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

MINUTES OF SECOND SESSION – FIRST DAY
April 13, 2004

April 13, 2004 Session:

The first meeting of the second Negotiated Rulemaking (Neg-Reg) Advisory Committee session on the Operating Fund Allocation System (the Committee) was called to order at 8:30 am on Tuesday, April 13, 2004, by Mr. Michael Liu, the Assistant Secretary of Public and Indian Housing. Ms. Tran served as the facilitator. The location of the meeting was room B182 of the U.S. Department of Housing and Urban Development; 451 7th Street, Washington, DC 20410. Mr. Liu provided welcoming remarks and the committee members were introduced.

Committee members in attendance and interests represented were:

No.	Committee Member	Organization
1	Mr. Michael Liu	Assistant Secretary, Public and Indian Housing
2	Mr. William Russell	Deputy Assistant Secretary, Public Housing and Voucher Programs
3	Mr. Steve Nolan	Atlanta Housing Authority
4	Mr. Felix Lam	New York City Housing Authority
5	Mr. Carlos Laboy-Diaz	Puerto Rico Housing Authority
6	Mr. Michael Moore	Chicago Housing Authority
7	Ms. Ann Lott	Dallas Housing Authority
8	Mr. Larry Loyd	Housing Commission of Anne Arundel County
9	Mr. Rufus Myers	Indianapolis Housing Authority
10	Mr. Steven Longo	Albany Housing Authority
11	Mr. Rick Parker	Athens Housing Authority
12	Mr. Richard Murray	Housing Authority of East Baton Rouge
13	Mr. Michael McInnish	Housing Authority of the City of Montgomery
14	Mr. Willie Martin	Jackson Housing Authority
15	Ms. Deanna Watson	Boise City/Ada County Housing Authority
16	Mr. David Morton	Reno Housing Authority
17	Ms. Ophelia Basgal	Alameda County Housing Authority
18	Ms. Sharon Scudder	Meade County Housing Authority
19	Mr. John Cooper	Massachusetts Union of Public Housing Tenants
20	Ms. Veronica Sledge	Resident Advisory Board/Victory Point RMC
21	Mr. Ned Epstein	Housing Partners, Inc.
22	Mr. Greg Byrne	Harvard Cost Study
23	Mr. Dan Anderson	Bank of America
24	Mr. David Land	Lindsey and Company
25	Ms. Sunia Zaterman	Council of Large Public Housing Authorities (CLPHA)
26	Mr. Saul Ramirez	National Association of Housing and Redevelopment Officials (NAHRO)
27	Mr. Tim Kaiser	Public Housing Authorities Directors Association (PHADA)
28	Mr. Michael Kelly	National Organization of African Americans in Housing (NOAAH)

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Appendix 1 contains the meeting agenda and attendance listing for the Committee members.

Ms. Tran	Let's get started. On your desk you will find copies of data requests from the first session that were sent out via e-mail from Claudia Yarus. The copies on your desk are hardcopies of the e-mail. I believe this completes all the requests. Also, on Friday, a final version of the Meeting Minutes was sent to all the committee members. Can we approve them? Please raise your hand if you agree to approve the meeting minutes from the first session.

Majority of hands raised.

Ms. Zaterman	I have a one word change. Instead of "inexplicably" it should be "inextricably."
Ms. Scudder	I had "1.36" and they had "1.6."
Ms. Tran	Ms. Scudder, we will work with you during the break.
Mr. Morton	I would like to compliment the meeting minute takers for the accuracy and thoroughness of the notes.
Ms. Tran	Mr. Liu, did you want to start this morning?
Mr. Ramirez	We would like to call a caucus.
Ms. Tran	Will ten minutes be sufficient?
Mr. Ramirez	Yes.

Caucus granted at 8:45 am. The committee reconvened at 9:17 am

Ms. Tran	Let's get started, Mr. Liu.
Mr. Liu	On behalf of HUD and Secretary Jackson, I want to thank you for committing your time to this three-day session. We certainly believe we can come to consensus on key items during this session. I am saying this so that if there are any thoughts to extend this past Thursday the answer will be no. I also want to congratulate Mr.

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Morton on his work. I think you have copies of the work he's done. It shows that we all do many things besides public housing and the good work that we do. I also want to congratulate Mr. Cooper on his son's returning home from Iraq. Our prayers are with him.

Mr. Cooper: He just left Ireland and is on his way to NY.

Mr. Liu: I understand various individuals and groups may have proposals. HUD has a comprehensive proposal also. I would like to suggest, with the consensus of the committee, that those of us that have proposals bring them forward and we can all go through the proposals and then break or caucus for 45 minutes to go through the proposals.

Ms. Tran: Does everyone agree to go through the proposals, and clarify any points but not to debate the proposals? Then we can break so members can read the proposals more fully. Mr. Liu would you like to go through your proposal?

Mr. Kaiser: I think it is a good idea. We are still straining to hear you down here. I don't want to delay further.

Ms. Tran: Okay, also try to speak into the mike. Mr. Liu, you indicated HUD has a proposal.

Mr. Liu: Yes, I'd like to pass it out and then have Mr. Russell go through it.

[HUD proposal passed out. See Appendix 2 and Appendix 3 (green sheet)].

Mr. Liu: I think everyone has copy. Mr. Russell.

Mr. Russell: Good morning. I'm fighting a head cold so hopefully you will still be able to hear me all right. I'm just going to walk through this and at that point, we can hear from others as well, and take some time if any points of clarification need to be made. Our basic position is to accept Harvard's methodology of PELs and project-based management except where modified. We want a more transparent, simplified formula with incentives.

Under the PEL and PBA heading, we are proposing to reduce the non-profit coefficient from 10 to 9%. For mixed finance, there are concerns for properties where the deals have already been closed and the properties have already moved to mixed finance. We will be sensitive to those properties and take a look at those AELs. Under PBA we would modify the regulations to include a tighter definition of project and cost center, to include all accounting transitions, require information to be submitted to PIH, allow PHAs under 100 units to treat everything as one property, and up to 200 scattered site units would be treated as a single property. The full transition would be implemented no later than FY2007.

For add-ons, we think it is important to keep audit costs as a separate add-on. Harvard wanted it as part of the PEL, but we are concerned about the quality of our audits. REAC has done a great job of looking at companies that perform audits and have cracked down on a few. We want to continue to pay for the costs of a quality audit, we rely on that information as well and the taxpayer is entitled to accurate audit information. We also support the establishment of resident participation as an add-on as it currently exists. HUD believes it is time to eliminate three other add-ons: 1) costs attributable to deprogrammed units, 2) phase-down funding, and 3) long term vacancies. After hearing the debate in week one, we think it is appropriate to consider an add-on for the asset management fee, especially for those that are in the businesses of managing large assets.

Under utilities, as Mr. Kubacki presented, we will eliminate the existing utility adjustment and codify a mechanism to use the normalized actual consumptions and average rates, which we are proposing to make effective in 2005. We would maintain the existing mechanisms for rate and consumption reduction incentives and reduce rate risk, we would codify the inclusion of resident paid utilities and energy performance contracts currently processed by waivers, and use a benchmarking approach starting in 2008. As Harvard mentioned, we do have project-based utility data that we have been asking you to roll up. We have not been tracking project rates and we want to start doing that.

Under the formula for income determination, we're looking at ways to change the methodology, and to allow PHAs to unlock the value of their assets to access private capital. There are a couple of ways to do this. One, the formula would not consider any revenue, tenant paid rents or other income revenue the PHA generates. All the costs of the property would be added-up and HUD would pay a certain percent of the costs. The rest of the costs would be paid by revenues the PHA generates. Another way is to take historical data and apply an inflation factor.

For the transition policy, in year one, PHAs with a reduction of more than 5% would be capped at 5% and those with increases of more than 20% would be capped at 20%. The determination of who is affected would be based on FY 2004 data.

The appeals policy would basically be budget neutral, especially in a year in which we have already budgeted for an appropriation. We will reserve a certain amount of money for appeals and if there are no appeals the money would be redistributed as part of the formula. In subsequent years, there may be a way to accommodate the appropriate formula amount in budget development. Appeals are voluntary but must cover the entire portfolio not just one property. There will be two categories of appeals: (1) Harvard coefficients are incorrect—e.g. geographic location or some other characteristics that you think is inaccurate or doesn't apply and (2) We should opt out of the Harvard PEL. Coming in, if a PHA has been operating under real asset-based management for at least two years, they could substitute that for the PEL. An independent assessment would be required. The appellate will pay the cost of the assessment. The assessment would be reviewed by a HUD designee, to be paid by HUD. HUD will contract with vendors in all 50 states and Puerto Rico to do a professional review of the appeals. After the professional review, the reviewer would make a recommendation to the Assistant Secretary or designee and HUD would make a final determination. If the appeal is granted, the agency would have the independent assessment level. The first type of appeal will be limited to one year after the publication of the regulation, and new projects coming in.

Implementation of the final formula: We want to simplify the funding formula and financial oversight. We would collect all the data at one time and fund all PHAs based on calendar year. It is already done this way in the voucher program and I believe in the Capital Fund and makes for a more rational funding process. We would reduce the reporting burden by using data already in HUD systems and reduce as many hard copy forms as possible. The goal is to have our systems over time calculate the Operating Subsidy automatically. The calculation will be similar to the current formula. The agency PEL is rolled-up project PELs. The formula will run: (agency PEL + agency utilities - agency rent) x UMAs + add-ons = subsidy. Over time as systems are enhanced, subsidy will be calculated at a more specific project-level where the total PHA subsidy equals the sum of individual projects. In the near term, PHAs that move to project based management and have actual cost data would opt out of the Harvard PEL. In the mid-term, all PHAs will move away from the Harvard PEL and use actual verified cost data to distribute Operating Subsidy by property.

Fungibility between the Operating Fund and Capital Fund would remain the same as under QHWRA: small PHAs have 100% and large PHAs have 20%.

For other reforms, HUD is interested in simplification of laws, regulations, handbooks, notices, and forms. We do not have the time to take this up in this Negotiated Rulemaking, but HUD is ready, willing, and able to entertain specific proposals from the industry to deregulate and simplify the operating environment. We also want to change from agency-centric to property-based management as is the case with almost all other multifamily properties.

Ms. Tran — Are there any questions seeking clarification on the proposal?

Mr. Ramirez — On the transition policy, number two says, "Transition funding will be offset by PHAs that gain over 20% due to the new formula. These PHAs will have their gains capped at 20% in year 1." Does this mean they go up to their full gain in year two?

Mr. Russell — Yes.

Mr. Lam — Does that mean with respect to those losing, they would realize the full value of the recommended loss in year two?

Mr. Russell — Yes. This is a longer transition than might appear. The year one transition policy would not take place until FY 2006. In FY 2005, you would have a full year to transition, then in FY 2006, you would have a 5% reduction, and in FY 2007, you would be where Harvard says you are.

Mr. Lam	Thank you for the clarification. With respect to section three – add-ons – I think from the last session there was a statement by HUD that supported the continuation of energy conservation contracts. These are typically 10-12 year contracts with financers and banks. Would these continue as add-ons to the formula?
Mr. Russell	Yes.
Mr. Lam	With respect to section 8, would a PHA have the ability to move subsidy funds from one property to another, or would it be restricted to spend the subsidy on one specific property?
Mr. Kubacki	On a certain level we are OK with that but on the other hand it deals with appeals. This is something that still needs to be discussed. We do not have a definite view either way.
Mr. Lam	So I guess we're not sure yet.
Mr. Kubacki	We are open to discuss it, but we don't have a view either way.
Mr. Lam	Is HUD still open about relaxing the definition for use of funds for resident participation?
Mr. Russell	We're willing to look at other proposals.
Mr. Lam	With respect to formula income determination—section 5, is some of the thinking to create a rent incentive to generate additional income to be more economically self-sufficient? Did that drive the first option?
Mr. Liu	The first option was driven by the idea that we may want to let the world know that HUD's Operating Subsidy has never fully funded the operating expenses for public housing, it would be a way to make that point very clear and delink it from rents. Whether this is an incentive to increase rents is up to the PHA. It may also be an incentive to raise income from other sources. We thought it might provide greater leverage for the PHA to work with residents to rationalize the rent structure.
Mr. Lam	Would something like section five, if a PHA made a local decision to raise rents, could the PHA expect to retain a greater portion than currently allowed under PFS?

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Mr. Liu — Yes, and we also hope it would be helpful in bringing in private sector financing for rehab and modernization, which would of course benefit both residents and the PHA.

Mr. Lam — You are making this much more broad, including rent but also including other income.

Mr. Nolan — I would like to commend HUD for a very comprehensive proposal, I am very impressed. I have a few questions. My first concern is for the three add-ons that are eliminated. For PHAs repositioning inventory, debt financing…

Ms. Tran — Is this a point of clarification?

Mr. Nolan — It is. How does HUD plan to compensate PHAs during that transition period? Is it included in asset management or is HUD expecting the PHA to cover transition expenses on its own?

Mr. Liu — To some extent, it is covered under asset management. We also take a global view on units vacant or demolished, but we can discuss this later.

Mr. Nolan — In reference to section five, if the formula changed, would that also change the formula in section eight? Will it be based on each project or will it be a global percentage?

Mr. Russell — Section five does not include any income. In section eight, we would be baselining it. If the committee agreed, it would change quite a bit.

Mr. Nolan — So would the percent be the same for all PHAs?

Ms. Basgal — In section seven, the appeal assumes it is budget neutral, but what if appeals exceeded the 2%, what would the Department do in that case?

Mr. Liu — Let's just say for the moment that this is a placeholder. That is a scenario, regardless of the percentage. The thinking of having a set-aside rather than adjusting the pot from the whole is that it is much cleaner from a budgeting perspective. This is a cleaner approach, but we can talk about the percentage.

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Ms. Zaterman	With respect to fungibility, you do make a reference to QHWRA. I am puzzled by the response regarding fungibility across properties. Can you clarify what your position is?
Mr. Russell	My understating is that there are two issues. PHAs are unable to use Operating Subsidy for capital purposes and vice versa and that is governed by statute. The second question is that as PHAs get subsidy by PEL can PHAs take the subsidy from property A and give it to property B. We are open to that at some level, but we don't want to get away from property-based accounting and management, which is our long-term goal.
Ms. Zaterman	I think QHWRA assumes fungibility across projects for Capital Fund and Operating Fund. With rent proposals, are you thinking of a number for the percent. What range might that number be in?
Mr. Liu	The fact is the percentage for PHAs runs the gamut from low to high, 0% to 80%. We need to do further analysis based on the discussion here if there is some interest. We don't have an across the board percentage. It could be across the board, but with the variation that currently exists we thought it would be imprudent to come up with a percentage. If we have interest, we can do some data runs over the next few days.
Ms. Zaterman	You have a 2% holdback for appeals, but I don't see anything like that on the utility side. Would you use the same principal to deal with utility adjustments?
Mr. Russell	Under what we proposed two weeks ago, we wouldn't need to make any adjustments because you would pay actuals two years later.
Mr. Kaiser	Bill, can you explain the rational for Roman numeral II, reducing the coefficient from 10% to 9%.
Mr. Russell	At this point we just want to touch on points of clarification, later we will have time to debate why or if the industry disagrees. I don't really want to get into a debate now.
Mr. Kaiser	I was just asking for a point of clarification, but we can hold that thought until later. On page 2, number six – Transition – the phase-in

for those PHAs with a reduction of more than 5% in year one. Is it 5% of the total operating subsidy or 5% of AEL?

Mr. Russell — Mr. Kubacki tells me it's based on AEL but we could run it either way.

Mr. Kaiser — Those are significantly different amounts.

Mr. Russell — Our proposal is PEL versus AEL.

Mr. Kaiser — This reads operating subsidy, but the intent is PEL versus AEL.

Mr. Russell — Correct.

Mr. Kaiser — You use the term "modest inflation factor." Is there any specific amount you are contemplating?

Mr. Russell — We don't have an exact amount, but we look at historical trends and figures used in the past.

Mr. Kaiser — One last question under #2 Project Based Accounting, with respect to agencies with 100 units or less having some administrative relief. Typically the definition used by Congress and HUD, and this administration has been very supportive, is of 250 units or less. Why did the number go down?

Mr. Russell — It's just something we thought was a reasonable number for a very small agency. We might be willing to look at different numbers.

Mr. Nolan — Would PILOT also be an add-on?

Mr. Russell — Correct.

Mr. Longo — So add-ons would not be prorated based on the 5% cap, going back to Tim's question?

Mr. Kubacki — How the transition is crafted, we looked at the difference between AEL and PEL to see who has losses or gains under Harvard. For add-ons, everything is always pro-rated to stay within budget limitations. If your AEL/PEL triggers a loss, that is who will be affected by the transition policy.

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Mr. Longo — So even with add-ons, if you're losing more than 5%, it would be included in the transition.

Mr. Kubacki — No, to see who is affected, we're only looking at AEL and PEL.

Ms. Zaterman — I'd like to understand add-ons. You have add-ons for audit cost and resident participation that are subtracted from the PEL. So it's an add-off. We've coined a new term "add-off". So there would be no change in subsidy level.

Mr. Russell — Correct, it is budget neutral. Actually, under audit cost it may be a net gain, if Harvard is assuming an audit cost of X and you spend more than that, you wouldn't be reimbursed if it's inside the PEL.

Ms. Zaterman — So the energy add-on, is that an add-on or an add-off?

Ms. Tran — I believe that is outside the PEL.

Ms. Zaterman — So it's an add-on. So there are no add-ons in the true sense that provide additional funding except for the energy loan amortization.

Mr. Russell — Also, on page 2, we are proposing to create an additional add-on for asset management.

Ms. Zaterman — Could you give us some sense of what that is? Would everyone get the same amount, a PUM amount, across the board, or would it be based on individualized circumstances?

Mr. Russell — The honest answer is that we need to flush this out a little more. What we're saying here is that we are open to this additional add-on but how it's calculated has not been determined.

Ms. Zaterman — So if the PEL drops by 30%, in the first year it triggers a 5% reduction and the PHA gets the add-ons and the add-offs on the side. Then in the next year there would be an additional 25% loss in subsidy. When does the appeals process begin? How does the appeals process work? Let's go through timing.

Mr. Russell — The PHA would need to appeal in FY2006, the first year of the Harvard transition.

Ms. Zaterman	So based on the appeal it would be possible for there to be an additional 25% loss.
Mr. Russell	Correct.
Mr. Cooper	In HUD's proposal, how would this affect rents paid by residents? With the decreases in operating subsidy over a period of time, would residents pay a higher percentage of income and would the PHAs be allowed to charge higher rents?
Mr. Russell	The quick answer is no. We obviously have affordability standards in terms of how much residents can be charged. Also, there are some instances where PHAs haven't increased rent in years. Some PHAs don't have a minimum rent, that type of thing. I don't see this as causing PHAs to increase rents.
Mr. Lam	With respect to rent, following up on the rent issue, there is no proposal to change the Brooke Amendment as it stands. Under the current system, there are some economic disincentives for PHAs that increase their rent. As another clarification, the asset management fee, the PHA would be eligible to receive it as a way of covering overall administrative expenses, is that correct?
Mr. Russell	Not exactly. What we heard from many of you two weeks ago was that while management fees are included in Harvard, the cost of managing a number of assets is not picked up in the formula and that is something we are sensitive to. I wouldn't call it administrative costs. What we're telling you is that we expect you to move toward asset management. We are willing to add some of that into the model, but it will come with the expectation, quite frankly, the demand, that PHAs move toward that model. I would even say we'd use it as a stick so if a PHA hasn't gone toward asset management, HUD won't pay that fee anymore.
Mr. Lam	One other point of clarification. Energy conservation and loan amortization are add-ons outside of the PEL, does that mean they would come off the top of the nationwide appropriation so they would be fully funded, and then the remainder would be prorated?
Mr. Kubacki	No, we're still expecting to look at the old form, determine eligibility and then prorate.

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Mr. Kelly	On the green hand-out, FSS and EDSC - coordinators I guess. Is that not a special grant program that needs to be applied for?
Mr. Kubacki	FSS has always been an add-on for the Operating Fund, but in 2004 HUD switched FSS with EDSC. What we're showing is now EDSC is funded just like FSS as an add-on. EDSC was a grant program within ROSS.
Mr. Ramirez	Point of clarification, section five – Formula Income Determination. When you speak of example one, where the formula involves a percent, the percent is in question due to variance, and agencies don't have all that much discretion in determining percent. Relative to the whole universe, there is a little room for agencies to change percent. Are you saying this on an individual basis, or is that still up for discussion?
Mr. Liu	The simplest from a conceptual standpoint would be the option that incorporates options two and three, and we would go to historical data. For example, PHA X, over the past three years has gotten enough to cover 57%, or whatever the percent is.
Mr. Ramirez	Another point of clarification, has this actually been costed out?
Mr. Kubacki	We've costed it out for the individual line items. Some things like the asset management fee, because we don't have a number behind it, we have not flushed out.
Mr. Ramirez	Are you prepared to show those cost numbers?
Mr. Kubacki	Sure.
Mr. Nolan	Would it be possible to get a run of the revised PELs since we have removed add-ons?
Mr. Kubacki	We have already prepared this and can hand it out.
Mr. Kaiser	If there are no other questions, I would ask for a caucus.
Ms. Tran	Would you like to put forth some proposals first?

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Mr. Kaiser — I think we'd rather do a 10-15 minute caucus.

Ms. Tran — Let's reconvene at 10:30.

[Analysis handed out. See Appendix 4]

Caucus granted at 10:25 am. The committee reconvened at 10:50 am.

Ms. Tran — Can everyone please move towards their seats. Thank you. Are there other proposals that the members would like to put forth?

Mr. Ramirez — Thank you for putting a proposal on the table. We would like to respond to the first 2 principal items: (1) HUD's general position and (2) project-based accounting. We'll be presenting impacts that have been raised under the baseline proposal. As an aside, before we go into our presentation, we ask that you would provide the committee a run for the first and second year for individual agencies.

Ms. Tran — The data team will get that done.

Mr. Ramirez — I'd like to yield my time to Mr. Kaiser or his alternate.

Mr. Kaiser — We appreciate seeing the Department's proposal. We were asked last time not to put together a piece-meal proposal so we would like to put forward a comprehensive proposal, using the Harvard data that was previously provided. Mr. Ted Van Dyke, our technical expert, has prepared a presentation working with other groups. As my alternate, I would like to have him walk us through it. I will go ahead and hand out the presentation to those who do not have a copy.

[Mr. Kaiser's presentation handed out. See Appendix 5].

Mr. Van Dyke — I want to thank the Department for its proposal. We've basically tried to use the cost study as our basis for this proposal. As such, we've organized it into four categories.

1. Model predicted estimate—$3.7 billion is the number that the Harvard Study predicted, and is also included in the handout just provided. We included the items that we felt were legitimately part of the Cost Study estimate as we discussed at the last three sessions. The first is the last-minute adjustments. Our recommendation is to eliminate the last-

minute reductions, which would result in the removal of ceilings, but we kept the floors, because the model is not very accurate at that level. Other last minute reductions that were made were the change of the non-profit coefficient from 12% to 10%, and the addition of ceilings and reduction of those above $325 by 4%.

2. The other area the model did not account for was the age of properties. We have included the age delta that is provided in PFS for properties over 25 years, which as you know the model basically flat lined for the rest of their life.

3. It includes all the PFS add-ons that the Study considers outside the model such as funding for phase-down for demolition and we also included the four add-ons: Audit costs, Resident Participation of $25 per unit per year, Unit Reconfiguration and Non-dwelling Rental Income add-ons. Those are what we consider to be needed, if you take the cost study as it was statistically done. We feel this is the amount that actually portrays the cost of running "well-run" public housing.

4. As a result of last session, there were some additional items that were not included in the model. First is the asset management fee and related expenses. The Study said that the fee should run in the range of $5 to $15 PUM, so we took the middle range that is $10 PUM. Second, the cost study evaluated the cost of fourteen regulations that apply to public housing that don't apply to FHA. The median cost is $3.25 PUM. Finally, the Cost Study identified the cost of managing IT in public housing that exceeds the cost in FHA by $6 PUM. So if we just include the areas identified the additional total cost is $19.54, as shown in the report. The third item is the resident services component. In FHA, there is no direct expense to run resident services. The Department ran the numbers and it came to $137 million. We took that amount as the cost to be used for resident services and that comes to $9.56 PUM. The study also documented that the benefit structure in pubic housing is different from FHA, primarily because of pensions, also the PHAs have been obligated to base their benefit structure on local government practices. The study identified that PHAs pay 33% of salaries for benefits, and FHA pays 25%. We took that difference and calculated it to be $11 PUM, which gives the subtotal $325.72 PUM. We are also proposing that their loss should be restricted to 5% reduction of AEL and a one-time loss – a final reduction. If the cost were funded at what we outlined here, we would need $3.49 PUM to

pay for that. We also recognize that there will be an appeals process and we have not estimated the cost of that but it would be an increase, if an appeal was granted because the study was incorrect, then the additional funding should not be subtracted from someone else's funding.

Mr. Byrne — I am looking at the numbers, am I right that the total dollar impact is somewhere around $1.1 billion? What is the total impact?

Mr. Van Dyke — I don't think it's quite that high, but it's in that ballpark.

Mr. Ramirez — We agree that the use of the Study with some modifications is appropriate. We do need to address the question of floors, especially for small PHAs, given the error rate of almost 50% on a property-by-property basis, and also need to explore the appeals process. The way the proposal is crafted on loss limitation, there would be appeals few and far between as a result. PHAs can retain and use investment and other income without a corresponding offset.

[Appendix 6 was handed out.]

Mr. Ramirez — We also included the option of fixed rental income as of FY 2002 for the purposes of determining operating subsidy. Agencies would therefore receive 100% of the benefits from increases in income and 100% of the risks for decreases. A preliminary observation of the utility proposal would create a lack in immediate reimbursement and the PHA would have to bear the burden of any spikes in utilities for that current year. We are concerned about fungibility. We need as much fungibility as possible for properties. We do need to increase flexibility. We are here to provide public housing beyond bricks and sticks, we are not looking to create a profitable venture. We have a public purpose. The funding system should also be reexamined every three years and compared to FHA. As we move toward greater project accountability, we will need to review how we relate to FHA. The Study does not take into account the true regulatory differences between public housing and FHA and Mr. White did make a point about that. It is a fluctuation of almost 50%, as Professor White indicated.

The property centric management concept, we believe is worth reviewing although our rulemaking does not allow us to go into this, we do feel this is some thing that can be discussed but not as a quid pro quo to getting this rule done. The definition of property-centric accounting can mean up to three things: project-based accounting, project-based management and property based budgeting and funding. Public housing is a unique structure and we need to make sure the true costs are identified. I concur with the Department, we need to work towards a deregulatory environment. I've abbreviated my presentation but ask that the entire document become a part of the minutes.

Ms. Tran — The document you submitted will be included in the meeting minutes. Are there any other proposals?

Mr. Anderson — I would like to hand something out.

[Appendix 7 was handed out.]

Mr. Anderson — Let me give you some background. Like many folks here, we were frustrated with the lack of forward motion at the last session. Mr. Epstein, Mr. Byrne, myself and some other folks that worked on the Study met via phone to put some ideas together. You will find some points of overlap on the two suggestions already handed out. The very first item on this list is to clarify the primary mission of public housing, that is real estate. There are other activities but they are not the primary mission. The ability to carry them out and the depth to carry them out must evolve from the primary mission. Secondly, we think that regulatory relief needs to move forward in the immediate slipstream in the implementation of this rule. We think that Appendix H in the Study is a good place to start that needs to be jointly advanced by the Departments and the industry groups. With respect to fungibility, we approached it the same way that the rest of real estate approaches in terms of property operating statements. To the extent that if there is nothing on the net operating income line (NOI), there is nothing to fund. With strong properties there may be something left to fund weak properties. There is a strong endorsement of fungibility but there is a right way to do this – from the bottom of the operating statement and not from the top. The last item on our list is the way we look at a formula based approach, generally this is not an alternate destination contrasted with the existing formula. This is a path for aligning and connecting public housing with the larger world of affordable housing and mainstream real estate practices. When we talk about phase-in methods, we need to discuss phase-out practices. Over a short period of time, 6 years – every property should be on property-based budgeting and in conjunction with that it should be linked to the systematic recapitalization of public housing for the system to experience systematic reinvestment as well as use it to determine individual operating subsidies. The two are closely linked: they support one another and sustained long-term stewardship of the institution.

Ms. Tran — Are there any points of clarification?

Mr. Kubacki — On the first one, Mr. Van Dyke that you presented, I just want to make sure my understanding is correct. How do we go from the actual appropriation from $250 to $285?

Mr. Van Dyke — I took the projected cost of the Harvard Cost Study that HUD provided last session and I reversed the last minute adjustments, except for the floors, added the age delta, and costed out the four add-ons considered to be in the model that we are suggesting should continue to be funded.

Mr. Kubacki — On number three – resident services – is this over and above the $25 per unit?

Mr. Van Dyke — Yes.

Mr. Kubacki — You mentioned that there is a 5% one-time loss. Is that as low as anyone can go?

Mr. Van Dyke — Yes.

Ms. Tran — Are there any other questions or clarifications on either the industry proposal or what Mr. Anderson discussed?

Silence.

Ms. Basgal — I just wanted to confirm on number four for the appeals process, it is not an appeal of the Harvard study determination of costs, but it is based on a property-based budget evaluated by independent experts.

Mr. Anderson — There are two types of appeals discussed by the Department: (1) How is the formula is constructed and (2) what are the consequences for particular portfolios. First of all, we are not proposing appeals of type number one, we only would accept appeals for particular portfolios, and yes, they would be budget-based if the agency wished to pursue an appeal.

Mr. Kelly — Has the second proposal been costed out?

Mr. Anderson — No. Our starting recommendation is that PHOCS recommended PELs be implemented with the 6% funding increase over FY2003.

Mr. Epstein — In our proposal the asset management fee comes out of investment income, basically it is not an additional appropriation.

Mr. Lam — In Mr. Anderson's proposal, what assumptions are being made for security expenses or police forces currently funded by the PHAs? How are those considered, if at all?

Mr. Anderson — The proposal, other than the treatment of property and asset management fees, does not decompose into any other individual budget line items.

Mr. Lam — Just for clarification, since in the FHA database there are no significant security or police expenses, those types of expenses would not be considered eligible expenses since they are not included in the base model of today's proposal?

Mr. Anderson — We may be headed to a land beyond clarification, but I can respond.

Ms. Tran — Let's hold off. Are there any other points of clarification that need to be made for the three proposals that are on the table.

Silence.

Ms. Tran — If there are no other comments at this time, let's break for lunch to give everyone time to read through the proposals and we will try to reconvene at 12:30 p.m.

Break at 11:24 am. The committee reconvened at 12:00 pm.

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[The Transition Policy Scenario Model Estimate for Committee Member PHAs for FY 2003 was handed out. See Appendix 8. Operating Subsidy Eligibility as a percent of the Total Operating Expenses by PHA Size Category and Geographic Region (FY 2003) report was also handed out. See Appendix 9]

Ms. Tran: Can everyone please get seated. Everyone will find a copy of the Transition Policy Scenario and the Operating Subsidy eligibility report on their desks.

Mr. Liu: In the interests of moving the discussions along and learning as we discuss the various proposals, we would like to present a verbal revised proposal to let you know where HUD is at and we sincerely believe this can get us not two yards down the field but maybe 15 or 20 yards.

Mr. Russell: We are willing to make a few revisions to this morning's proposal. (See **Appendix 2**). It would probably be easier to make notations on our proposal then we will revise and redistribute it. We are willing to increase the non-profit coefficient to 10% with the understanding that we are "buying" resident services. On project-based accounting, 3rd bullet, we are willing to allow PHAs with fewer than 250 units to treat their portfolio as a single property. On the 2nd page, we will create an add-on for asset management at $4 PUM, with the caveat that only PHAs with 250 units or greater would be eligible for this asset management fee. We are also willing to consider an IT add-on of $2 PUM. Under formula income determination, we will distribute a national summary of where people fall in ranges of 10%, in terms of dependency on subsidy for operations. We favor our first example, as where you see the percent sign you would use the existing dependents – whatever percent you are currently dependent on for federal subsidy with the understanding that there would be no PHA that is more than 90% dependent. Today, there are only a few PHAs that are in this situation. I think we could all agree that PHAs should be able to come up with 10%. Based on industry's proposal to revisit the model, we would take a look at where your dependency is, and if your dependency has significantly lessened, we would take that into consideration. But for three years, it would be based on your existing dependency. On the very last page under fungibility, we propose to go with the policy endorsed by Anderson, Epstein and Byrne and Co. To summarize, individual properties would use property specific PEL as the base and any excess profit would be fungible.

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Ms. Tran — Are there any questions?

Mr. Ramirez — On the fungibility question, what you are adding would be point No. 1 or are you adding all 4 points, (on number 5 of the third proposal)?

Mr. Russell — I think we're saying we would adopt the entire number five.

Mr. Anderson — I don't think I got the full benefit of the point you were making about the ratio of operating subsidy to total expenses and how that worked with the phase-in, if I could trouble you to go through that one more time.

Mr. Russell — Are you referring to Roman numeral V on our proposal?

Ms. Tran — On the handout that has been passed out.

Mr. Anderson — Yes, for the first year.

Mr. Russell — For example, Wichita, KS is at 60%. So 60% of their costs are picked up by HUD current subsidy, so we would plug that number in for the first three years until we revisit the formula.

Mr. Parker — So, it would be each individual PHA depending on how they fell. If they are 40%, they get 40%, 80% they get 80%, and I think you said it backwards before, there would be a 90% cap on federal subsidy and 10% would have to be provided locally.

Mr. Ramirez — For the 1st three years you are locked in at the current percent. After three years, if your dependency has been reduced for that three-year period, the number is adjusted to reflect the lack of dependency on subsidy, is that correct?

Mr. Russell — When we review how the Harvard Cost Study is performing in three years, this would be an aspect of the review. If a PHA in FY 2006 was 80% dependent and in FY 2008 they were 60% we would want to take a look at that.

Mr. Liu — We hope there will be a different regulatory environment which may also play a factor on mix of various types of revenues, and it does not have to be a three year period, it could be every three, four, or five years.

Mr. Ramirez — Thank you. As a follow-up, if during that three year period, it doesn't say if this is optional or not, I assume you are saying it is a mandatory lock. Is it across the industry or at the agency's option?

Mr. Russell — This would be a mandatory lock.

Mr. Ramirez — If mandatory, what would happen to agencies that work towards lessening its dependency? Let's say there are two employers in the town and one of the employers' leaves town and economy collapses, will there be any regress or are they locked in?

Mr. Russell — I suppose we could discuss an appeal policy.

Mr. Ramirez — I think we all want to minimize the number of appeals the department has to deal with. Maybe what we should be talking about is if there is a trigger based on the information provided to HUD for review, instead of waiting for a situation that would deteriorate rapidly for some communities, to get regress in a sufficient and timely manner. Secondly, regarding the whole process of appealing, the 3rd piece of Roman numeral II, the Study recognizes that there is a 50% variance. What will trigger an appeal there? There is a possibility that out of 17,000 projects, half of them may be off. That can certainly become quite onerous on the Department. We need to think of the appeal process as something that raises a red flag rather than a percent.

Ms. Zaterman — The percent of dependence on subsidy would be calculated every year during that three-year period or would you use the same percent for all three years?

Mr. Russell — That is right, you would use the same percent for all three years.

Ms. Zaterman — Are the IT and asset management add-ons real add-ons or are they really add-offs?

Mr. Russell — They are real add-ons.

Ms. Zaterman — We currently don't have a system in place for PHAs to track NOI or record NOI on the fungibility issue.

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Mr. Russell	If I may, I'll direct to Mr. Anderson or Mr. Epstein.
Mr. Anderson.	The ability to measure net operating income (NOI) is an intrinsic benefit of project-based accounting. The move to project-based accounting will allow you to track and account for net operating income.
Ms. Zaterman	I have a few questions? Does HUD expect to have systems, forms, budgeting, etc. in place to require PHAs to track that this as new funding starts, or is this a goal over the next three to five year period?
Mr. Russell	That's a good question. We acknowledge that our systems right now are not entirely capable of implementing the formula on a project-by-project basis, so the NOI fundability requirements would kick in when systems able to fund on project-by-project basis.
Mr. Anderson	I suspect I am just being thick, but I am back on Roman numeral V of the Department's proposal. If during a transition period the relation of operating expense to subsidy is held at a constant relationship that is leaving me to the conclusion that one of the findings of the Study is that are some agencies that are under funded and over funded and that remains wholly unaddressed. What am I missing? I certainly recognize there will be phase-ins, and holdbacks to deal with appeals, but tying an existing relationship to subsidy would not address the problem.
Mr. Parker	You are thinking about two different things. If a PHA that has been historically under funded, that will be addressed by the new PEL. Locking the relationship of the locally generated revenue will not affect the PEL and the locally generated revenue rate does not change much from year to year. You have to make the calculation against the new PEL and not against the old PEL. If you use the old percent of income to subsidy then you have a problem, but if you use the new PEL number then it's fine.
Mr. Russell	There is another way to look at this: If a current AEL is $250 and a PHA is 90% dependent and the new PEL is $300 then the PHA is still 90% dependent, leaving aside UEL for simplicity sake.

Mr. Anderson	That would imply an increase in tenant rent and that is something that occurs very slowly from what I understand from Mr. Cooper. There is an algebraic disconnect.
Mr. Parker	You can't relate it to the old PEL; you have to apply it to the new PEL.
Mr. Anderson	But the percent is based on history.
Mr. Liu	Mr. Anderson, part of the conundrum of tying in rent into the formula has engendered the outcome that you mentioned – a very slow rise in rents. We do not expect to see an acceleration in rent increases because there are other regulations that require that rents remain reasonable and within reach of low-income families. One of the differences of PHAs is that they lose in the Operating Subsidy game because of the current structure.
Mr. Nolan	This formula drives an incredible amount of behavior. If you drive PHAs to act more business-like, that is the direction we will go and want to go. How we verify rent and income is something that the PHAs will pursue. Going back to some of the suggestions, regarding Roman numeral V, I would recommend that the percent is of the PEL only rather than the PEL + add-ons + utilities. Some PHAs would not be able to keep pace with the changing utilities. That is my situation - my water rates increased by 30%. It would be a better formula for us if we did the percent of PEL only. I would also suggest that we elevate the asset management fee to be of equal standing to the PEL rather than an add-on. The other point on the asset management fee - $4 PUM and $2 PUM for IT costs - I would like to contrast those numbers with other programs administered by HUD. If you look at Section 8, and provided that the duties are different, but maybe they are similar in some respects and the workload might be even be less in Section 8, but they are $50 per month. There were some references to $20 PUM rather than $4 PUM and if you bump the number up we could absorb the asset management fee and the IT fee.
Mr. Lam	With respect to fungibility, would investment income continued to be retained by the PHA?
Mr. Russell	It would continue to be retained.

Mr. Lam	What about future inflationary adjustments? Would past practices continue? Would the appropriation be increased by an appropriate inflation adjustment?
Mr. Russell	The answer is most likely yes. As we do with other programs, we look at inflation factors but that would be part of the annual budget process and not something we would plug into the formula.
Mr. Lam	Obviously, subject to budget constraints but we want to make sure those will be asked for.
Mr. Russell	Yes.
Ms. Sledge	Regarding Mr. Nolan's statement, you do not want the add-ons to be taken from the PEL?
Ms. Tran	I think that Mr. Nolan suggested that the asset management fee should not be treated as an add-on, but should be part of the operating subsidy equation: operating subsidy = PEL + add-ons +utilities + asset management – rental income. In HUD's proposal on rental income, the percent would apply to PEL only and not to the rest of the formula.
Mr. Kaiser	I want to clarify HUD's proposal for small PHAs. We are raising the number to 250 units and PHAs with less than 250 units would not be eligible for the asset management fee. Even if they had two or three properties, they would report them as one property and they would have full fungibility.
Mr. Russell	That is correct.
Ms. Scudder	My understanding is that for the asset management fee for PHAs with less than 250 units, they would not have a management fee.
Mr. Russell	PHAs with under 250 units are not required to report on a budget-by-budget basis. The entire portfolio would be treated as one asset, so you would not get a management fee since there would be less administrative work.
Ms. Zaterman	I would like to clarify the rent calculation proposal. Let me give you an example, if my AEL is $50 and I collected $50 in rent, then I am 50% dependent. If the Study gives me a PEL of $150 and I still collect

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$50 in rent, 30% is now covered by rent. So would use you 50% or 30%?

Mr. Russell — We would use 50% for the next three years.

Ms. Zaterman — So where is the incentive and how is this simplified? In this example the subsidy dependence would be increased under the PEL and decreased under the old AEL.

Mr. Ramirez — Based on the information provided, have you costed out this proposal?

[Mr. Russell nods yes].

Mr. Ramirez — Can you percent this back to a PUM. We have already gone down this with asset management. I would be helpful for me. The transition policy remains in tack.

Mr. Parker — I ran this proposal using an odd split - using an 80/20 scenario. Sometimes when the math is too simple it throws things off. I have a question for Mr. Anderson for Number 5, Mr. Anderson can you please clarify bullet number 4 and 5.

Mr. Anderson — Its been observed that relative to many other operators that the relationship of property level expenses is tilted towards central expenses in public housing due to a variety of factors like public mission. It has also been observed that the bi-product of that split is the level of investment of staff time has not flowed as deeply and to properties as it might and as it should. This is an effort to get to that criticism. There is a parallel to FHA that the basic notion is that there should be some notion of competition of bidding for that service and that is should not be sole source.

Mr. Parker — Who will determine what the acceptable amount of items are for number 3 and number 4? Does that mean that you would not be able to use your own maintenance crew? I don't understand where the limits are.

Mr. Anderson — There is not a great deal of detail here, and I can't give that to you, but the notion that one should habitually spend more when there is an option to spend less is a defensible notion.

Ms. Tran	We do have markers is someone wants to illustrate an example on the flip charts.
Mr. Parker	If the PEL is historically under funded and they have 80% subsidy and the AEL is $165 and the PEL is $225, they are generating 33% in rent. If you apply 80% to the new PEL number the subsidy goes to $180 but the rent goes to 45%. That implies that the PHA must achieve a 36% increase in rent in year one. The alternative is to take this is to lock it at that level. The subsidy number goes to $192 and the split is 85.3% over 14.7%, in that case the PHA is locked at the current actual rent level. It does change to get to $225. Otherwise they don't get anywhere new.
Mr. Ramirez	That assumes that we are able to raise rents. Some folks are already at their 30% cap and until BROOKE gets eliminated there is no place to go. I'm just saying that is a reality that is not addressed in this formula.
Mr. Nolan	There is an upside limit for how much we can raise rents. This will allow some PHAs moveability. Going back to freezing the rent to encourage a more business-like practice, I was wondering if HUD has given thought to PHAs that are trying to reposition their properties. How will the asset management fee apply to those PHAs?
Mr. Russell	We have not give this special consideration.
Mr. Nolan	I would be to both our advantage and HUD's advantage to reposition our properties and a fee needs to be factored in, maybe by way of an add-on.
Mr. Lam	The point of revisiting the model in three year, I don't completely understand. In terms of implementing the PEL for PHAs with 250 units or more, how would a PHA recover their central costs, i.e. cash management? Would the asset management fee cover all these costs?
Mr. Russell	Yes, that is basically the thought. The asset management fee would go to the asset management functions you are doing at the corporate level. In some cases this may very well throw off other revenues the PHA may decide to subsidize, but it would be up to the PHA weather or not to mention the other revenues the properties generate.

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Mr. Lam	What does is mean to revisit the formula in three years?
Mr. Russell	The industry recommended that we should reassess how Harvard is doing after three years.
Ms. Sledge	During the course of the formula change and the PHAs take on this additional responsibility. How will this affect those on the waiting list. Who would be eligible to live in public housing? Certainly who is let in and incomes will have to change to come up with extra dollars.
Mr. Russell	We don't envision any changes to the stat regulations regarding income targeting. We are not proposing to alter that. There are still local preferences. It is not our intention to mandate a formula that says that PHAs must increase their rental income. Tenant income is not the only income that PHAs generate. Many PHAs generate investment income.
Mr. Liu	Let me elaborate.
Ms. Sledge	I was not finished. My real concern is not for those in public housing but for those on the waiting list if the formula changes.
Mr. Liu	I do not see such a massive change to rent policy in the short or medium term that would change public housing. For those PHAs that have been traditionally under funded, for example those at $165) but should have been at $265, for the last 10 years that PHA was able to make up that difference from sources other than rent. We hope the PHA will continue to look at other sources of funding and not only look at tenant income, but that is why we are here.
Ms. Sledge	This will be revisited in three years.
Mr. Liu	Yes.
Ms. Tran	We have 3 proposals on the table. Given that, how do we want proceed?
Mr. Lam	The Department ran some numbers during lunch using the original proposal, we should give them time to run the numbers using the revised proposal.

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Mr. Byrne — May I go up to the flip chart?

Non profit - $34 million (9% to 10%)
Asset Management – $57 million
IT Costs – $29 million
$120 million

Prior to lunch it was a $129 million increase now we have a total dollar impact of $249 million. We are not close to where we want to be. Rather than haggling over whether it is $2 PUM or $5 PUM if we are close to the same dollar impact, if we have:

$16 PUM for other
$7 PUM for investment
$23 total PUM

So you recognize it as an allowable cost?

Mr. Ramirez — Can you explain how you take investment income to pay for asset management costs.

Mr. Byrne — The $249 million is the expense level, so you are covered.

Mr. Ramirez — When we began our discussions HUD said that they would accept the Harvard cost study and now we are back to the formula that I thought that HUD had bought into from the beginning. Lets not try to kid ourselves that this is a gain.

Mr. Russell — The reason we are not at $250 is because we have a lot of pieces in the puzzle and we are not factoring in the transition. By year two or three we would reach those levels.

Mr. Ramirez — The assumption is that this study shows that public housing has been underfunded, some more than others. I don't that the report shows that some PHAs have been getting more than they deserve. Although there are concessions being discussed there are still other factors that we need to discuss to see if they are cost attributed to see if it a wash. I am not disagreeing that we are moving the ball forward, but we are not ½ million dollars above the game. Some of the $330 million that looks like a gain will cover expenses that are not included in the current proposal over the next 3 years.

Mr. Russell — Harvard is saying that some PHAs should get five to six percent more but some PHAs have been getting more than they receive. I don't think it is an accurate statement to say the whole industry has been underfunded.

Mr. Ramirez — Lets say that 75% of the industry has been underfunded.

Ms. Zaterman — My understanding with the first proposal is that the difference was that if you removed the add-ons from the PEL and reduced the non-profit coefficient…we started with the assumption that the increases proposed with the Cost Study would be there. With the exception of the add-ons for energy, asset management and IT, the others would be subtracted from the PEL. I would suggest a discussion on the add-ons and why there were taken out of the PEL. I also think we need to discuss asset management some more.

Ms. Tran — We can do that. On the add-ons, if I could summarize. Let's look at the current PEL (2nd column of Appendix 3). Harvard proposed the following add-ons to be within the PEL:

- FICA
- Audit
- Unemployment
- Unit Reconfiguration
- Non-dwelling
- Resident Participation

They are proposing that audit be taken out of the PEL and the PEL would be reduced commensurately. Is there agreement with the question of audit?

Mr. Morton — You will be able to get consensus on audit.

Ms. Tran — Audit costs would be funded outside the PEL and the PEL would be reduced by that amount. Is the industry OK with that?

Mr. Russell — The Harvard analysis looked at audit costs and included those costs within the PEL. There are audit costs imbedded in the PEL and we will take that out and then pay for the real costs of your audits, as we do today.

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Mr. Kaiser — You alluded to the rising costs and so that is why we want it as an add-on.

Ms. Tran — For add-ons, HUD pays the actual costs.

Mr. Kaiser — But you are reducing the PEL.

Ms. Tran — So are you saying the Department should pay for audit costs twice?

Mr. Parker — By pulling the audit out of the PEL then you are not tempted to go for the cheaper audit and so you keep the quality of the audits the same. If the logic holds for the audit, the logic does not hold for the resident participation dollars, because those are a statutory requirement. There could be a possibility of a trade-off. That does not represent an industry consensus.

Ms. Tran — Let me summarize, for audit you would fund it as an add-on and the PEL would be reduced but for resident participation you would fund this as an add-on but the PEL would not be reduced?

Mr. Parker — That is correct.

Mr. Lam — I object to the language that some PHAs have received more money than they deserve, that is an unfair characterization. I want to set the record straight. Those PHAs have spent that money on the residents and to say that our residents weren't deserving of those public funds is completely unfair. I am not familiar with investment regulations within FHA and I know that public housing regulations are strict and conservative, I would appreciate if someone could educate me on the differences between PHA and FHA investment regulations.

Mr. Epstein — Investment income on the FHA side falls into a number of categories. The largest category is the replacement reserve account – earned investment income and that income is redistributed into the reinvestment account. Investment income on working capital can flow down to the bottom line but that can get trapped with limited dividend. The owner is not able to see that money b/c of the dividend. The dividend goes to the dividend partners. The uses are not has generous as what you have on the PHA side.

Mr. Lam	My question has to do with the very specific guidelines on how PHA can invest its cash. For example there is a requirement that investments must be 100% collateralized, such as federal notes and bonds? Are FHA managers given more leeway than public housing managers?
Mr. Epstein	There are very strict guidelines. Most are used to buy treasuries. A manager does not have the ability to invest in any kind of thing they want. The investment must be insured and generally speaking they all invest in the U.S. Treasury and money markets that don't lose market value.
Mr. Lam	Do they follow the same investment guidelines as those stated in the handbook?
Mr. Morton	Are we at a point that we can agree on some small items, such as the 250 unit count and the audit fee without tying those items to other points?
Mr. Ramirez	I agree that we should try to find a common ground. A few weeks ago we said that we would not piece meal this but talk this through and come out with something at then end of the day. We are trying to avoid the Christmas tree scenario. If we break for 15 minutes I ask that we caucus.
Mr. Parker	I ask that we take a longer break.
Mr. Longo	The audit amount is an estimate, correct?
Mr. Russell	Can Mr. Byrne share those numbers with us?
Mr. Byrne	On page 52 of the Harvard Cost Study, I will read footnote 40. In FY 2002 the average FHA was $6 PUM compared to the public housing $2 PUM. We did say that in the case studies that it was a modest cost. We felt this was one offset where public housing pays $2 PUM and FHA pays $6 PUM.
Mr. Longo	So you would take out $2 PUM from the AEL? So we are being reimbursed for the actual costs to avoid being penalized for getting a good audit? But the estimate is being removed from the PEL.

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Mr. Morton	That makes sense.
Mr. Russell	We know the actual cost of audit in public housing, which is $19 million. We will pull $19 million out of the PEL, so it's a wash.
Mr. Ramirez	Is that FY 2001 data?
Mr. Russell	It is FY 2003 data.
Mr. Morton	If there are things we can agree on, I suggest we move forward. Otherwise we might not have time at the end.
Ms. Tran	Can we break until 3:00 pm.

Caucus from 2:27 pm to 3:41 pm.

Mr. Kubacki is now serving as the HUD representative and Elizabeth Hanson is serving as the Federal Designated Officer.

Ms. Tran	I think we'll start doing bingo rounds at these breaks. I'd like to introduce Liz Hanson, the Director of the Real Estate Assessment Center. She'll be acting as the DFO this afternoon, and Mr. Kubacki will be the HUD representative
Ms. Hanson	I want to introduce Anil Gola, he is the Director of IT and he is the systems expert for REAC. He wants to give you a presentation on implementation and when systems can be ready.

[Appendix 10 was handed out].

Ms. Tran	The slides are being passed around.
Mr. Gola	From this process, there will be publication of the regulation in a few months. Once things settle down, we will build a system for HUD before we go to project-based. We were building a system two and a half years ago, and we scrapped that system recently. Once these regulations are published, we are looking into buying a COTS software for all of HUD, which is tied into *e-grants*. HUD has a big initiative through CIO. The 2nd bullet is Resource Allocation. Sometime in July of this year we should have the regulation and the formula will need to be effective in FY 2005.

As far as the operating fund IT system, it follows a government wide data process. Data needs is collected, we run it, and tie it to our accounting system. HUD is also looking into a COTS system for accounting. Currently we have homegrown accounting systems. Once we get the COTS package here we will customize for HUD's generic grant process into the software. First we will build Capital Fund and Native American grant programs. We're planning to release mid-2005. Once we are done, in January of next year, we'll start looking at the Operating Fund Program.

Ms. Basgal — What does COTS stand for?

Mr. Gola — Commercial Off The Shelf. Like what we have done in the past, we have eliminated paper from all processes; we will also try to eliminate paper from this process. You are very familiar with the current system named PIC. We are collecting all building, unit and tenant data via PIC. We are looking for PIC to be streamlined. We are actually going through a business reengineering process to find the problems that we encountered with the building and unit submissions on phase 2 of the initiative. We want to be able to fix the problems and also build some credibility into the process so that the inventory is good enough to run the Operating Fund and Capital fund formula. We will clean up the existing data, put more internal controls (more checks and balances) in the process, and provide more horsepower if needed for the system. This has already begun from the business side. We have appointed a project manager who will be issuing a contract in a month or two. Finally, for project-based accounting which will come out in two and half years from now, we want to use the FASS software used by REAC.

Ms. Tran — Are there any questions?

Mr. Kelly — Moving towards having everyone on a calendar year budget, how does that relate to two releases in this presentation?

Mr. Gola — Two releases have nothing to do with the budget year. Normally our money is available in January and February for the fiscal year. We have quarterly releases and six-month releases. You can only jam so many requirements in one release.

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Mr. Kelly	How do you propose getting everyone on the same fiscal calendar, and when will that happen?
Ms. Tran	To clarify, releases refer to functionalities built into the system at certain points in time. The two releases add certain functionalities into the software system so the next release will have more functionality.
Mr. Gola	Yes, this has nothing to do with funding. These are the dates the software will be released.
Mr. Kubacki	To clarify, we're not having PHAs change their fiscal year end, we're just collecting all their characteristics at the same time. Just like the Capital Fund, we would use the same type of data. Currently, submissions come in every quarter. Instead of doing this four times a year, we would do this one time so everyone would know in January how much money they would receive for the calendar year.
Mr. Ramirez	I'm confused, and just for clarification. If we are going on a calendar year, how does that impact the budget preparation process for agencies relative to trying to shift or working in the spirit of cooperation in creating budget-based accounting and gathering all this information, it has no impact? Is that what you are saying?
Mr. Kubacki	From your budgeting standpoint?
Mr. Ramirez	Yes.
Mr. Kubacki	This goes in the simplification of the forms. In the end, we don't necessarily want you to budget to a HUD form. We want you to budget as a budget should be prepared. If you are a June PHA, you would already know half of your subsidy because that is estimated in December. But that is not much different from right now. Some PHAs' fiscal years are almost over and HUD hasn't given out their final subsidy amount.
Mr. Ramirez	What is the rationale for collecting it all at one time?
Mr. Kubacki	It will simplify the process, so from HUD's resource standpoint it would be done once. From a PHA standpoint, depending on your

FYE you would have a better idea of what the budget is. If your subsidy amount goes out in December, everyone would know the proration amount, and that it would cover 100% of your eligibility.

Mr. Nolan — I would really like to review that more thoroughly after looking at the 11B program because that is a similar program. The problem is that, in Section 8 there are settle-ups at the end of the year. I'll need to give it more thought, but for the system that is contemplated, will there be an upload capability for the financials, or will we have to go in on the Internet and manually input?

Mr. Gola — There will always be upload capability. If software that is bought does not have upload capability, we will build it.

Mr. Nolan — The upload capability that exists now? How many PHAs use it?

Mr. Land — 360.

Mr. Nolan — Why?

Mr. Land — We're the only ones using it right now. We've tested it and it works great.

Mr. Nolan — Does that require us to develop software that matches on our end?

Mr. Gola — If you have the software you will not encounter any added problems.

Mr. Nolan — So you will give us fields in XML format if we want to develop our own stuff?

Mr. Gola — Yes.

Ms. Basgal — One of the problems with the development of PIC was that it actually drove vendors out of business. The IT costs are so much higher than the FHA side because of PIC. Maybe you need to build software that accepts data in whatever format; otherwise it is a huge cost to us. You need to think through something that will not require huge software changes on our part.

Mr. Gola	We will certainly try and are looking for input. Whatever we do is going to be XML based, which is not very costly.
Ms. Tran	Any more questions on IT?

No questions. Liu and Russell return. Mr. Liu is now serving as the DFO and Mr. Russell is now serving as the HUD representative.

Ms. Tran	Welcome back, we just finished with the IT presentation. I'm not quite sure where the committee would like to go next.
Mr. Nolan	In the absence of subject matter to discuss, I was wondering if we could start talking about the funding for agencies that are trying to reposition their properties.
Ms. Tran	That is fine.
Mr. Nolan	In the proposal earlier today, HUD proposed eliminating add-ons for deprogrammed units and phase-down funding. Those costs have been historically difficult to obtain, hard to track, and have to be funded based on when each unit is vacated. I know HUD is proposing to eliminate add-ons due to the complexity of the calculation. In the end this would not increase cost. If you benchmarked today and went through infinity, generally speaking, most properties come back with less units. You will save over time. My proposal is from the time demo application is approved, we establish a benchmark where we get three years of funding that would fund the time period to vacate, relocate, and give time to reposition the property. This is no different than the current scenario where we get funding while the unit is occupied and for two years that is spread across three. At the end of three years all those units drop off, and at the end of the three years if new units have hit DOFA, they will come on. In the long run, HUD will see savings because the unit count will drop. This encourages us to reposition inventory and in the long run helps HUD on funding.
Mr. Kelly	In terms of incentivizing non-HUD funding, it is a valuable tool for PHAs to do that rather than maintain properties in their current state.
Ms. Tran	Any other comments?

Ms. Zaterman	I just want to reiterate the importance of phase-down funding as it related to the long-term goals. It is a policy priority for HUD to rid of distressed housing and to improve the housing stock. The proposal, now without any funding for phase-down, is punitive and will bring to a halt the ability of PHAs to do this redevelopment. There are simpler ways than the way the add-on is currently calculated. I am sure there is an easier way to estimate need, but it is absolutely essential to any type of redevelopment program.
Mr. Nolan	You can do this in a simple way without constructing it as an add-on, by giving instructions on how to count units; is not an add-on. It is simply a way to do a unit count. This will provide an incentive for PHAs to reposition. Putting it as an add-on makes it look like you are really giving us something. You've already benchmarked the total unit count, so why pull it out and show it as something separate. We will adjust the unit count at the appropriate time.
Mr. Lam	I have a question for the Department; did the Department have a chance to rerun the scenario based on the counterproposals for each of the PHAs?
Mr. Kubacki	Not yet.
Ms. Tran	Are there any other comments on this topic?
Silence.	
Ms. Tran	Do we want to go back to add-ons discussion?
Ms. Basgal	I want to be sure I understand the formula that was proposed. Maybe I could put my numbers on the board and you could show me if I missed something. I have a current AEL of \$327. My subsidy is \$39.66, which is 12.12 % so my rent is making up the difference, \$287.34 that is 88%. The transition AEL is \$377. My total subsidy is \$108,502, the transition gives me \$324,828. Therefore my subsidy would be \$45.24 and my rent would have to go up. I do get an increase, but because my subsidy dependence has been low, it will always be low. If the PHA has a high subsidy already, they get a better increase. I am getting about 3%. That

seems perverse. I understand this is the way HUD has always worked, the less subsidy you get the less subsidy you always get.

Mr. Liu	Yes, but I don't understand why you think it is perverse. The formula is not intended to reward past behavior.
Ms. Basgal	But it does, because if this were reversed, I would get 85% of this number.
Mr. Liu	You're saying that if you had lower subsidy dependence historically you should get some benefit. I don't think that is what the formula is about.
Ms. Basgal	If you have a PHA that has a lot of vacant units you are getting more subsidy. But if you are more dependent on subsidy than I am, doesn't it reflect something about management in there?
Mr. Liu	Within the concept of looking at project-based, PHAs will have a stronger incentive to move toward becoming better managers of their property, and as we indicated, the formula should be reviewed periodically. I disagree fundamentally that the formula should recognize one way or the other, in some qualitative function, what a PHA has or hasn't done up to this point in time. We need to look forward.
Ms. Basgal	Do we believe the AEL the formula generates is in fact what the cost is? We're saying it may generate this for you pointing to the PEL number on the chart, but you're getting by on this pointing to the % on the subsidy. Can someone explain?
Mr. Parker	I have a questions that may be tied to this issue. Are you basing this off the handout that was given out this afternoon? I don't understand what is happening between the columns. It would be helpful to have someone walk us through the columns. That might answer some of my questions and could show the Department why the assumptions in that model are off. I've looked at it four or five times and cannot figure this out.
Mr. Kubacki	You're not seeing all the details. If we can hold off until tomorrow morning we can break the detail down, and we will walk through it.

Mr. Parker	Okay, that makes more sense if I am not seeing the whole picture.
Mr. Kubacki	We'll give it out tomorrow and do some examples of what we're talking about here.
Mr. Nolan	The percent that is being suggested, is that applied against the old AEL or the new PEL?
Mr. Kubacki	That's the issue here. If you apply it to a new PEL, there's not an issue. If you apply it to the old AEL, there's an issue. We need to think about it a little more.
Ms. Basgal	You said it is based on the existing percent ratio; maybe I misunderstood what was stated earlier.
Mr. Laboy-Diaz	Chris, are you saying you will be revising or coming forth with an explanation or example and we would be better off waiting until we saw this?
Mr. Kubacki	Yes. We want to take a look tonight and come up with a solid scenario.
Ms. Tran	My understanding is that HUD wants to take time and digest the industry position and come back with some comments.
Mr. Liu	It's HUD's view that through our proposal this afternoon, in key ways we have responded to the industry's initiative. Agree or disagree, that's our view of what has been proposed. There may be further discussion, for example pensions and the differences there, but in terms of where we made revisions to our proposal, these were in response to what the industry put forth.
Ms. Tran	Speaking of pensions, FICA and unemployment is listed as an add-on under Harvard and proposed as an add-on under HUD. Can someone speak to the industry position?
Mr. Van Dyke	We considered it to be part of the PEL.

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Ms. Tran	Do we want to continue on add-ons? We talked about audit and resident participation, we covered a little on phase-down and long-term vacancies. Mr. Nolan provided a proposal.
Mr. Russell	I'd like to move that we proceed with public comments. We will run a bunch of numbers based on what we discussed. There is plenty to think about and then we can reengage in negotiations tomorrow.
Ms. Tran	If there are no objections, we can begin with public comments. Please come up, state your name, and use the microphone.

Mr. John Comerford, the former director of the Public Housing Operating Fund came forward.

	John Comerford. I have question. From the current appropriations and for the four fiscal year beginnings, did I understand you to say that a PHA with a June FYB there would be a one time calculation and the PHA would obligate 6 months of funds from current year and 6 months from next year?
Ms. Tran	Mr. Comerford, I respectfully remind you that the public comment period is to make comments and not ask questions. Any other comments?
Mr. Comerford	Fine, but Chris you have to answer my question personally.

No additional member of the public came forward.

Ms. Tran	In that case, we are adjourned until tomorrow.
Mr. Kaiser	There will be a caucus at the L'Enfant Plaza hotel in the LaFayette Room as soon as possible, so make your way over there as soon as possible.

The committee adjourned at 4:38 pm.

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List of Appendices for the April 13, 2004 Session:

1. Sign-in sheet for committee members, guests of committee members and members of the public.

2. Proposed Position for the Final Operating Fund Formula (HUD).

3. Comparison of Interim Formula, Harvard Study, and HUD Proposal (HUD).

4. Report 1: Budget Impact – Comparison of Current Model Estimates, Harvard Model and Scenario Model (FY 2003), Scenario 4.0 HUD's Position. (HUD).

5. The Cost of Managing Well Run Public Housing based on the Harvard Cost Study (Industry Groups).

6. Rulemaking Proposal – Public Housing Operating Fund Negotiated Rulemaking (Industry Groups).

7. Suggested Approach to Implementing the PHOCS Operating Fund Changes (4/9/04 v5) (Anderson, Epstein, Byrne).

8. Transition Policy Scenario Model for Committee Member PHAs (FY 2003) (HUD).

9. Operating Subsidy Eligibility as a percent of the Total Operating Expenses by PHA Size Category and Geographic Region (FY 2003) (HUD).

10. Implementation of the New Operating Fund Formula (HUD).

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Consensus Items for the April 13, 2004 Session: None