

will not be eligible for relocation assistance.

§ 972.233 Timing of submission of conversion plans to HUD.

A PHA that wishes to convert a public housing project to tenant-based assistance must submit a conversion plan to HUD. A PHA must prepare a conversion plan, in accordance with § 972.230, and submit it to HUD, as part of the next PHA Annual Plan within one year after submitting the full conversion assessment, or as a significant amendment to that Annual Plan. The PHA may also submit the conversion plan in the same Annual Plan as the conversion assessment.

§ 972.236 HUD process for approving a conversion plan.

Although a PHA will submit its conversion plan to HUD as part of the PHA Annual Plan, the conversion plan will be treated separately for purposes of HUD approval. A PHA needs a separate written approval from HUD in order to proceed with conversion. HUD anticipates that its review of a conversion plan will ordinarily occur within 90 days following submission of a complete plan by the PHA. A longer process may be required where HUD's initial review of the plan raises questions that require further discussion with the PHA. In any event, HUD will provide all PHAs with a preliminary response within 90 days following submission of a conversion plan. A lack of a HUD response within this time frame will constitute automatic HUD approval of the conversion plan.

§ 972.239 HUD actions with respect to a conversion plan.

(a) When a PHA submits a conversion plan to HUD, HUD will review it to determine whether:

(1) The conversion plan is complete and includes all of the information required under § 972.230; and

(2) The conversion plan is consistent with the conversion assessment the PHA submitted.

(b) HUD will disapprove a conversion plan only if HUD determines that:

(1) The conversion plan is plainly inconsistent with the conversion assessment;

(2) There is reliable information and data available to the Secretary that contradicts the conversion assessment; or

(3) The conversion plan is incomplete or otherwise fails to meet the requirements under § 972.230.

APPENDIX TO PART 972—METHODOLOGY OF COMPARING COST OF PUBLIC HOUSING WITH THE COST OF TENANT-BASED ASSISTANCE

I. PUBLIC HOUSING-NET PRESENT VALUE

The costs used for public housing shall be those necessary to produce a viable development for its projected useful life. The estimated cost for the continued operation of the development as public housing shall be calculated as the sum of total operating cost, modernization cost, and costs to address accrual needs. Costs will be calculated at the property level on an annual basis covering a period of 30 years (with options for 20 or 40 years). All costs expected to occur in future years will be discounted, using an OMB-specified real discount rate provided on the OMB Web site at <http://www.whitehouse.gov/OMB/Budget>, for each year after the initial year. The sum of the discounted values for each year (net present value) for public housing will then be compared to the net present value of the stream of costs associated with housing vouchers.

Applicable information on discount rates may be found in Appendix C of OMB Circular A-94, "Guidelines and Discount Rates for Benefit Cost Analysis of Federal Programs," which is updated annually, and may be found on OMB's Web site at <http://www.whitehouse.gov/OMB>. All cost adjustments conducted pursuant to this cost methodology must be performed using the real discount rates provided on the OMB Web site at <http://www.whitehouse.gov/OMB/Budget>. HUD will also provide information on current rates, along with guidance and instructions for completing the cost comparisons on the HUD Homepage (<http://www.hud.gov>). The Homepage will also include a downloadable spreadsheet calculator that HUD has developed to assist PHAs in completing the assessments. The spreadsheet calculator is designed to walk housing agencies through the calculations and comparisons laid out in the appendix and allows housing agencies to enter relevant data for their PHA and the development being assessed. Results, including net present values, are generated based on these housing agency data.

A. Operating Costs

1. Any proposed revitalization or modernization plan must indicate how unusually

high current operating expenses (*e.g.*, security, supportive services, maintenance, tenant, and PHA-paid utilities) will be reduced as a result of post-revitalization changes in occupancy, density and building configuration, income mix, and management. The plan must make a realistic projection of overall operating costs per occupied unit in the revitalized or modernized development, by relating those operating costs to the expected occupancy rate, tenant composition, physical configuration, and management structure of the revitalized or modernized development. The projected costs should also address the comparable costs of buildings or developments whose siting, configuration, and tenant mix is similar to that of the revitalized or modernized public housing development.

2. The development's operating cost (including all overhead costs pro-rated to the development—including a Payment in Lieu of Taxes (P.I.L.O.T.) or some other comparable payment, and including utilities and utility allowances) shall be expressed as total operating costs per year. For example, if a development will have 375 units occupied by households and will have \$112,500 monthly non-utility costs (including pro-rated overhead costs and appropriate P.I.L.O.T.) and \$37,500 monthly utility costs paid by the PHA, and \$18,750 in monthly utility allowances that are deducted from tenant rental payments to the PHA because tenants paid some utility bills directly to the utility company, then the development's monthly operating cost is \$168,750 (or \$450 per unit per month) and its annual operating cost would be \$5,400 (\$450 times 12). Operating costs are assumed to begin in the initial year of the 30-year (or alternative period) calculation and will be incurred in each year thereafter.

3. In justifying the operating cost estimates as realistic, the plan should link the cost estimates to its assumptions about the level and rate of occupancy, the per-unit funding of modernization, any physical re-configuration that will result from modernization, any planned changes in the surrounding neighborhood, and security costs. The plan should also show whether developments or buildings in viable condition in similar neighborhoods have achieved the income mix and occupancy rate projected for the revitalized or modernized development. The plan should also show how the operating costs of the similar developments or buildings compare to the operating costs projected for the development.

4. In addition to presenting evidence that the operating costs of the revitalized or modernized development are plausible, when the projected initial year per-unit operating cost of the renovated development is lower than the current per unit cost by more than 10 percent, then the plan should detail how the revitalized development will achieve this reduction in costs. To determine the extent to

which projected operating costs are lower than current operating costs, the current per-unit operating costs of the development will be estimated as follows:

a. If the development has reliable operating costs and if the overall vacancy rate is less than 20 percent, then the development-based method will be used to determine projected costs. The current costs will be divided by the sum of all occupied units and vacant units fully funded under the Operating Fund Program plus 20 percent of all units not fully funded under the Operating Fund Program. For instance, if the total monthly operating costs of the current development are \$168,750 and it has 325 occupied units and 50 vacant units not fully funded under the Operating Fund Program (or a 13 percent overall vacancy rate), then the \$2,250,000 is divided by 335—325 plus 20 percent of 50—to give a per unit figure of \$504 per unit month. By this example, the current costs per occupied unit are at least 10 percent higher (12 percent in this example) than the projected costs per occupied unit of \$450 for the revitalized development, and the reduction in costs would have to be detailed.

b. If the development currently lacks reliable cost data or has a vacancy rate of 20 percent or higher, then the PHA-wide method will be used to determine projected costs. First, the current per unit cost of the entire PHA will be computed, with total costs divided by the sum of all occupied units and vacant units fully funded under the Operating Fund Program plus 20 percent of all vacant units not fully funded under the Operating Fund Program. For example, if the PHA's operating cost is \$18 million, and the PHA has 4,000 units, of which 3,875 are occupied and 125 are vacant and not fully funded under the Operating Fund Program, then the PHA's vacancy adjusted operating cost is \$385 per unit per month—\$18,000,000 divided by the 3,825 (the sum of 3,800 occupied units and 20 percent of 125 vacant units) divided by 12 months. Second, this amount will be multiplied by the ratio of the bedroom adjustment factor of the development to the bedroom adjustment factor of the PHA. The bedroom adjustment factor, which is based on national rent averages for units grouped by the number of bedrooms and which has been used by HUD to adjust for costs of units when the number of bedrooms vary, assigns to each unit the following factors: .70 for 0-bedroom units, .85 for 1-bedroom units, 1.0 for 2-bedroom units, 1.25 for 3-bedroom units, 1.40 for 4-bedroom units, 1.61 for 5-bedroom units, and 1.82 for 6 or more bedroom units. The bedroom adjustment factor is the unit-weighted average of the distribution. For instance, consider a development with 375 occupied units that had the following under an ACC contract: 200 two-bedroom units, 150 three-bedroom units, and 25 four-bedroom

units. In that example, the bedroom adjustment factor would be 1.127—200 times 1.0, plus 150 times 1.25, plus 25 times 1.4 with the sum divided by 375. Where necessary, HUD field offices will arrange for assistance in the calculation of the bedroom adjustment factors of the PHA and its affected developments.

c. As an example of estimating development operating costs from PHA-wide operating costs, suppose that the PHA had a total monthly operating cost per unit of \$385 and a bedroom adjustment factor of .928, and suppose that the development had a bedroom adjustment factor of 1.127. Then, the development's estimated current monthly operating cost per occupied unit would be \$467—or \$385 times 1.214 (the ratio of 1.127 to .928). By this example, the development's current operating costs of \$467 per unit per month are not more than 10 percent higher (3.8 percent in this example) than the projected costs of \$450 per unit per month and no additional justification of the cost reduction would be required.

B. Modernization

Under both the required and voluntary conversion programs, PHAs prepare modernization or capital repair estimates in accordance with the physical needs of the specific properties proposed for conversion. There are three key assumptions that guide how PHAs prepare modernization estimates that affect remaining useful life and determine whether the 20-, 30-, or discretionary 40-year remaining useful life evaluation period are used for the cost-test. When calculating public housing revitalization costs for a property, PHAs will use a 30-year period if the level of modernization addresses all accumulated backlog needs and the planned redesign ensures long-term viability. For modernization equivalent to new construction or when the renovations restore a property to as-new physical conditions, a 40-year remaining useful life test is used. When light or moderate rehabilitation that does not address all accumulated backlog is undertaken, but it is compliant with the International Existing Building Codes (ICC) or Public Housing Modernization Standards in the absence of a local rehabilitation code, the 20-year remaining useful life evaluation period must be used.

Except for some voluntary conversion situations as explained in paragraph E below, the cost of modernization is, at a minimum, the initial revitalization cost to meet viability standards. In the absence of a local code, PHAs may refer to the Public Housing Modernization Standards Handbook (Handbook 7485.2) or the International Existing Building Codes (ICC) 2003 Edition. To justify a 40-year amortization cycle that increases the useful life period and time over which moderniza-

tion costs are amortized, PHAs must demonstrate that the proposed modernization meets the applicable physical viability standards, but must also cover accumulated backlog and redesign that achieves as-new physical conditions to ensure long-term viability. To be a plausible estimate, modernization costs shall be justified by a newly created property-based needs assessment (a life-cycle physical needs assessments prepared in accordance with a PHA's Capital Fund annual or 5-year action plan and shall be able to be reconciled with standardized measures, such as components of the PHAs physical inspection and chronic vacancy due to physical condition and design. Modernization costs may be assumed to occur during years one through four, consistent with the level of work proposed and the PHA's proposed modernization schedule. For example, if the initial modernization outlay (excluding demolition costs) to meet viability standards is \$21,000,000 for 375 units, a PHA might incur costs in three equal increments of \$7,000,000 in years two, three, and four (based on the PHA's phased modernization plan). In comparing the net present value of public housing to voucher costs for required conversion, a 30-year amortization period will normally be used, except when revitalization would bring the property to as-new condition and a 40-year amortization would be justified. On the other hand, when the modernization falls short of meeting accumulated backlog and long-term redesign needs, only a 20-year amortization period might be justified.

C. Accrual

Accrual projections estimate the ongoing replacement repair needs for public housing properties and building structures and systems required to maintain the physical viability of a property throughout its useful life as the lifecycle of building structures and systems expire. The cost of accrual (i.e., replacement needs) will be estimated with an algorithm that meets all ongoing capital needs based on systems that have predictable lifecycles. The algorithm starts with the area index of housing construction costs (HCC) that HUD publishes as a component of its TDC index series. Subtracted from this HCC figure is half the estimated modernization per unit, with a coefficient of .025 multiplied by the result to provide an annual accrual figure per unit. For example, suppose that the development after modernization will remain a walkup structure containing 200 two-bedroom, 150 three-bedroom, and 25 four-bedroom occupied units, and if HUD's HCC limit for the area is \$66,700 for two-bedroom walkup structures, \$93,000 for three-bedroom walkup structures, and \$108,400 for four-bedroom walkup structures. Then the unit-weighted HCC cost is \$80,000 per unit

and .75 of that figure is \$60,000 per unit. Then, if the per unit cost of the modernization is \$56,000, the estimated annual cost of accrual per occupied unit is \$1,300. This is the result of multiplying .025 times \$52,000 (the weighted HCC of \$80,000) minus \$28,000 (half the per-unit modernization cost of \$56,000). The first year of total accrual for the development is \$487,500 (\$1,300 times 375 units) and should be assumed to begin in the year after modernization is complete. Accrual—like operating cost—is an annual expense and will occur in each year over the amortized period. Because the method assumes full physical renewal each year, this accrual method when combined with a modernization that meets past backlog and redesign needs justifies a 30- or 40-year amortization period, because the property is refreshed each year to as-new or almost as-new condition.

D. Residual Value (Voluntary Conversion Only)

Under the voluntary conversion program, PHAs are required to prepare market appraisals based on the “as-is” and post-rehabilitation condition of properties, assuming the buildings are operated as public or assisted, unassisted, or market-rate housing. Section 972.218 requires PHAs to describe the future use for a property proposed for conversion and to describe the means and timetable to complete these activities. HUD will permit a PHA to enter the appraised market value of a property into the cost-test in Years 1 through 5 when a PHA anticipates selling a property or receiving income generated from the sale or lease of a property.

As a separate line item to be added to total public costs as a foregone opportunity cost, a PHA shall include in the voluntary cost-test calculations the appraised market or residual value (or net sales proceeds) from the sale or lease of a property that is to be voluntarily converted to tenant-based voucher assistance. The PHA must hire an appraiser to estimate the market value of the property using the comparable sale, tax-assessment, or revenue-based appraisal methods. PHAs are advised to select one or more of these appraisal methods to accurately determine the actual or potential market value of a property, particularly the comparable sales or revenue-based methods. The market or residual value is to be determined by calculating the estimated market value for the property based on the appraisal, minus any costs required for demolition and remediation. The residual value must be incorporated into the cost-test instead of the actual market value only when any demolition, site remediation, and clearance costs that are necessary are covered by the selling PHA. However, if the sum of the estimated per unit cost of demolition and remediation exceeds 10 percent of the average Total Development Cost (TDC)

for the units, the lower of the PHA estimate or a figure based on 10 percent of TDC must be used. Suppose the estimated remediation and demolition costs necessary for conversion sale are \$7,000 per unit. Also, suppose the TDC limits are \$115,000 for a two-bedroom unit, \$161,000 for a three-bedroom unit, and \$184,000 for a four-bedroom unit. Then the average TDC of a development with 200 two-bedroom units, 150 three-bedroom units, and 25 four-bedroom units is \$138,000 (200 times \$115,000, plus 150 times \$161,000, plus 25 times \$184,000, the sum divided by 375) and 10 percent of TDC is \$13,800. In this example, the estimated \$7,000 per unit costs for demolition and remediation is less than 10 percent of TDC for the development, and the PHA estimate of \$7,000 is used. If estimated expenses had exceeded 10 percent of TDC (\$13,800 in this example), demolition and remediation expenses must be capped at the lower amount.

E. Accumulated Discounted Cost: Public Housing

The overall cost for continuing to operate the development as public housing is the sum of the discounted values of the yearly stream of costs up for the amortization period, which can range from 20 to 30 to 40 years, depending on the extent of modernization relative to the current physical and redesign needs of the development. In calculating net present value for required conversion, the sum of all costs in each future year is discounted back to the current year using the OMB-specified real discount rate. For voluntary conversion, the discount rate is applied forward as a direct inflation factor. To assist PHAs in completing the net present value comparison and to ensure consistency in the calculations, HUD has developed a spreadsheet calculator that is available for downloading from the HUD Internet site. Using PHA data and property specific inputs (to be entered by the housing agency), the spreadsheet will discount costs as described above and will generate net present values for amortization periods of 20, 30, and 40 years.

II. TENANT-BASED ASSISTANCE

The estimated cost of providing tenant-based assistance under Section 8 for all households in occupancy shall be calculated as the unit-weighted average of recent movers in the local area; plus the administrative fee for providing such vouchers; plus \$1,000 per unit (or a higher amount allowed by HUD) for relocation assistance costs, including counseling. However, if the sum of the estimated per unit cost of demolition, remediation, and relocation exceeds 10 percent of the average Total Development Cost (TDC) for the units, the lower of the PHA estimate

or a figure based on 10 percent of TDC must be used.

For example, if the development has 200 occupied two-bedroom units, 150 occupied three-bedroom units, and 25 occupied four-bedroom units, and if the monthly payment standard for voucher units occupied by recent movers is \$550 for two-bedroom units, \$650 for three-bedroom units, and \$750 for four-bedroom units, the unit-weighted monthly payment standard is \$603.33. If the administrative fee comes to \$46 per unit, then the monthly per unit operating voucher costs are \$649.33, which rounds to an annual total of \$2,922,000 for 375 occupied units of the same bedroom size as those being demolished in public housing. To these operating voucher costs, a first-year relocation is added on the voucher side. For per-unit relocation costs of \$1,000 per unit for relocation, then \$375,000 for 375 units is placed on the voucher cost side of the first year.

Accumulated Discounted Cost: Vouchers

The overall cost for vouchers is the sum of the discounted values of the yearly stream of costs up for the amortization period, which can range from 20 to 30 to 40 years, depending on the extent of modernization relative to the current physical and redesign needs of the development. The amortization period chosen is the one that was appropriate for discounting public housing costs. In calculating net present value for required conversion, the sum of all costs in each future year is discounted back to the current year using the OMB-specified real discount rate. For voluntary conversion, the discount rate is applied forward as a direct inflation factor.

To assist PHAs in completing the net present value comparison and to ensure consistency in the calculations, HUD has developed a spreadsheet calculator that will be available for downloading from the HUD Internet site.

III. RESULTS OF THE EXAMPLE

With the hypothetical data used in the examples, under an amortization period of 30 years, the discounted public housing costs under required conversion sums to \$69,633,225, and the discounted voucher cost under required conversions totals \$60,438,698. The ratio is 1.15, which means that public housing is 15 percent more costly than vouchers. With this amortization and this data, the PHA would be required to convert the development under the requirements of subpart A of this part, except in a situation where a PHA can demonstrate a distressed property that has failed the cost-test can be redeveloped by meeting each of the four factors that compose the long-term physical viability test to avoid removal from the inventory. With the same data, but a 40-year amortization period, public housing is still 11

percent costlier than vouchers, and with a 20-year amortization, public housing is 25 percent costlier than vouchers. In voluntary conversion, with the same hypothetical data, but a slightly different methodology (use of residual value as a public housing cost, inflating forward the discount numbers), the ratio of public housing costs to voucher costs would be 1.16 for the 20-year amortization period, 1.03 for the 30-year amortization period, and .97 for the 40-year amortization period. Thus, in voluntary conversion, the appropriate amortization period would decide whether public housing is more costly or is slightly more costly, or less than vouchers. Under a 20-year amortization assumption and possibly under a 30-year amortization period, the PHA would have the option of preparing a conversion plan for the development under subpart B of this part. Different sets of data would yield different conclusions for required and voluntary conversion determinations.

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**PART 982—SECTION 8 TENANT
BASED ASSISTANCE: HOUSING
CHOICE VOUCHER PROGRAM**

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