, audits and certain other items) for the Base Year, computed as provided in § 990.105.

Current Budget Year. The fiscal year in which the PHA is currently operating.

Dwelling rent. The amount charged monthly for a dwelling unit occupied by a resident or family eligible for public housing as determined in § 960.253 of this title. For purposes of determining subsidy eligibility, the dwelling rent will not reflect decreases resulting from the PHA's implementation of any optional earned income exclusions.

Formula. The revised formula derived from the actual expenses of the sample group of PHAs receiving assistance under the Operating Fund Formula, which is used to determine the Formula Expense Level and the Range of each PHA (see § 990.105(c)).

FHA-based operating expense level (FHAEL). The per unit per month dollar amount of expenses (excluding utilities and expenses allowed under § 990.108) computed in accordance with § 990.105(e), which is used on a one-time basis to adjust the AEL for selected PHAs.

Formula Expense Level. The per unit per month dollar amount of expenses (excluding utilities and audits) computed under the Formula, in accordance with § 990.105.

HUD Field Office. The HUD Field Office that has been delegated authority under the U.S. Housing Act of 1937 to perform functions pertaining to this subpart for the area in which the PHA is located.

Local Inflation Factor. The HUD-supplied weighted average percentage increase in local government wages and salaries for the area in which the PHA is located and non-wage expenses.

Long-term vacancy. This term means the same as it is used in the definition of "Unit Months Available" in this section.

Nondwelling rent. The amount charged monthly, including utility and equipment charges, to a lessee for a dwelling unit that is being used for nondwelling purposes. For purposes of determining operating subsidy:

(1) If the nondwelling unit has been approved for subsidy (e.g., the unit is being used for economic self-sufficiency services or anti-drug activities) at the rate of the PHA's AEL, the PHA will include all charges as nondwelling rent;

(2) If the nondwelling unit has not been approved for subsidy, a PHA will include as nondwelling rent only that portion of the charge that exceeds the rate of the PHA's AEL.

Operating budget. The PHA's operating budget and all related documents, as required by HUD, approved by the PHA Board of Commissioners.

Other income. Income from rent billed to lessees of dwelling units rented for nondwelling purposes, and from charges to residents for excess utility consumption for PHA supplied utilities.

Project. Each project under an Annual Contributions Contract to which the Operating Fund Formula is applicable, as provided in § 990.103.

Project Units. All dwelling units of a PHA's Projects.

Projected Operating Income Level. The per unit per month dollar amount of dwelling rental income plus other income, computed as provided in § 990.109.

Requested Budget Year. The budget year (fiscal year) of a PHA following the Current Budget Year.

Rolling Base Period. The 36-month period that ends 12 months before the beginning of the PHA Requested Budget Year, which is used to determine the Allowable Utilities Consumption Level used to compute the Utilities Expense Level.

Top of Range. Formula Expense Level multiplied by 1.15.

Transition funding. Funding for excessively high-cost PHAs, as provided in § 990.106.

Unit Approved for Deprogramming. (1) A dwelling unit for which HUD has approved the PHA's formal request to remove the dwelling unit from the PHA's inventory and the Annual Contributions Contract but for which removal, i.e., deprogramming, has not yet been completed; or

(2) A nondwelling structure or a dwelling unit used for nondwelling purposes which the PHA has determined will no longer be used for PHA purposes and which HUD has approved for removal from the PHA's inventory and Annual Contributions Contract.

Unit months available. Project Units multiplied by the number of months the Project Units are available for occupancy during a given PHA fiscal year. For purposes of this part, a unit is considered available for occupancy from the date established as the End of the Initial Operating Period for the Project until the time the unit is approved by HUD for deprogramming and is vacated or is approved for nondwelling use. In the case of a PHA development involving the acquisition of scattered site housing, see also § 990.104(b). A unit will be considered a long-term vacancy and will not be considered available for occupancy in any given PHA Requested Budget Year if the PHA determines that:

(1) The unit has been vacant for more than 12 months at the time the PHA determines its Actual Occupancy Percentage;

(2) The unit is not either:

(i) A vacant unit undergoing modernization; or

(ii) A unit vacant for circumstances and actions beyond the PHA's control, as these terms are defined in this section; and

(3) The PHA determines that it will have a vacancy percentage of more than 3% and will have more than five vacant units, for its Requested Budget Year, even after adjusting for vacant units undergoing modernization and units that are vacant for circumstances and actions beyond the PHA's control, as defined in this section. (Reference in this part to "more than five units" or "fewer than five units" shall refer to a circumstance in which five units equals or exceeds 3% of the number of units to which the 3% threshold is applicable.)

Units vacant due to circumstances and actions beyond the PHA's control. Dwelling units that are vacant due to circumstances and actions that prohibit the PHA from occupying, selling, demolishing, rehabilitating, reconstructing, consolidating or modernizing vacant units and are beyond the PHA's control. For purposes of this definition, circumstances and actions beyond the PHA's control are limited to:

(1) Litigation. The effect of court litigation such as a court order or settlement agreement that is legally enforceable. An example would be units that are being held vacant as part of a court-ordered or HUD-approved desegregation plan.

(2) Laws. Federal or State laws of general applicability, or their implementing regulations. Units vacant

only because they do not meet minimum standards pertaining to construction or habitability under Federal, State, or local laws or regulations will not be considered vacant due to circumstances and actions beyond the PHA's control.

(3) Changing market conditions. For example, small PHAs that are located in areas experiencing population loss or economic dislocations may face a lack of demand in the foreseeable future, even after the PHA has taken aggressive marketing and outreach measures.

(4) Natural disasters.

(5) RMC Funding. The failure of a PHA to fund an otherwise approvable RMC request for Federal modernization funding.

(6) Casualty Losses. Delays in repairing damage to vacant units due to the time needed for settlement of insurance claims.

Utilities. Electricity, gas, heating fuel, water and sewerage service.

Utilities expense level. The per unit per month dollar amount of utilities expense, computed as provided in § 990.107.

Vacant unit undergoing modernization. A vacant unit in a project not considered to be obsolete (as determined using the indicia in § 970.6 of this chapter), when the project is undergoing modernization that includes work that is necessary to reoccupy the vacant unit, and in which one of the following conditions is met:

(1) The unit is under construction (.e., the construction contract has been awarded or force account work has started); or

(2) The treatment of the vacant unit is included in a HUD-approved modernization budget (or its successor under the public housing Capital Fund program), but the time period for placing the vacant unit under construction has not yet expired. The PHA must place the vacant unit under construction within two Federal Fiscal Years (FFYs) after the FFY in which the modernization funds are approved.

§ 990.103 Applicability of the Operating Fund Formula.

(a) *General.* The Operating Fund Formula will be used in determining the amounts of operating subsidy payable to PHAs.

(b) *Applicability of the Operating Fund Formula.* The Operating Fund Formula is applicable to all PHA rental units under Annual Contributions Contracts. The Operating Fund Formula applies to PHAs that have not received operating subsidy payments previously, but are eligible for such payments under the Operating Fund Formula.

(c) *Inapplicability of the Operating Fund Formula.* The Operating Fund Formula, as described in this part, is not applicable to Indian Housing, the Section 23 Leased Housing Program, the Section 23 Housing Assistance Payments Program, the Section 8 Housing Assistance Payments Program, the Mutual Help Program, or the Turnkey III or Turnkey IV Homeownership Opportunity Programs.

(d) *Applicability of the Operating Fund Formula to the PHAs of the Virgin Islands, Puerto Rico, Guam, and Alaska.* (1) The following provisions of this subpart A are applicable to housing owned by the PHAs of the Virgin Islands, Puerto Rico, Guam, and Alaska:

(i) The definition of ''other income'' at § 990.102;

(ii) Section 990.105 (Computation of allowable expense level). However, § 990.105(e) (Computation of FHA-based operating expense level for application in FY 2001) does not apply to these PHAs;

(iii) Section 990.105(f) (Flood insurance adjustment for FY 2001);

(iv) Section 990.108(e) (Funding for resident participation activities);

(v) Section 990.109(b) (Computation of projected average monthly dwelling rental income);

(vi) Section 990.110(b) (Adjustments to utilities expense level); and

(vii) Section 990.116 (Increases in dwelling rental income).

(2) With the exception of the provisions listed in paragraph (d)(1) of this section, the Operating Fund Formula is not applicable to the PHAs of the Virgin Islands, Puerto Rico, Guam and Alaska. Operating subsidy payments to these PHAs are made in accordance with subpart B of this part.

(e) *Financial management, monitoring and reporting.* The financial management system, monitoring and reporting on program performance and financial reporting will be in compliance with 24 CFR 85.20, 85.40 and 85.41 except to the extent that HUD requirements provide for additional specialized procedures which are determined by HUD to be necessary for the proper management of the program in accordance with the requirements of the U.S. Housing Act of 1937 and the Annual Contributions Contracts between the PHAs and HUD.

§ 990.104 Determination of amount of operating subsidy under the Operating Fund Formula.

(a) The amount of operating subsidy for which each PHA is eligible shall be determined as follows: The Projected Operating Income Level is subtracted from the total expense level (Allowable Expense Level plus Utilities Expense Level). These amounts are per unit per month dollar amounts, and must be multiplied by the Unit Months Available. Transition Funding, if applicable, and other costs as specified in § 990.108 are then added to this total in order to determine the total amount of operating subsidy for the Requested Budget Year, exclusive of consideration of the cost of an independent audit. As an independent operating subsidy eligibility factor, a PHA may receive operating subsidy in an amount, approved by HUD, equal to the actual cost of an independent audit to be prorated to operations of the PHA-owned rental housing. See § 990.110 regarding adjustments.

(b) In the case of a PHA development involving the acquisition of scattered site housing, the PHA may submit, and HUD shall review and approve, a revised Development Cost Budget (or its successor under the public housing Capital Fund program) reflecting the number of units that were occupied during the previous six months, and the Unit Months Available used in the calculation of operating subsidy eligibility shall be revised to include the number of months the new/acquired units are actually occupied.

(c) A special phase-down of subsidy to PHAs is applicable when demolition of units is approved by HUD. See § 990.114.

(d) The calculation of operating subsidy for a PHA in the Moving to Work demonstration program shall be made in accordance with the applicable Moving to Work Agreement, and any amendments to such agreements, as may be approved by HUD.

§ 990.105 Computation of allowable expense level.

The PHA shall compute its Allowable Expense Level using forms prescribed by HUD, as follows:

(a) *Computation of Base Year Expense Level.* The Base Year Expense Level includes Payments in Lieu of Taxes (PILOT) required by a Cooperation Agreement even if PILOT is not included in the Operating Budget for the Base Year because of a waiver of the requirements by the local taxing jurisdiction(s). The Base Year Expense Level includes all other operating expenditures as reflected in the PHA's Operating Budget for the Base Year except the following:

(1) Utilities expense;

(2) Cost of an independent audit;

(3) Adjustments applicable to budget years before the Base Year;

(4) Expenditures supported by supplemental subsidy payments

applicable to budget years before the Base Year;

(5) All other expenditures which are not normal fiscal year expenditures as to amount or as to the purpose for which expended; and

(6) Expenditures which were funded from a nonrecurring source of income.

(b) *Adjustment.* In compliance with the above six exclusions, the PHA shall adjust the AEL by excluding any of these items from the Base Year Expense Level if this has not already been accomplished. If such adjustment is made in the second or some subsequent fiscal year of receipt of operating subsidy under this part, the AEL shall be adjusted in the year in which the adjustment is made, but the adjustment shall not be applied retroactively. If the PHA does not make these adjustments, the HUD Field Office shall compute the adjustments.

(c) *Computation of Formula Expense Level.* The PHA shall compute its Formula Expense Level in accordance with a HUD-prescribed formula that estimates the cost of operating an average unit in a particular PHA's inventory. It uses weights and a Local Inflation Factor assigned each year to derive a Formula Expense Level for the current year and the requested budget year. The formula is the sum of the following six numbers and the weights of the formula and the formula are subject to updating by HUD:

(1) The number of pre-1940 rental units occupied by poor households in 1980 as a percentage of the 1980 population of the community multiplied by a weight of 7.954. This census-based statistic applies to the county of the PHA, except that, if the PHA has 80% or more of its units in an incorporated city of more than 10,000 persons, it uses city-specific data. County data will exclude data for any incorporated cities of more than 10,000 persons within its boundaries.

(2) The Local Government Wage Rate multiplied by a weight of 116.496. The wage rate used is a figure determined by the Bureau of Labor Statistics. It is a county-based statistic, calibrated to a unit-weighted PHA standard of 1.0. For multi-county PHAs, the local government wage is unit-weighted. For this formula, the local government wage index for a specific county cannot be less than 85% or more than 115% of the average local government wage for counties of comparable population and metro/non-metro status, on a state-by-state basis. In addition, for counties of more than 150,000 population in 1980, the local government wage cannot be less than 85% or more than 115% of the wage index of private employment determined by the Bureau of Labor Statistics and the rehabilitation cost index of labor and materials determined by the R.S. Means Construction Cost Index.

(3) The lesser of the current number of the PHA's two or more bedroom units available for occupancy, or 15,000 units, multiplied by a weight of .002896.

(4) The current ratio of the number of the PHA's two or more bedroom units available for occupancy in high-rise family projects to the number of all the PHA's units available for occupancy multiplied by a weight of 37.294. For this indicator, a high-rise family project is defined as averaging 1.5 or more bedrooms per unit available for occupancy and averaging 35 or more units available for occupancy per building and containing at least one building with units available for occupancy that is 5 or more stories high.

(5) The current ratio of the number of the PHA's three or more bedroom units available for occupancy to the number of all the PHA's units available for occupancy multiplied by a weight of 22.303.

(6) An equation calibration constant of −.2344.

(d) *Computation of Allowable Expense Level (AEL).* The PHA shall compute its Allowable Expense Level as follows:

(1) *AEL for first budget year of operating subsidy under this part where Base Year Expense Level does not exceed the top of the range.* Every PHA whose Base Year Expense Level is less than the top of the range shall compute its AEL for the first budget year of operating subsidy under this part by adding the following to its Base Year Expense Level (before adjustments under § 990.110):

(i) Any increase approved by HUD in accordance with § 990.110;

(ii) The increase (decrease) between the Formula Expense Level for the Base Year and the Formula Expense Level for the first budget year of operating subsidy under this part; and

(iii) The sum of the Base Year Expense Level, and any amounts described in paragraphs (d)(1) (i) and (ii) of this section multiplied by the Local Inflation Factor.

(2) *AEL for first budget year of operating subsidy under this part where Base Year Expense Level exceeds the top of the range.* Every PHA whose Base Year Expense Level exceeds the top of the range shall compute its AEL for the first budget year of operating subsidy under this part by adding the following to the top of the range (not to its Base Year Expense Level, as in paragraph (d)(1) of this section):

(i) The increase (decrease) between the Formula Expense Level for the Base Year and the Formula Expense Level for the first budget year of operating subsidy under this part;

(ii) The sum of the figure equal to the top of the range and the increase (decrease) described in paragraph (d)(2)(i) of this section, multiplied by the Local Inflation Factor. (If the Base Year Expense Level is above the AEL, computed as provided above, the PHA may be eligible for Transition Funding under § 990.106.)

(3) *AEL for first budget year of operating subsidy under this part for a new project.* A new project of a new PHA or a new project of an existing PHA that the PHA decides to place under a separate ACC, which did not have a sufficient number of units available for occupancy in the Base Year to have a level of operations representative of a full fiscal year of operation is considered to be a ''new project.'' The AEL for the first budget year of operating subsidy under this part for a ''new project'' will be based on the AEL for a comparable project, as determined by the HUD Field Office. The PHA may suggest a project or projects it believes to be comparable. In determining what constitutes a ''new project'' under this paragraph, HUD will be guided by its public housing development regulations at 24 CFR part 941.

(4) *Adjustment of AEL for budget years after the first budget year of operating subsidy under this part.* HUD may adjust the AEL of budget years after the first year of operating subsidy under this part, in accordance with the provisions of § 990.105(b) or § 990.108(c).

(5) *Allowable Expense Level for budget years after the first budget year of operating subsidy under this part.* For each budget year after the first budget year of operating subsidy under this part, the AEL shall be computed as follows:

(i) The AEL shall be increased by any increase to the AEL approved by HUD under § 990.108(c).

(ii) The AEL for the Current Budget Year also shall be adjusted as follows:

(A) Increased by one-half of one percent (.5%); and

(B) If the PHA has experienced a change in the number of units in excess of 5% or 1,000 units, whichever is less, since the last adjustment to the AEL based on this paragraph, it shall use the increase (decrease) between the Formula Expense Level calculated using the PHA's characteristics that applied to the Requested Year when the last adjustment to the AEL was made based on this paragraph and the Formula Expense Level calculated using the PHA's characteristics for the Requested Budget Year.

(iii) The amount computed in accordance with paragraphs (d)(5)(i) and (ii) of this section shall be multiplied by the Local Inflation Factor.

(6) *Adjustment of AEL for budget years after the first budget year of operating subsidy under this part.* HUD may adjust the AEL of budget years after the first year of operating subsidy under this part, in accordance with the provisions of § 990.105(b) or § 990.108(c).

(e) *Computation of FHA-based operating expense level (FHAEL) for application in FY 2001.* (1) *HUD calculation of FHAEL.* For every PHA that is eligible to receive operating subsidy under the Operating Fund Formula, HUD will calculate an FHAEL (based upon FY 2000 data and for application in FY 2001) as follows:

(i) *Step 1: Calculation of average national operating cost.* HUD will calculate an FHA-based national average cost of operating a two-bedroom public housing unit, exclusive of utility costs and property taxes. The average national cost will be calculated using privately managed (FHA multifamily insured and/or assisted) rental housing financial data available to HUD for the most recent year of full reporting and adjusted to reflect a two-bedroom size by using Section 8 Fair Market Rent (FMR) relationships (i.e., increase or decrease the national average cost depending on whether the average cost-weighted bedroom size is greater or less than 2.0 bedrooms per unit). (See 24 CFR part 888 for additional information regarding FMRs.)

(ii) *Step 2: Adjustment of average national two-bedroom operating cost for local cost differences.* HUD will adjust the average national two-bedroom operating cost for local cost differences using the location adjustment factors provided in the R.S. Means Residential Construction Costs Index.

(iii) *Step 3: Adjustment of average national operating cost for PHA-specific bedroom-size distribution.* For each PHA, HUD will further adjust the average national operating cost for the bedroom size distribution of the PHA using Section 8 FMR cost relationships (i.e., increase or decrease the average national cost depending on whether the average cost-weighted bedroom size for the PHA's inventory is greater or less than 2.0 bedrooms per unit).

(iv) *Step 4: Update of PHA-specific average operating cost to reflect FY 2000 costs.* HUD will update this PHA-specific operating cost to reflect increased FY 2000 operating costs by using the Public Housing AEL inflation factor.

(2) *Availability of FHAEL to PHA.* HUD will make the following information available to each PHA:

(i) *FHAEL.* The FHAEL for the PHA;

(ii) *PHA bedroom distribution.* The PHA bedroom distribution used to make the PHA-specific bedroom adjustment under paragraph (e)(1)(iii) of this section; and

(iii) *Base average national cost.* The two-bedroom base average national cost calculated under paragraph (e)(1)(i) of this section.

(3) *Use of FHAEL for FY 2000 for PHAs with less than 500 units under contract.* Each PHA with less than 500 units shall review the FHAEL and bedroom distribution provided by HUD, and do the following:

(i) *The PHA will determine if the bedroom size distribution used by HUD was appropriate.* (A) *Mandatory recalculation.* If the bedroom size distribution calculated by the PHA produces a weighted average bedroom size that differs by more than .02 from the weighted average used by HUD, the PHA shall recalculate its FY 2000 FHAEL using the two-bedroom base average national operating cost provided by HUD.

(B) *Discretionary recalculation.* If the bedroom size distribution calculated by the PHA produces a weighted average bedroom size that differs by less than .02 from the weighted average used by HUD, the PHA may recalculate its FY 2000 FHAEL using the two-bedroom base average national operating cost provided by HUD.

(ii) *Comparison of FHAEL to AEL.* The PHA shall compare its FHAEL with its approved FY 2000 AEL.

(iii) *If the PHA has less than 250 units.* PHAs with less than 250 units shall use the higher of their current AEL or 85% of the FHAEL. However, in no case will the PHA use an amount that exceeds 120% of its FHAEL for purposes of FY 2001 subsidy determinations under the Operating Fund Formula (see paragraph (e)(3)(v) of this section).

(iv) *If the PHA has 250–499 units.* PHAs with 250–499 units shall use the higher of their current AEL, or 70% of FHAEL. However, in no case will the PHA use an amount that exceeds 120% of its FHAEL for purposes of FY 2001 subsidy determinations under the Operating Fund Formula (see paragraph (e)(3)(v) of this section).

(v) *If the PHA with less than 500 units has an AEL greater than 120% of its FHAEL.* If a PHA with less than 500 units has an FY 2000 AEL that is greater than 120% of its FHAEL, the PHA shall use 120% of its FHAEL in place of its actual FY 2000 AEL for purposes of FY 2001 subsidy determinations under the Operating Fund Formula.

(4) *Use of FHAEL for FY 2000 for PHAs with more than 500 units under contract.* Each PHA with more than 500 units shall review the FHAEL and bedroom distribution provided by HUD and do the following:

(i) *The PHA shall determine if the bedroom size distribution used by HUD was appropriate.* (A) *Mandatory recalculation.* If the bedroom size distribution calculated by the PHA produces a weighted average bedroom size that differs by more than .02 from the weighted average used by HUD, the PHA shall recalculate its FY 2000 FHAEL using the two-bedroom base average national operating cost provided by HUD.

(B) *Discretionary recalculation.* If the bedroom size distribution calculated by the PHA produces a weighted average bedroom size that differs by less than .02 from the weighted average used by HUD, the PHA may recalculate its FY 2000 FHAEL using the two-bedroom base average national operating cost provided by HUD.

(ii) *Comparison of FHAEL to AEL.* The PHA shall compare its FHAEL with its approved FY 2000 AEL.

(iii) *If the PHA's FY 2000 AEL is less than or equal to 85% of its FHAEL.* If the PHA's FY 2000 AEL is less than or equal to 85% of its FHAEL, the PHA shall use its FY 2000 AEL for purposes of FY 2001 subsidy determinations under the Operating Fund Formula.

(iv) *If the PHA's FY 2000 AEL is greater than 85% of its FHAEL.* If the PHA's FY 2000 AEL is greater than 85% of its FHAEL, the PHA shall use 98.64% of its FY 2000 AEL for purposes of calculating its FY 2001 subsidy determinations under the Operating Fund Formula.

(v) *Inapplicability of AEL reduction to certain PHAs.* The AEL reduction described in paragraph (e)(4)(iv) of this section does not apply to the PHAs of the Virgin Islands, Puerto Rico, Guam and Alaska. These PHAs will use their FY 2000 AELs for purposes of FY 2001 subsidy determinations, regardless of whether the PHA's AEL is greater than 85% of its FHAEL.

(vi) *Cap on AEL value reduction.* In no instance shall a PHA subject to an AEL reduction, reduce the FY 2000 AEL value used in calculating its FY 2001 AEL for purposes of operating subsidy determinations to a value less than 85% of its FHAEL.

(f) *Flood insurance adjustment for FY 2001.* To simplify the calculation of operating subsidy, the AEL computation for the PHA's fiscal year beginning in 2001 will include an additional step following the determination made in accordance with paragraphs (a) through (e) of this section: the AEL per unit month derived in accordance with those paragraphs is to be adjusted by adding the flood insurance charge per unit month, as reflected in the last HUD approved subsidy calculation for FY 2000. This adjustment is a one-time permanent adjustment made only in FY 2001. However, if the flood map is revised at a future date, HUD will adjust the AEL for the affected PHAs in accordance with this paragraph.

§ 990.106 Transition funding for excessively high-cost PHAs.

(1) *Eligibility.* If a PHA's Base Year Expense Level exceeds its AEL for any budget year under the Operating Fund Formula, the PHA may be eligible for Transition Funding.

(2) *Amounts.* Transition Funding shall be an amount not to exceed the difference between the Base Year Expense Level and the AEL for the Requested Budget Year, multiplied by the number of Unit Months Available.

(3) *Reduction in transition funding.* HUD shall have the right to discontinue payment of all or part of the Transition Funding in the event HUD at any time determines that the PHA has not achieved a satisfactory level of management efficiency, or is not making efforts satisfactory to HUD to improve its management performance.

§ 990.107 Computation of utilities expense level.

(a) *Computation of the utilities expense level.* The PHA's Utilities Expense Level for the requested Budget Year shall be computed by multiplying the Allowable Utilities Consumption Level (AUCL) per unit per month for each utility, determined as provided in paragraph (c) of this section, by the projected utility rate determined as provided in paragraph (b) of this section.

(b) *Utilities rates.* (1) The current applicable rates, with consideration of adjustments and pass-throughs, in effect at the time the Operating Budget is submitted to HUD will be used as the utilities rates for the Requested Budget Year, except that, when the appropriate utility commission has, prior to the date of submission of the Operating Budget to HUD, approved and published rate changes to be applicable during the Requested Budget Year, the future approved rates may be used as the utilities rates for the entire Requested Budget Year.

(2) If a PHA takes action, such as wellhead purchase of natural gas, or administrative appeals or legal action beyond normal public participation in rate-making proceedings to reduce the rate it pays for utilities (including water, fuel oil, electricity, and gas), then the PHA will be permitted to retain one-half of the cost savings during the first 12 months attributable to its actions. Upon determination that the action was cost-effective in the first year, the PHA may be permitted to retain one-half the annual cost savings, if the actions continue to be cost-effective. See also paragraph (e) of this section and § 990.110(b).

(c) *Computation of Allowable Utilities Consumption Level.* The Allowable Utilities Consumption Level used to compute the Utilities Expense Level of PHAs for the Requested Budget Year generally will be based on the availability of consumption data. For project utilities where consumption data are available for the entire Rolling Base Period, the computation will be in accordance with paragraph (c)(1) of this section. Where data are not available for the entire period, the computation will be in accordance with paragraph (c)(2) of this section, unless the project is a new project, in which case the computation will be in accordance with paragraph (c)(3) of this section. For a project where the PHA has taken special energy conservation measures that qualify for special treatment in accordance with paragraph (f)(1) of this section, the computation of the Allowable Utilities Consumption Level may be made in accordance with paragraph (c)(4) of this section. The AUCL for all of a PHA's projects is the sum of the amounts determined using all of these subparagraphs, as appropriate.

(1) *Rolling Base Period System.* (i) For project utilities with consumption data for the entire Rolling Base Period, the AUCL is the average amount consumed per unit per month during the Rolling Base Period adjusted in accordance with paragraph (d) of this section. The PHA shall determine the average amount of each of the utilities consumed during the Rolling Base period (i.e., the 36-month period ending 12 months prior to the first day of the Requested Budget Year).

(ii) An example of a rolling base is as follows:

PHA Fiscal Year (affected fiscal year)		Rolling base period	
Beginning	Ending	Begins	Ends
1–1–01	12–31–01 (1st year)	1–1–97	12–31–99
1–1–02	12–31–02 (2nd year)	1–1–98	12–31–00

(2) *Alternative method where data is not available for the entire Rolling Base Period.* (i) If the PHA has not maintained or cannot recapture consumption data regarding a particular utility from its records for the whole Rolling Base Period mentioned in paragraph (c)(1) of this section, it shall submit consumption data for that utility for the last 24 months of its Rolling Base Period to the HUD Field Office for approval. If this is not possible, it shall submit consumption data for the last 12 months of its Rolling Base Period. The PHA also shall submit a written explanation of the reasons that data for the whole Rolling Base Period is unavailable.

(ii) In those cases where a PHA has not maintained or cannot recapture consumption data for a utility for the entire Rolling Base Period, comparable consumption for the greatest of either 36, 24, or 12 months, as needed, shall be used for the utility for which the data is lacking. The comparable consumption shall be estimated based upon the consumption experienced during the Rolling Base Period of comparable project(s) with comparable utility delivery systems and occupancy. The use of actual and comparable consumption by each PHA, other than those PHAs defined as New Projects in paragraph (c)(3) of this section, will be determined by the availability of complete data for the entire 36-month Rolling Base Period. Appropriate utility consumption records, satisfactory to HUD, shall be developed and maintained by all PHAs so that a 36-month rolling average utility consumption per unit per month under paragraph (c)(1) of this section can be determined.

(iii) If a PHA cannot develop the consumption data for the Rolling Base Period or for 12 or 24 months of the

Rolling Base Period, either from its own project(s) data, or by using comparable consumption data the actual per unit per month (PUM) utility expenses stated in paragraph (d) of this section shall be used as the Utilities Expense Level.

(3) *Computation of Allowable Utilities Consumption Levels for New Projects.* (i) A New Project, for the purpose of establishing the Rolling Base Period and the Utilities Expense Level, is defined as either:

(A) A project which had not been in operation during at least 12 months of the Rolling Base Period, or a project which enters management after the Rolling Base Period and prior to the end of the Requested Budget Year; or

(B) A project which during or after the Rolling Base Period, has experienced conversion from one energy source to another; interruptable service; deprogrammed units; a switch from resident-purchased to PHA-supplied utilities; or a switch from PHA-supplied to resident-purchased utilities.

(ii) The actual consumption for New Projects shall be determined so as not to distort the Rolling Base Period in accordance with a method prescribed by HUD.

(4) *Freezing the Allowable Utilities Consumption Level.* (i) Notwithstanding the provisions of paragraphs (c)(1) and (c)(2) of this section, if a PHA undertakes energy conservation measures that are approved by HUD under paragraph (f) of this section, the Allowable Utilities Consumption Level for the project and the utilities involved may be frozen during the contract period. Before the AUCL is frozen, it must be adjusted to reflect any energy savings resulting from the use of any HUD funding. The AUCL is then frozen at the level calculated for the year during which the conservation measures initially will be implemented, as determined in accordance with paragraph (f) of this section.

(ii) If the AUCL is frozen during the contract period, the annual three-year rolling base procedures for computing the AUCL shall be reactivated after the PHA satisfies the conditions of the contract. The three years of consumption data to be used in calculating the AUCL after the end of the contract period will be as follows:

(A) *First year:* The energy consumption during the year before the year in which the contract ended and the energy consumption for each of the two years before installation of the energy conservation improvements;

(B) *Second year:* The energy consumption during the year the contract ended, energy consumption during the year before the contract ended, and energy consumption during the year before installation of the energy conservation improvements;

(C) *Third year:* The energy consumption during the year after the contract ended, energy consumption during the year the contract ended, and energy consumption during the year before the contract ended.

(d) *Utilities expense level where consumption data for the full Rolling Base Period is unavailable.* If a PHA does not obtain the consumption data for the entire Rolling Base Period, or for 12 or 24 months of the Rolling Base Period, either for its own project(s) or by using comparable consumption data as required in paragraph (c)(2) of this section, it shall request HUD Field Office approval to use actual PUM utility expenses. These expenses shall exclude Utilities Labor and Other Utilities Expenses. The actual PUM utility expenses shall be taken from the year-end Statement of Operating Receipts and Expenditures, Form HUD–52599, (Office of Management and Budget approval number 2577–0067) prepared for the PHA fiscal year which ended 12 months prior to the beginning of the PHA Requested Budget Year (e.g., for a PHA fiscal year beginning January 1, 2001, the PHA would use data from the fiscal year ended December 31, 1999). Subsequent adjustments will not be approved for a budget year for which the utility expense level is established based upon actual PUM utility expenses.

(e) *Adjustments.* PHAs shall request adjustments of Utilities Expense Levels in accordance with § 990.110(b), which requires an adjustment based upon a comparison between actual experience and estimates of consumption and of utility rates.

(f) *Incentives for energy conservation improvements.* If a PHA undertakes energy conservation measures (including those covering water, fuel oil, electricity, and gas) that are financed by an entity other than the Secretary, such as physical improvements financed by a loan from a utility or governmental entity, management of costs under a performance contract, or a shared savings agreement with a private energy service company, the PHA may qualify for one of the two possible incentives under this part. For a PHA to qualify for these incentives, HUD approval must be obtained. Approval will be based upon a determination that payments under the contract can be funded from the reasonably anticipated energy cost savings, and the contract period does not exceed 12 years.

(1) If the contract allows the PHA's payments to be dependent on the cost savings it realizes, the PHA must use at least 50% of the cost savings to pay the contractor. With this type of contract, the PHA may take advantage of a frozen AUCL under paragraph (c)(4) of this section, and it may use the full amount of the cost savings, as described in § 990.110(b)(2)(ii).

(2) If the contract does not allow the PHA's payments to be dependent on the cost savings it realizes, then the AUCL will continue to be calculated in accordance with paragraphs (c)(1) through (c)(3) of this section, as appropriate; the PHA will be able to retain part of the cost savings, in accordance with § 990.110(b)(2)(i); and the PHA will qualify for additional operating subsidy eligibility (above the amount based on the allowable expense level) to cover the cost of amortizing the cost of the energy conservation measures during the term of the contract, in accordance with § 990.110(c).

§ 990.108 Other costs.

(a) *Cost of independent audits.* (1) Eligibility to receive operating subsidy for independent audits is considered separately from the Operating Fund Formula. However, the PHA shall not request, nor will HUD approve, an operating subsidy for the cost of an independent audit if the audit has already been funded by subsidy in a prior year.

(2) A PHA that is required by the Single Audit Act (31 U.S.C. 7501–7507) (see 24 CFR part 85) to conduct a regular independent audit may receive operating subsidy to cover the cost of the audit. The actual cost of an independent audit, applicable to the operations of PHA-owned rental housing, is not included in the Allowable Expense Level, but it is allowed in full in computing the amount of operating subsidy under § 990.104, above.

(3) A PHA that is exempt from the audit requirements under the Single Audit Act (24 CFR part 85) may receive operating subsidy to offset the actual cost of an independent audit chargeable to operations (after the End of the Initial Operating Period) if the PHA chooses to have an audit.

(b)(1) Costs attributable to units that are approved for deprogramming and vacant may be eligible for inclusion, but must be limited to the minimum services and protection necessary to protect and preserve the units until the units are deprogrammed. Costs attributable to units temporarily unavailable for occupancy because the units are utilized for PHA-related activities are not eligible for inclusion.

In determining operating subsidy calculations under the Operating Fund Formula, these units shall not be included in the calculation of Unit Months Available. Units approved for deprogramming shall be listed by the PHA, and supporting documentation regarding direct costs attributable to such units shall be included as a part of the Operating Fund Formula calculation in which the PHA requests operating subsidy for these units. If the PHA requires assistance in this matter, the PHA should contact the HUD Field Office.

(2) Units approved for nondwelling use to promote economic self-sufficiency services and anti-drug activities are eligible for operating subsidy under the conditions provided in this paragraph (b)(2), and the costs attributable to these units are to be included in the operating budget. If a unit satisfies the conditions stated below, it will be eligible for subsidy at the rate of the AEL for the number of months the unit is devoted to such use. Approval will be given for a period of no more than 3 years. HUD may renew the approval to allow payments after that period only if the PHA can demonstrate that no other sources for paying the non-utility operating costs of the unit are available. The conditions the unit must satisfy are:

(i) The unit must be used for either economic self-sufficiency activities directly related to maximizing the number of employed residents or for anti-drug programs directly related to ridding the development of illegal drugs and drug-related crime. The activities must be directed toward and for the benefit of residents of the development.

(ii) The PHA must demonstrate that space for the service or program is not available elsewhere in the locality and that the space used is safe and suitable for its intended use or that the resources are committed to make the space safe and suitable.

(iii) The PHA must demonstrate satisfactorily that other funding is not available to pay for the non-utility operating costs. All rental income generated as a result of the activity must be reported as income in the operating subsidy calculation.

(iv) Operating subsidy may be approved for only one site (involving one or more contiguous units) per public housing development for economic self-sufficiency services or anti-drug programs, and the number of units involved should be the minimum necessary to support the service or program. Operating subsidy for any additional sites per development can only be approved by HUD Headquarters.

(v) The PHA must submit a certification with its Operating Fund Formula Calculation that the units are being used for the purpose for which they were approved and that any rental income generated as a result of the activity is reported as income in the operating subsidy calculation. The PHA must maintain specific documentation of the units covered. Such documentation should include a listing of the units, the street addresses, and project/management control numbers.

(3) Long-term vacant units that are not included in the calculation of Unit Months Available are eligible for operating subsidy in the Requested Budget Year at the rate of 20% of the AEL. Allowable utility costs for long term vacant units will continue to be funded in accordance with § 990.107.

(c) *Costs attributable to changes in Federal law or regulation.* In the event that HUD determines that enactment of a Federal law or revision in HUD or other Federal regulation has caused or will cause a significant increase in expenditures of a continuing nature above the Allowable Expense Level and Utilities Expense Level, HUD may in HUD's sole discretion decide to prescribe a procedure under which the PHA may apply for or may receive an increase in operating subsidy.

(d)(1) *Costs resulting from combination of two or more units.* When a PHA redesigns or rehabilitates a project and combines two or more units into one larger unit and the combination of units results in a unit that houses at least the same number of people as were previously served, the AEL for the requested year shall be multiplied by the number of unit months not included in the requested year's unit months available as a result of these combinations that have occurred since the Base Year. The number of people served in a unit will be based on the formula ((2 x No. of Bedrooms) minus 1), which yields the average number of people that would be served. An efficiency unit will be counted as a one bedroom unit for purposes of this calculation.

(2) An exception to paragraph (d)(1) of this section is made when a PHA combines two efficiency units into a one-bedroom unit. In these cases, the AEL for the requested year shall be multiplied by the number of unit months not included in the requested year's unit months available as a result of these combinations that have occurred since the Base Year.

(e) *Funding for resident participation activities*—(1) *Funding amount.* Each PHA shall include in the operating subsidy eligibility calculation, $25 per occupied unit per year for resident participation activities, including (but not limited to) those described in part 964 of this title. For purposes of this section, a unit may be occupied by a public housing resident, a PHA employee, or a police officer. If, in any fiscal year, appropriations are not sufficient to meet all funding requirements under this part, then the $25 will be subject to pro-ration.

(2) *Use of vacant rental units.* If there is no community or rental space available for providing resident participation activities, HUD may approve, at the request of the PHA, the use of one or more vacant rental units for resident participation purposes. A unit that satisfies the following conditions will be eligible for operating subsidy at the rate of the AEL for the number of months the unit is devoted to such use:

(i) The PHA must demonstrate that safe and suitable space for the resident participation activities is not otherwise readily available;

(ii) One or more contiguous units may be used for resident participation activities. However, the units must be located on a single site per public housing development. Further, the number of units involved must be the minimum necessary to support the resident participation activities;

(iii) The PHA must submit a certification with its Operating Fund Formula calculation that the units are being used for the purpose for which they were approved and that any rental income generated as a result of the activity is reported as income in the operating subsidy calculation; and

(iv) The PHA must maintain specific documentation of the units covered. Such documentation must include a listing of the units, the street addresses, and project/management control numbers.

§ 990.109 Projected operating income level.

(a) *Policy.* The Operating Fund Formula determines the amount of operating subsidy for a particular PHA based in part upon a projection of the actual dwelling rental income and other income for the particular PHA. The projection of dwelling rental income is obtained by computing the average monthly dwelling rental charge per unit for the PHA, and applying an upward trend factor (subject to updating). This amount is then multiplied by the Projected Occupancy Percentage for the Requested Budget Year. There are special provisions for projection of dwelling rental income for new projects.

(b) *Computation of projected average monthly dwelling rental income*—(1) *General.* The projected average monthly dwelling rental income per unit for the PHA is calculated as follows:

(i) *Step 1: Calculation of the current year and three year averages.* The PHA calculates:

(A) The average monthly dwelling rental charge per unit for the current budget year (the ''current year average'' calculated in accordance with paragraph (b)(2) of this section); and

(B) The average monthly dwelling rental charge per unit for the current budget year and the immediate past two budget years (the ''three year average'' calculated in accordance with paragraph (b)(3) of this section).

(ii) *Step 2: Adjustment for any increase in dwelling rental income.* If the current year average is greater than the three year average, the PHA has increased dwelling rental income. If a PHA has increased dwelling rental income, it shall perform the following calculation. The PHA shall:

(A) Subtract the three year average from the current year average;

(B) Divide the result by 2; and

(C) Add this sum to the three year average.

(iii) *Step 3: Calculating the amount of increased rental revenue that may be retained.* PHAs shall be allowed to retain 50% of any increases in dwelling rental income, so long as the PHA uses the increased revenue for the provision of resident-related improvements and services as described in § 990.116. The retained income will not be recognized in the PHA's calculation under the Operating Fund Formula. The annual amount of increased revenue retained by the PHA is calculated by subtracting the three year average from the current year average and multiplying the result by the projected occupancy percentage (see § 990.109(b)(6)), and the unit months available (see § 990.102).

(iv) *Step 4: Applying the rental income adjustment factor.* The lower of the amount calculated under paragraph (b)(i)(A) or (b)(ii) of this section is then adjusted by the dwelling rental income adjustment factor described in paragraph (b)(5) of this section.

(2) *Average monthly dwelling rental charge per unit.* (i) The average monthly dwelling rental charge per unit shall be computed using the total dwelling rental charges for all Project Units, as shown on the Tenant Rent Rolls which the PHA is required to maintain, for the first day of the month which is six months before the first day of the Requested Budget Year. However, if a change in the total of the Rent Rolls has occurred in a subsequent month which is before the beginning of the Requested Budget Year, and before the submission of the Requested Budget Year calculation of operating subsidy eligibility, the PHA may use the latest changed Rent Roll for the purpose of the computation.

(ii) This aggregate dollar amount shall be divided by the number of occupied dwelling units as of the same date.

(iii) The Rent Roll used for calculating the projected operating income level will not reflect decreases resulting from the PHA's implementation of an optional earned income exclusion authorized by the explanation of ''annual income'' in 24 CFR 5.609.

(3) *Three year average monthly dwelling rental charge per unit.* The three year average monthly dwelling rental charge shall be computed by averaging the amounts calculated under paragraph (b)(2) of this section for the current budget year and the immediate past two budget years.

(4) *Changes in supply of utilities.* The PHA must adjust the rent rolls used for purposes of the calculations described in paragraphs (b)(2) and (b)(3) of this section to reflect any change from PHA-paid utilities to resident-paid utilities, or vice versa, between the rent roll date and the projected budget year.

(5) *Dwelling rental income adjustment factor.* An adjustment factor will be applied to the calculations described in paragraphs (b)(2) and (b)(3) of this section. In FY 2001, the inflation factor will be 3%. In subsequent years, the average monthly dwelling rental charge per unit will be increased for inflation using a HUD supplied adjustment factor for the requested budget year to obtain the projected average monthly dwelling rental charge per unit of the PHA for the Requested Budget Year.

(6) *Projected occupancy percentage.* The PHA shall determine its projected percentage of occupancy for all Project Units (Projected Occupancy Percentage), as follows:

(i) *General.* Using actual occupancy data collected before the start of the budget year as a beginning point, the PHA will develop estimates for its Requested Budget Year (RBY) of: how many units the PHA will have available for occupancy; how many of the available units will be occupied and how many will be vacant, and what the average occupancy percentage will be for the RBY. The conditions under which the RBY occupancy percentage will be used as the projected occupancy percentage for purposes of determining operating subsidy eligibility are described below.

(ii) *High Occupancy PHA—No adjustments necessary.* If the PHA's RBY Occupancy Percentage, calculated in accordance with § 990.117, is equal to or greater than 97%, the PHA's Projected Occupancy Percentage is 97%. If the PHA's RBY Occupancy Percentage is less than 97%, but the PHA demonstrates that it will have an average of five or fewer vacant units in the requested budget year, the PHA will use its RBY Occupancy Percentage as its projected occupancy percentage.

(iii) *Adjustments in determining occupancy.* If the PHA's RBY Occupancy Percentage is less than 97% and the PHA has more than 5 vacant units, the PHA will adjust its estimate of vacant units to exclude vacant units undergoing modernization and units that are vacant due to circumstances and actions beyond the PHA's control. After making this adjustment, the PHA will recalculate its estimated vacancy percentage for the RBY.

(A) *High Occupancy PHA after adjustment.* If the recalculated vacancy percentage is 3% or less (or the PHA would have five or fewer vacant units), the PHA will use its RBY Occupancy Percentage as its projected occupancy percentage.

(B) *Low Occupancy PHA—adjustment for long-term vacancies.* If the recalculated vacancy percentage is greater than 3% (or the PHA would have more than 5 vacant units), the PHA will then further adjust its RBY Occupancy Percentage by excluding from its calculation of Unit Months Available (UMAs), those unit months attributable to units that have been vacant for longer than 12 months that are not vacant units undergoing modernization or are not units vacant due to circumstances and actions beyond the PHA's control.

(iv) *Low Occupancy PHA after all adjustments.* A PHA that has determined its RBY Occupancy Percentage in accordance with paragraph (b)(6)(iii)(B) of this section will be eligible for operating subsidy as follows:

(A) Long-term vacancies removed from the calculation of UMAs will be eligible to receive a reduced operating subsidy calculated at 20% of the PHA's AEL.

(B) If the recalculated RBY Occupancy Percentage is 97% or higher, the PHA will use 97%.

(C) If the recalculated RBY Occupancy Percentage is less than 97%, but the vacancy rate after adjusting for vacant units undergoing modernization and units that are vacant due to circumstances and actions beyond the PHA's control is 3% or less (or the PHA has five or fewer vacant units), the PHA may use its recalculated RBY

Occupancy Percentage as its projected occupancy percentage.

(D) If the recalculated RBY Occupancy Percentage is less than 97% and the vacancy percentage is greater than 3% (or the PHA has more than five vacant units) after adjusting for vacant units undergoing modernization and units that are vacant due to circumstances and actions beyond the PHA's control, the PHA will use 97% as its projected occupancy percentage, but will be allowed to adjust the 97% by the number of vacant units undergoing modernization and units that are vacant due to circumstances and actions beyond the PHA's control. For a small PHA using five vacant units as its occupancy objective for the RBY, the PHA will determine what percentage five units represents as a portion of its units available for occupancy and subtract that percentage from 100%. The result will be used as the PHA's projected occupancy percentage, but the PHA will be allowed to adjust the projected occupancy percentage by vacant units undergoing modernization and units that are vacant for circumstances and actions beyond the PHA's control.

(c) *Projected average monthly dwelling rental charge per unit for new Projects*. The projected average monthly dwelling rental charge for new Projects which were not available for occupancy during the budget year prior to the Requested Budget Year and which will reach the End of the Initial Operating Period (EIOP) within the first nine months of the Requested Budget Year, shall be calculated as follows:

(1) If the PHA has another Project or Projects under management which are comparable in terms of elderly and nonelderly resident composition, the PHA shall use the projected average monthly dwelling rental charge for such Project or Projects.

(2) If the PHA has no other Projects which are comparable in terms of elderly and nonelderly resident composition, the HUD Field Office will provide the projected average monthly dwelling rental charge for such Project or Projects, based on comparable Projects located in the area.

(d) *Estimate of additional dwelling rental income*. After implementation of the provisions of any legislation enacted or any HUD administrative action taken subsequent to the effective date of these regulations, which affects rents paid by residents of Projects, HUD may adjust the projected average monthly dwelling rental charge per unit to reflect such change. HUD also shall have complete discretion to reduce or increase the operating subsidy approved for the PHA current fiscal year in an amount equivalent to the change in the rental income.

(e) *PHA's estimate of other income*. All PHAs shall estimate Other Income based on past experience and a reasonable projection for the Requested Budget Year, which estimate shall be subject to HUD approval. The estimated total amount of Other Income, as approved, shall be divided by the number of Unit Months Available to obtain a per unit per month amount.

(f) *Projected operating income level*. The projected average dwelling rental income per unit (calculated under paragraphs (b), (c), and (d) of this section) shall be added to the estimated Other Income (calculated under paragraph (e) of this section) to obtain the Projected Operating Income Level. This amount shall not be subject to the provisions regarding program income in 24 CFR 85.25.

§ 990.110 Adjustments.

Adjustment information submitted to HUD under this section must be accompanied by an original or revised calculation of operating subsidy eligibility.

(a) *Adjustment of base year expense level*—(1) *Eligibility*. A PHA with projects that have been in management for at least one full fiscal year, for which operating subsidy is being requested under the Operating Fund Formula for the first time, may, during its first budget year under the Operating Fund Formula, request HUD to increase its Base Year Expense Level. Included in this category are existing PHAs requesting subsidy for a project or projects in operation at least one full fiscal year under separate ACC, for which operating subsidy has never been paid, except for independent audit costs. This request may be granted by HUD, in its discretion, only where the PHA establishes to HUD's satisfaction that the Base Year Expense Level computed under § 990.105(a) will result in operating subsidy at a level insufficient to support a reasonable level of essential services. The approved increase cannot exceed the lesser of the per unit per month amount by which the top of the Range exceeds the Base Year Expense Level.

(2) *Procedure*. A PHA that is eligible for an adjustment under paragraph (a)(1) of this section may only make a request for such adjustment once for projects under a particular ACC, at the time it submits the calculation of operating subsidy eligibility for the first budget year under the Operating Fund Formula. Such request shall be submitted to the HUD Field Office, which will review, modify as necessary, and approve or disapprove the request. A request under this paragraph must include a calculation of the amount per unit per month of requested increase in the Base Year Expense Level, and must show the requested increase as a percentage of the Base Year Expense Level.

(b) *Adjustments to Utilities Expense Level*. A PHA receiving operating subsidy under § 990.104, excluding those PHAs that receive operating subsidy solely for independent audit (§90.108(a)), must submit an adjustment regarding the Utility Expense Level approved for operating subsidy eligibility purposes. This adjustment, which will compare the actual utility expense and consumption for the PHA fiscal year to the estimates used for subsidy eligibility purposes, shall be submitted on forms prescribed by HUD. This adjustment, applicable to PHA fiscal years beginning on or after January 1, 1999, shall be submitted to the HUD Field Office within 45 days after the close of the PHA fiscal year that is being adjusted. Failure to submit the required adjustment of the Utilities Expense Level by the due date may, in the discretion of HUD, result in the withholding of approval of future obligation of operating subsidies and/or a delay in the recognition of the adjustment. Adjustments under this section normally will be made in the operating subsidy calculation for the second PHA fiscal year following the year being adjusted, unless a repayment plan is necessary as noted in paragraph (d) of this section.

(1) *Rates*. A change in the Utilities Expense Level because of changes in utility rates-to the extent funded by the operating subsidy-will result in an adjustment of future operating subsidy payments. However, where the rate reduction covering utilities, such as water, fuel oil, electricity, and gas, is directly attributable to action by the PHA, such as wellhead purchase of natural gas, or administrative appeals or legal action beyond normal public participation in rate-making proceedings, then the PHA will be permitted to retain one-half of the cost savings attributable to its actions for the first year and, upon determination that the action was cost-effective in the first year, for as long as the actions continue to be cost-effective, and the other one-half of the cost savings will be deducted from operating subsidy otherwise payable.

(2) C*onsumption*. (i) Generally, 75% of any decrease in the Utilities Expense Level attributable to decreased consumption after adjustment for any utility rate change, will be retained by

the PHA; 25% will be offset by HUD against subsequent payment of operating subsidy.

(ii) However, in the case of a PHA whose energy conservation measures have been approved by HUD as satisfying the requirements of § 990.107(f)(1) (regarding non-HUD financed incentives for energy conservation improvements), the PHA operating fund eligibility shall reflect the retention of 100% of the savings from decreased consumption after payment of the amount due the contractor until the term of the financing agreement is completed. The decreased consumption is to be determined by adjusting for any utility rate changes and may be adjusted, subject to HUD approval, using a heating degree day adjustment for space heating utilities. The savings realized must be applied in the following order:

(A) Retention of up to 50% of the total savings from decreased consumption to cover training of PHA employees, counseling of residents, PHA management of the cost reduction program and any other eligible costs; and

(B) Prepayment of the amount due the contractor under the contract.

(iii) 25% of an increase in the Utilities Expense Level attributable to increased consumption, after adjustment for any utility rate change, will be reflected in the operating subsidy eligibility for the second PHA fiscal year following the year being adjusted, in accordance with § 990.111.

(iv) PHAs are encouraged to:

(A) Provide conservation incentives and training to residents in order to realize increased utility savings;

(B) Share information with residents regarding changes in utility costs related to rate changes and to changes in consumption; and

(C) Explain to residents conservation benefits and impacts of excess consumption on the operating budget.

(3) *Documentation.* Supporting documentation substantiating the requested adjustments shall be retained by the PHA pending HUD audit.

(c) *Energy conservation financing.* If HUD has approved an energy conservation contract under § 990.107(f)(2), then the PHA is eligible for additional operating subsidy each year of the contract to amortize the cost of the energy conservation measures under the contract, subject to a maximum annual limit equal to the cost savings for that year and a maximum contract period of 12 years.

(1) Each year, the energy cost savings would be determined as follows:

(i) The consumption level that would have been expected if the energy conservation measure had not been undertaken would be adjusted for any change in utility rate and may be adjusted, subject to HUD approval, using a heating degree day adjustment for space heating utilities;

(ii) The actual cost of energy (of the type affected by the energy conservation measure) after implementation of the energy conservation measure would be subtracted from the expected energy cost, to produce the energy cost savings for the year. (See also paragraph (b)(2)(i) of this section for retention of consumption savings.)

(2) 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 (c) 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.

(3) 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.

(d) *Additional HUD-initiated adjustments.* Notwithstanding any other provisions of this subpart, HUD may at any time make an upward or downward adjustment in the amount of the PHA's operating subsidy as a result of data subsequently available to HUD which alters projections upon which the approved operating subsidy was based. If a downward adjustment would cause a severe financial hardship on the PHA, the HUD Field Office may establish a recovery schedule which represents the minimum number of years needed for repayment.

§ 990.111 Submission and approval of operating subsidy calculations and budgets.

(a) *Required documentation.* (1) Prior to the beginning of its fiscal year, the PHA shall prepare an operating budget in a manner prescribed by HUD. The Board of Commissioners shall review and approve the budget by resolution. Each fiscal year, the PHA shall submit to the HUD Field Office, in a time and manner prescribed by HUD, the approved board resolution and the required operating subsidy eligibility calculation forms. The PHA shall submit revised calculations in support of any adjustments based on procedures prescribed by HUD.

(2) HUD may direct the PHA to submit its complete operating budget if the PHA has failed to achieve certain specified operating standards, or for other reasons which in HUD's determination threaten the PHA's future serviceability, efficiency, economy, or stability.

(b) *HUD operating budget review.* (1) The HUD Field Office will perform a detailed review on operating budgets that are subject to HUD review and approval. If the HUD Field Office finds that an operating budget is incomplete, includes illegal or ineligible expenditures, mathematical errors, errors in the application of accounting procedures, or is otherwise unacceptable, the HUD Field Office may at any time require the submission by the PHA of further information regarding an operating budget or operating budget revision.

(2) 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 to HUD for review and approval.

(c) *Compliance with environmental review requirements*—(1) *General.* Operating subsidy funds made available to a PHA to support the operation and management of public housing are generally for activities that are not subject to environmental review requirements. A PHA, however, may use public housing program resources (including operating subsidy funds, rental and nonrental income, and operating reserves) to carry out non-routine maintenance and capital expenditure activities that may require an environmental review, as those activities are defined in HUD's prescribed Chart of Accounts.

(2) *Initial operating budget.* The ACC requires that operating expenditures may not be incurred except pursuant to an approved operating budget. Before the funding of non-routine maintenance and capital expenditure activities may be incorporated into the PHA's initial operating budget, and before the PHA may commit any funds to such activities, the PHA must obtain either:

(i) An environmental review from the Responsible Entity and submit and receive HUD approval of a Request for Release of Funds under part 58 of this title, or, in cases where HUD has determined to do an environmental review under part 50 of this title, the

PHA must obtain an environmental approval from HUD; or

(ii) A determination from the Responsible Entity under part 58 of this title that the PHA's proposed non-routine maintenance and capital expenditure activities are exempt from environmental review in accordance with § 58.34(a)(12) of this title.

(3) *Revisions to operating budget.* If subsequent to adoption of its initial operating budget, a PHA determines to undertake a new non-routine maintenance or capital expenditure activity, the PHA must obtain an environmental review and release of funds, HUD environmental approval, or an exemption from such review, as described in paragraph (c)(2) of this section, before the funding of the activity may be incorporated into a revised operating budget and before the PHA may commit any funds to such activities.

(4) *Determination of exempt activities.* If the Responsible Entity documents that a proposed non-routine maintenance or capital expenditure activity is an exempt activity, as described in (c)(2)(ii) of this section, no further action is required from the PHA and the activity may be incorporated into the PHA's initial or revised operating budget, as appropriate.

§ 990.112 Payments procedure for operating subsidy under the Operating Fund Formula.

(a) *General.* Subject to the availability of funds, payments of operating subsidy under the Operating Fund Formula shall be made generally by electronic funds transfers, based on a schedule submitted by the PHA and approved by HUD. The schedule may provide for several payments per month. If a PHA has an unanticipated, immediate need for disbursement of approved operating subsidy, it may make an informal request to HUD to revise the approved schedule. (Requests by telephone are acceptable.)

(b) *Payments procedure.* In the event that the amount of operating subsidy has not been determined by HUD as of the beginning of a PHA's budget year under this part, annual or monthly or quarterly payments of operating subsidy shall be made, as provided in paragraph (a) of this section, based upon the amount of the PHA's operating subsidy for the previous budget year or such other amount as HUD may determine to be appropriate.

(c) *Availability of funds.* In the event that insufficient funds are available to make payments approvable under the Operating Fund Formula for operating subsidy payable by HUD, HUD shall have complete discretion to revise, on a pro rata basis or other basis established by HUD, the amounts of operating subsidy to be paid to PHAs.

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

(a) *Policy.* The income of each family must be reexamined at least annually. PHAs must be in compliance with this reexamination requirement to be eligible to receive full operating subsidy payments.

(b) *PHAs in compliance with requirements.* Each submission of the original calculation of operating subsidy eligibility for a fiscal year shall be accompanied by a certification by the PHA that it is in compliance with the annual income reexamination requirements and that rents have been or will be adjusted in accordance with current HUD requirements.

(c) *PHAs not in compliance with requirements.* Any PHA not in compliance with annual income reexamination requirement at the time of the submission of the calculation of operating subsidy eligibility shall furnish to the HUD Field Office a copy of the procedure it is using to attain compliance and a statement of the number of families that have undergone reexamination during the twelve months preceding the date of the Operating Budget submission, or the revision thereof. If, on the basis of such submission, or any other information, the Field Office Director determines that the PHA is not substantially in compliance with the annual income reexamination requirement, he or she shall withhold payments to which the PHA might otherwise be entitled under this part, equal to his or her estimate of the loss of rental income to the PHA resulting from its failure to comply with those requirements.

§ 990.114 Phase-down of subsidy for units approved for demolition.

(a) *General.* Units that have both been approved by HUD for demolition and been vacated in FY 1995 and after will be excluded from a PHA's determination of Unit Months Available when vacated, but they will remain eligible for subsidy in the following way:

(1) For the first twelve months beginning with the month that a unit meets both conditions of being approved for demolition and vacant, the full AEL will be allowed for the unit.

(2) During the second twelve-month period after meeting both conditions, 66% of the AEL will be allowed for the unit.

(3) During the third twelve-month period after meeting both conditions, 33% of the AEL will be allowed for the unit.

(b) *Special case for long-term vacant units.* Units that have been vacant for longer than 12 months when they are approved for demolition are eligible for funding equal to 20% of the AEL for a 12-month period.

(c) *Treatment of units replaced with Section 8 Certificates or Vouchers.* Units that are replaced with Section 8 Certificates or Vouchers are not subject to the provisions of this section.

(d) *Treatment of units replaced with public housing units.* When replacement conventional public housing units become eligible for operating subsidy, the demolished unit is no longer eligible for any funding under this section.

(e) *Determination of what units are ''replaced.''* For purposes of this section, replacements are applied first against units that otherwise would fall in paragraph (a) of this section; any remaining replacements should be used to reduce the number of units qualifying under paragraph (b) of this section.

(f) *Treatment of units combined with other units.* Units that are removed from the inventory as a result of being combined with other units are not considered to be demolished units for this purpose.

§ 990.116 Increases in dwelling rental income.

(a) *General.* As described in § 990.109(b)(1), PHAs shall be allowed to retain 50% of any increases in dwelling rental income, so long as the PHA uses the increased income for the provision of resident-related improvements and services. The retained income will not be recognized in the PHA's calculation under the Operating Fund Formula.

(b) *Eligible uses for increased rental revenue.* The uses for the retained income must be developed with front end resident participation and ongoing input and shall be made part of the PHA plan submission. (*See* 24 CFR part 903). Examples of eligible uses for the retained income include, but are not limited to:

(1) Physical and management improvements that benefit residents;

(2) Resident self-sufficiency services;

(3) Maintenance operations;

(4) Resident employment and training services;

(5) Resident safety and security improvements and services; and

(6) Optional earned income exclusions.

§ 990.117 Determining actual and requested budget year occupancy percentages.

(a) *Actual occupancy percentage.* When submitting Operating Fund Formula calculations for Requested Budget Years, the PHA shall determine an Actual Occupancy Percentage for all Project Units included in the Unit Months Available. The PHA shall have the option of basing this option on either:

(1) The number of units occupied on the last day of the month that ends 6 months before the beginning of the Requested Budget Year; or

(2) The average occupancy during the month ending 6 months before the beginning of the Requested Budget Year. If the PHA elects to use an average occupancy under this paragraph (a)(2), the PHA shall maintain a record of its computation of its Actual Occupancy Percentage.

(b) *Requested budget year occupancy percentage.* The PHA will develop a Requested Budget Year Occupancy Percentage by taking the Actual Occupancy Percentage and adjusting it to reflect changes up or down in occupancy during the Requested Budget Year due to HUD-approved activities such as units undergoing modernization, new development, demolition, or disposition. If after the submission and approval of the Operating Fund Formula calculations for the Requested Budget Year, there are changes up or down in occupancy because of modernization, new development, demolition or disposition that are not reflected in the Requested Budget Year Occupancy Percentage, the PHA may submit a revision to reflect the actual change in occupancy due to these activities.

(c) *Documentation required to be maintained.* The PHA must maintain and, upon HUD's request, make available to HUD specific documentation of the occupancy status of all units, including long-term vacancies, vacant units undergoing modernization, and units vacant due to circumstances and actions beyond the PHA's control. This documentation shall include a listing of the units, street addresses, and project/management control numbers.

§ 990.120 Audit.

PHAs that receive financial assistance under this part shall comply with the audit requirements in 24 CFR part 85.26. If a PHA has failed to submit an acceptable audit on a timely basis in accordance with that part, HUD may arrange for, and pay the costs of, the audit. In such circumstances, HUD may withhold, from assistance otherwise payable to the PHA under this part, amounts sufficient to pay for the reasonable costs of conducting an acceptable audit, including, when appropriate, the reasonable costs of accounting services necessary to place the PHA's books and records into auditable condition. The costs to place the PHA's books and records into auditable condition do not generate additional subsidy eligibility under this part.

§ 990.121 Effect of rescission.

If there is a rescission of appropriated funds that reduces the level of funding under the Public Housing Capital Fund program, to the extent that the PHA can document that it is not possible to complete all the vacant unit rehabilitation in the PHA's approved Annual Statement, the PHA may seek and HUD may grant a waiver for 1 fiscal year to permit full eligibility under the Operating Fund Formula for those units approved but not funded. (See part 905 of this title for additional information regarding the Capital Fund program.)

Dated: June 7, 2000.

Harold Lucas,

Assistant Secretary for Public and Indian Housing.

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