1. PURPOSE: This Notice establishes a three year Performance Funding System (PFS) incentive adjustment designed to prevent the loss of operating subsidy by a Housing Authority (HA) taking specified actions to increase rental income or other income. Without this adjustment, increases in rental or other income would automatically be offset by reductions in PFS operating subsidy. This revision to the PFS system is permitted because PFS is being funded at less than full eligibility levels and the revision will not affect total funding levels for public housing operating subsidy, which are determined by appropriations.

This Notice announces adjustments to PFS to allow HAs to offset PFS funding shortfalls by retaining:

1) increases in dwelling rental income that result from increases in residents' earned incomes, either because current residents go to work or increase income by obtaining better jobs or because newly admitted households have higher earned incomes than the households they replace, and

2) non-dwelling rental income earned by the HAs through entrepreneurial activities.

These adjustments would be effective for the shorter of either three years (Federal Fiscal Years (FFY) 1996 - 1998) or the period of time during which Congress does not appropriate sufficient operating subsidy to fulfill 100 percent of PFS eligibility.

This Notice, therefore, provides HAs additional incentives to undertake locally appropriate steps to encourage, attract and
retain working families in occupancy. Such steps include adoption of ceiling rents, adoption of earned income adjustments that help make work pay, repeal of Federal preferences and adoption of local worker preferences. These actions were authorized by the Balanced Budget Downpayment Act I enacted on January 26, 1996 (Public Law No. 104-99). Congress is considering extending such authority, and HUD plans to extend by regulation HAs' current authority to adopt earned income adjustments.

In addition to benefitting HA communities through the encouragement of resident employment, this Notice also provides a method of addressing the PFS shortfall in part. To the extent HAs undertake measures under the Notice that improve the income mix in their developments and thus increase dwelling rental income, or increase other income, the income available to HAs will be increased. In addition, HA's retention of additional rental income and other income above that permitted under the current PFS formula, up to 100 percent of PFS eligibility, will directly allow these HAs to provide better housing services in their communities.

2. AUTHORITY FOR REVISION: Authority for HUD to make this incentive adjustment to the PFS system is provided by the PFS regulation at 24 CFR 990.113(c) and 24 CFR 950.750(c), which states that "In the event that insufficient funds are available to make payments approvable under PFS 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 HAs." The changes to the PFS authorized by this Notice are designed to make it possible for HAs to bolster occupancy in public housing by more working families, while also generating additional income without offsetting reduction in their operating subsidy through FY 1998, or for such shorter period as there may be a PFS shortfall.

3. DWELLING RENTAL INCOME - RESIDENT EMPLOYMENT: The following optional dwelling rental income incentive adjustment will be in effect for FFY 1996-1998 if there is a shortfall in PFS funding:

A. CERTIFICATION OF HA EFFORTS TO SUPPORT RESIDENT SELF SUFFICIENCY: To encourage greater occupancy in public housing by working families in public housing, both to improve conditions and reduce their reliance on
subsidies, HAs should draw upon the full potential of residents in occupancy as well as attempting to attract working households upon turnover. Therefore, as a condition of benefiting from the more generous subsidy calculations allowed by this section of the Notice, HAs must certify by resolution of the Board of Commissioners that they are making significant efforts to utilize these earned income adjustments for existing residents and not solely taking actions regarding new admissions.

B. RENT ROLL: HAs will be permitted to retain any increase in dwelling rental income realized after a specified date (April 1, 1996) due to increased resident earned income, up to the amount of operating subsidy shortfall due to proration.

(1) As a result of this Notice, the HA may be eligible for an incentive adjustment equal to the amount of increased rent resulting from increases in resident earned income over the level of rent resulting from resident earned income in April 1996. The amount of the adjustment cannot exceed the amount of subsidy lost due to proration of PFS shortfall. The attached sample format can be used as a guide for performing this calculation. Thus, the effect of this adjustment will be to permit the HA to retain any increase in earned income above that in effect in April 1996, up to the amount of the proration shortfall.

(2) The adjustment in (1) above has no effect on the requirement that the HA must increase the total rent roll by the dollar value of any optional earned income deductions, exclusions or disregards adopted by the HA to encourage resident employment that are in addition to the statutorily-defined income adjustments. Authority to adopt such earned income adjustments was first announced in Notice PIH 96-6 (HA), Administrative Provisions of the January 26, 1996 Continuing Resolution Affecting Public and Indian Housing Programs dated February 13, 1996, which also provides that such optional adjustments to earned income are undertaken at the HA's risk.
C. CHANGE FACTOR: In the past, HUD has required HAs to assume that dwelling rental income will increase by 3 percent over the rent roll used at the beginning of the year (this requires an actual 6 percent increase from beginning to end of year to achieve an average month which is 3 percent higher). In recent years the assumption has not been borne out by real increases in dwelling rental income. Instead, HAs have experienced minimal increases in dwelling rental income and must wait until the year is over to request year end adjustments. In order to ensure that all HAs receive a level of funding that most nearly reflects their final eligibility, the change factor will be eliminated for FFYs 1996 - 1998, or for such shorter period as there is a PFS shortfall.

4. OTHER INCOME - ENCOURAGING ENTREPRENEURIAL HAs:

A. CURRENT PROCEDURE: The PFS divides HA income into three categories: Dwelling Rental Income, Investment Income, and Other Income. The Other Income category is defined at 990.102 and 950.102. Current PFS procedures require HAs to include an estimate of Other Income when determining operating subsidy. All anticipated Other Income is included except (1) grants and gifts for operations other than for utility expenses, (2) amounts charged to tenants for repairs for which the HA incurs an offsetting expense, and (3) legal fees in connection with eviction proceedings, when those fees are lawfully charged to tenants can be excluded from the estimate. Currently HAs have no incentive to increase Other Income because it becomes a direct offset to their PFS subsidy. The current definition also prevents HAs from pursuing other sources of income (other than grants or gifts) to make up the shortfall caused by the proration of operating subsidy.

B. NEW PROCEDURE: For purposes of calculating PFS operating subsidy eligibility, for FFYs 1996 through 1998 or for so long as there is a PFS shortfall, whichever is shorter, HAs will calculate an estimate of Other Income that is limited to income from the following three sources:

(1) Account 3120 Excess Utilities: This account
consists of charges to tenants for excess utility consumption for HA supplied utilities.

(2) Account 3190 Non Dwelling Rental Income: The new procedure will include rent billed to lessees of dwelling units rented for nondwelling purposes. Rent billed to lessees of nondwelling facilities will not be included except for rent billed to other HUD programs (e.g.; Section 8, congregate housing, family investment centers).

(3) Account 3690 Other Income: The new procedure will only include one element of this account in the PFS estimate. Only charges to other HUD programs (e.g.; Section 8, congregate housing, family investment centers) for use of community space, central office management and maintenance space will be taken into consideration. All other types of income credited to this account, including but not limited to income from rental of roof space for satellite dishes, income from billboards, commissions and profits from vending machines and laundry rooms, and charges for use of community space, will not be included in the estimate of Other Income and will be available to the HA to make up any shortfall in operating subsidy funding.

HAs will be permitted to retain any Other Income realized above the estimate under the new procedure, up to the amount of operating subsidy shortfall due to proration.

5. IMPLEMENTATION IN FFY 1996: This Notice is effective for HA fiscal years beginning in Calendar Year 1996.

A. HAs that have not submitted the Calculation of PFS Operating Subsidy Eligibility may apply this new policy in calculating their eligibility.

B. HAs that have already submitted the Calculation of PFS Operating Subsidy Eligibility should follow the following instructions:
1. HAs that are eligible for the optional incentive adjustment may submit a revised calculation.

2. The HUD Field Office will revise the calculation to reflect the elimination of the Change Factor; the HA is not required to submit a revision in order to effect this change.

3. All calculations should already include the increase to the total rent roll of the value of any adjustments to resident earned income adopted by the HA that are in addition to the statutorily-defined income adjustments. See Notice PIH 96-6 (HA) dated February 13, 1996.

4. HUD Offices will process any Calculations of Operating Subsidy based on the HA submission, with the revision for the elimination of the Change Factor and will not delay operating subsidy approvals pending revisions from HAs.

If additional information is needed, please contact Joan DeWitt, Director, Finance and Budget Division, Office of Public and Assisted Housing at (202) 708-1872. Offices of Native American Programs should contact Debbie Lalancette, Director, Housing Management Division, Office of Native American Programs at (202) 755-0088.

/s/Michael B. Janis for
Kevin Emanuel Marchman, Deputy Assistant Secretary for Distressed and Troubled Housing

Attachment
SAMPLE FORMAT FOR OPTIONAL PFS INCENTIVE ADJUSTMENT

Note: Line references are to PFS form HUD-52723.
A HA must calculate PFS subsidy eligibility and proration before completing this worksheet.

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>A</td>
<td>Line 40: Unfunded Portion of Operating Subsidy due to Proration:</td>
<td>$</td>
</tr>
<tr>
<td>B</td>
<td>Estimate of Other Income in accordance with Current PFS Regulation (Line 20 times UMA):</td>
<td>$</td>
</tr>
<tr>
<td>C</td>
<td>Estimate of Other Income in accordance with this Notice: (Include Excess Utilities, rents billed to dwelling units rented for nondwelling purposes, and rents and charges to other HUD programs).</td>
<td>$</td>
</tr>
<tr>
<td>D</td>
<td>Potential incentive adjustment for Other Income (B minus C):</td>
<td>$</td>
</tr>
</tbody>
</table>
DWELLING RENTAL INCOME INCENTIVE: Only for HA that certifies that it is making significant efforts to utilize earned income adjustments for existing residents.

<p>| E | Based on April 1, 1996 rent roll: Total rental income from wages and self employment divided by total number of occupied units at rent roll date. | PUM |</p>
<table>
<thead>
<tr>
<th></th>
<th>Description</th>
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<tbody>
<tr>
<td>F</td>
<td>From actual rent roll (not rent roll adjusted for PFS calculation by adding back earned income adjustments) for same month used for PFS calculation: Total rental income from wages and self employment divided by total number of occupied units. For FFY 96, if rent roll is earlier than April 1, 1996 skip to I.</td>
</tr>
<tr>
<td>G</td>
<td>PUM increase in rent from earned income: (E minus F):</td>
</tr>
<tr>
<td>H</td>
<td>Potential incentive adjustment for earned income (G times PFS unit months available):</td>
</tr>
<tr>
<td>I</td>
<td>Total potential incentive adjustment (D plus H)</td>
</tr>
<tr>
<td>J</td>
<td>Actual incentive adjustment (Enter smaller of A or I). Enter this amount on Line 37 of HUD-52723.</td>
</tr>
</tbody>
</table>