U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Operating Fund Negotiated Rulemaking Advisory Committee
8:30 am to 5:30 pm EST, Room B182 HUD Headquarters

SECOND SESSION: Consensus Agreement
April 15, 2004

RESOLVED that the Committee approves the attached outline of the Department's negotiated position concerning the public housing operating formula subject to the following items:

1. Mutual agreement on a provision for utilities adjustments.

2. Resolution of the New York City Housing Authority fungibility to use operating subsidy for certain state and city units as provided in its Annual Contribution Contract (ACC).

3. The convening of an additional 2-day session on the Committee to consider definitions and other issues relating to project-based accounting and management principles and threshold criteria, and agreement on those matters.

4. Resolution of outstanding issues relating to asset repositioning.

5. Incorporation of a reasonable annual inflation factor to be applied to the PEL.

6. Further, it is understood that final approval must later be given to specific rule language.

See Attachment: U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, POSITION FOR FINAL OPERATING FUND FORMULA -- As Presented to the Committee on April 15th, 2004; 12:45PM

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
POSITION FOR FINAL OPERATING FUND FORMULA
As Presented to the Committee on April 15th, 2004; 12:45PM

I. General Position

- Adopt Harvard's methodology in calculating project expense level except where modified below.
- Adopt a more simplified, transparent, and accurate Operating Fund formula.

II. Project Expense Level (PEL) & Project-based Accounting

- Coefficient
  Add $2PUM for Public Entity Cost to be included in the PEL.

- Mixed Finance Developments
  Provide a safe harbor for existing, closed mixed finance deals where the PHA has committed a specific level of operating subsidy. PHA will receive the higher of the Harvard PEL or the current AEL for that property.

- Project-Based Accounting
  Modify regulatory language to:
  - Include tighter definition and establishment of project and cost centers;
  - Include all accounting transactions (not just revenue and expenses);
  - Require information to be submitted to PIH;
  - Allow PHAs operating fewer than 250 units to treat their entire portfolio as a single property;
  - Allow groups of up to 250 scattered site dwelling units to be treated as a single property; and
  - Establish schedule for implementation to be no later than FFY 2007.

III. Add-ons

Add-ons outside the PEL
- Establish audit costs as an Add-on; reduce PEL by existing actual costs.
- Establish resident participation as an Add-on.

Eliminate the following Add-ons:
- Cost Attributed to Deprogrammed Units
- Phase-down funding
- Long-term Vacancies

<u>Create Add-on</u>

- Asset Management Fee ($4PUM for PHAs greater than 250 units; $2PUM for PHAs under 250 units. PHAs under 250 units must transition to project-based in order to receive the Asset Management Fee).
- Asset Repositioning Fee (50% UMA @ PEL for two years)
- IT Fee ($2PUM for all PHAs)

For clarification, the following items are proposed as Add-ons outside of the PEL:

- Audit Cost
- Resident participation
- Asset Management Fee
- Asset Repositioning Fee
- IT Fee
- EDSC
- Energy (loan amortization)
- PILOT

IV. Utilities

- Eliminate existing Utility Adjustment provision. (See attached utility policy example).
- Maintain existing mechanisms related to rate and consumption reduction incentives and reduce rate risk; effective FFY 2005.
- Codify inclusion of resident-paid utility in energy performance contracts currently processed by waiver; effective FFY 2005.
- Provide for a codified benchmarking approach in FY 08.

V. Formula Income Determination

1. Use historical rental income revenue and other income as currently defined in Section 990.102 and corresponding historical unit information to derive a PUM.
2. Freeze rental revenue income and other income as described in #1 above, at 2004 level.
3. Eliminate Part B from HUD form 52723.
4. Appeals for severe economic hardship will be permitted (See VII. Appeal #2).
5. Reevaluate formula in three years.
6. Investment income as well as other income not defined in Section 990.102 will not be included in the formula.

VI. Transition Policy

- For PHAs that will realize a loss from the interim Operating Subsidy level to the PEL-derived Operating Subsidy level, such losses will have an annual limit of 5% plus one-fifth of the balance of the difference between the interim Operating Subsidy level and the PEL-derived Operating Subsidy level. Such annual limits will continue for a period of up to 5 years. At 5 years, the full PEL will be realized. Alternatively, if the PHA can demonstrate a successful conversion to project-based management, HUD will discontinue the reduction of subsidy.
- For PHAs that gain from the interim Operating Subsidy level to the PEL-derived Operating Subsidy level, 50% of such gains will be realized in Year 1 and 100% in Year 2.
- PHAs of greater than 250 units that do not achieve project-based management by Year 5, will lose their Asset Management Fee. PHAs with less than 250 units that do not participate in Asset Management are exempt from this provision.
- The initial determination of affected PHAs would be calculated using 2004 data.

VII. Appeal Policy

- Appeals should generally be budget neutral by providing a 2% (i.e. approximately $72 – $78 million) hold back of Operating Fund appropriations to fund appeals, particularly appeals within a given fiscal year that has already been budgeted and appropriated for in the given fiscal year. Hold back funds not utilized, will be added back to the formula.
- Appeals are voluntary and must cover an entire portfolio (not single properties). The Secretary has the discretion to accept appeals of less than an entire portfolio for PHAs with greater than 6,600 units.
- Appeals would fall into four general categories:

  - <u>#1: Streamlined Appeal.</u> Appeal to demonstrate that the application of a specific Harvard model component has a blatant and objective flaw.
  - <u>#2:Appeal of Formula Income for Economic Hardship</u>. Once the PHA's rental income revenue and other income are baselined, the PHA can appeal to have the baseline adjusted to reflect severe economic hardship.
  - <u>#3: Appeal for specific local conditions</u>. Appeals based on demonstrations that the model's predictions are not reliable because of specific local conditions; to be eligible a variance of 10% or greater must be demonstrated.
  - <u>#4: Appeal to substitute actual project cost data for Harvard project expense level</u>. The PHA has to operate under a true PB management for at least <u>2</u> years and that legitimate cost data by property can be verified).

  For appeal under #3 and #4, the following are the requirements:
    - Appellant would be required to acquire an independent cost assessment of its projects.
    - The assessment would be reviewed by a professional procured by HUD who is familiar with property management practices and costs in the region or state the appealing PHA is located.

- The professional review and recommendation would then be forwarded to the Assistant Secretary or his designee for final determination.
- If appeal is granted, appellant agrees to be bound to the independent cost assessment regardless of new funding levels.
- Cost of services for independent cost assessment to be paid by appellant.
- PHAs that appeal under #1 and #3, are limited to one year after the publication of the regulation to submit their appeal. New projects entering a PHA's inventory would have of right of appeal for one year.

VIII. Implementation of Final Formula

Simplify and streamline funding mechanism and financial oversight:

- Collect all formula characteristics for all PHAs at one time (break the funding cycle based on a PHA fiscal year).
- Fund all PHAs based on a calendar year thereby better aligning funding with appropriations.
- Reduce PHA reporting burden by using data already collect in HUD's data systems.
- Reduce, eliminate, and simplify as many hard-copy forms as possible that are currently associated with the Operating Fund.

Overall goal is have PIH systems overtime calculate Operating Subsidy. Initial calculation will look similar to current formula (agency-wide).

(Agency PEL + Agency UEL – Agency Rent) X Agency UMAs + Agency Add-ons = Subsidy

But over-time as systems are enhanced the formula will be calculate more specifically at a project level

(Project$_1$ PEL + Project$_1$ UEL- Project$_1$ Rent) X Project$_1$ UMA + Project$_1$ Add-0ns = Project$_1$ Sub
(Project$_2$ PEL + Project$_2$ UEL- Project$_2$ Rent) X Project$_2$ UMA + Project$_2$ Add-0ns = Project$_2$ Sub

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(Project$_n$ PEL + Project$_n$ UEL- Project$_n$ Rent) X Project$_n$ UMA + Project$_n$Add-0ns = Project$_n$ Sub

Where total PHA subsidy = equals sum of individual projects.

In the near –term, PHA that are able to demonstrate real project based cost data that can be substantiated will have their PEL replaced with this cost data, with mid-term goal (five years after effective date of this formula) of using actual verified cost data to distribute all operating fund appropriations by property.

IX. Fungibility

- Fungibility between Operating and Capital Funds: Fungibility between the Operating and Capital Funds will remain the same as provided by QHWRA.
- Fungibility between Projects:
    - Until PHAs transition to PBA, subsidy is fully fungible.
    - When PBA is established, individual properties will use their specific PEL as their baseline operating budget but excess cash flow is fully fungible. However, PHAs retain fungibility for emergencies.
    - No fungibility at the top of the Operating Statement

X. Clarification of Project-Based

HUD will clarify project-based accounting and project-based management in this rule.