Regulatory Impact Analysis

Public Housing Capital Fund Proposed Rule (FR-5236-P-01)

Summary

The purpose of this proposed rule is to revise the regulations governing the use of assistance made available under the Public Housing Capital Funds Program (CFP) by combining and streamlining the former legacy public housing modernization programs into the CFP and to accommodate certain mandates of the Housing and Economic Recovery Act of 2008 (HERA).[1]

It is determined that this final rule would not have any impact on the level of funding for the CFP - which level is determined by annual congressional appropriations, but would potentially create some financial transfers among program participants. The total amount of transfer is estimated to be less than $100 million annually, with most of these transfers being inter-agency transfers attributable to the redistribution by formula of the second increment of the Replacement Housing Factor (RHF) when it is phased out. However, the benefits of the rule such as regulatory consolidation, program clarification, removal of obsolete references, and enhanced efficiencies make the rule necessary regardless of the transfers of funding involved. A detailed discussion on the need for and objectives of this proposed rule are located in the preamble to the proposed rule.

Background and History

The Public Housing CFP provides financial assistance to public housing agencies and resident management corporations to make improvements and repairs to existing public housing. The CFP also provides financial assistance to develop public housing, including mixed-finance developments that contain public housing units. Although HUD established the Capital Fund formula in 2000, HUD has continued to rely on CFP requirements to the extent that these requirements were not superseded by statutory requirements. The CFP replaces legacy housing modernization programs, including the Comprehensive Grant Program (CGP)[2], the Comprehensive Improvement Assistance Program (CIAP), and the Public Housing Development Program[3], including mixed-finance development.

The Capital Fund formula was initially established by final rule published on March 16, 2000 (65 FR 14422) and allocates capital fund grants by formula. In the formula, 50 percent of the capital grant is based on modernization backlog needs, and 50 percent is based on accrual. HUD notifies each PHA of the amount of the grant and after execution of an Annual Contribution Contract (ACC) Amendment, the PHA draws down funds for eligible costs described in the PHAs CFP annual Statement/Performance and evaluation

[1] Pub. L. 110-289 (approved July 30, 2008) (HERA).
[2] 24 CFR part 968
[3] 24 CFR part 941

report or CFP Five-year action plan. About $2.450 billion was appropriated by Congress for the public housing capital funds in 2009.

Proposed Regulatory Changes and Impact Analysis

This section of the report reviews major regulatory changes in the proposed rule and assesses their individual economic impact, if any. Statutory requirements and changes in the proposed rule are not discussed in this report unless their implementation by this rule is a factor.

1. **New Definition**

   HERA exempts qualified PHAs from submitting an annual plan, and this is reflected in the proposed rule. Specially, 24 CFR part 903.3(a) is modified to insert a definition of a qualified PHA as defined in the HERA as: "A qualified PHA is a public agency meeting both of the following requirements: (1) the sum of public housing dwelling units administered by the agency and the number of vouchers under Section 8(o) of the Act is 550 or fewer and (2) the agency is not designated as troubled PHA under section 9(j)(2) and does not have a failing score under the Section 8 Management Assessment Program (SEMAP) during the prior 12 months." Section 903.3(b) would incorporate the statutory exemption for these PHAs.

   Hundreds of entities would meet the definition of a qualified PHA and as such, would be exempted from the requirement to submit an annual plan. This proposed change in the rule conforms the rule to the statutory changes, which were first announced by PIH Notice 2008-41 (issued November 13, 2008), and which are designed to reduce the oversight of these prudently managed small entities and concentrate much needed resources on larger PHAs that are more likely to need help.

   This regulatory change would not have major a economic impact. In practice, the annual plan is the first year of the five year action plan and although these small entities would be exempted from submission of an annual plan, they are not exempt from the requirement to hold annual public hearings and to submit a Five Year Plan.

2. **Eligible Costs.**

   Housing authorities are allowed to use up to 10 percent of their CFP allocation for administration under Budget Line Item (BLI) 1410. Eligible under this definition are reasonable costs attributable to the central office cost center. The fee may include duties related to capital planning, preparation of the CFP Annual Statement/Performance and Evaluation Report, preparation of reports, drawing of funds, budgeting, accounting, and procurement of construction and other miscellaneous contracts, but is not intended to cover costs associated with construction, supervisory, and inspection functions that are considered a front-line cost of the project. With the transition to asset management, it became necessary to "de-federalize" the BLIs for housing authorities engaged in asset management. Housing authorities not engaged in asset management would continue to use BLI

1410 (Administration). This provision would not have any impact on funding and would not result in any transfers.

3. **Program Requirements.**

a. Management Improvement

Section 905.314(i) proposes the gradual phase down of the management improvements funding limit from up to 20 percent to up to 10 percent over a period of three fiscal years. Currently, the regulation limits a PHA to no more than 20 percent of its annual grant for management improvements, unless specifically approved by HUD or the PHA has been designated as both an over-all high performer and mod-high performer under the Public Housing Assessment System (PHAS). The 20 percent standard was implemented by regulation; it is not a statutory limitation.

Although housing authorities were permitted to budget up to 20 percent of their CFP formula allocation for management improvement, on average PHAs use approximately 8 percent of their Capital Fund grants on management improvements. Large PHAs with 550 or more dwelling units in management use approximately 9 percent of their Capital Fund for management improvements.

Percent of Management Improvement to Total CFP (in dollars)

fiscalyear	BLI 1408 Mgt Improvements	Total CFP Distributed	% MI
1998	$206,362,749	$2,627,591,706	7.85%
1999	$177,705,230	$2,838,922,408	6.26%
2000	$179,922,326	$2,906,801,710	6.19%
2001	$169,258,037	$2,899,577,461	5.84%
2002	$147,001,082	$2,714,425,951	5.42%
2003	$145,551,893	$2,621,232,624	5.55%
2004	$134,181,752	$2,564,760,635	5.23%
2005	$139,854,107	$2,470,989,410	5.66%
2006	$116,785,059	$2,254,396,549	5.18%
2007	$103,250,393	$2,359,794,986	4.38%
2008	$107,905,825	$2,383,772,298	4.53%
2009	$127,771,405	$2,374,406,058	5.38%

Assuming that PHAs are budgeting for the entire 20 percent permitted under the existing rule, a 10 percent reduction implies that about $238 million[4] could potentially be transferred from one group of stakeholders who traditionally received management improvement funds to other CFP eligible activities and stakeholders – still with no budgetary impact.

This program requirement would not have any impact on funding and would not result in any transfers.

[4] In 2008, $2.38 billion in formula funds were distributed to housing authorities.

Alternatives considered for the management improvement proposed changes:

Alternative A – Eliminate management improvements as a separate Capital Fund Program budget line item.

The Capital Fund Program eligible budget line items would more closely approximate the budget line items in the Financial Data System (FDS) used by the Operating Fund. Under the FDS operations includes activities identified as management improvements under the Capital Fund. However, the Capital Fund Program has three separate BLIs for administration (BLI 1410), operations (BLI 1406) and management improvements (BLI 1408). Eliminating management improvements from the CF would be a first step to aligning the two public housing programs.

The combined total of these three budget line items could be up to 50 percent of the annual grant for a large PHA. (i.e., large PHAs are PHAs with 250 or more public housing units in management). Notwithstanding the fact that management improvements a statutory eligible activity, it complete elimination would greatly increase the amount of CFP grant funds that would be used for modernization and development activities, but may cause hardship for large PHAs that appear to rely more on this line item and have included these items in the Capital Fund Five Year Action Plan.

Alternative B: Modify the description of management improvements to narrow the eligible activities thereby eliminating controversial activities such as security patrols.

HUD Field Offices have complained that it is difficult to determine which activities are eligible under management improvements because of the limited and outdated guidance in that area. As a part of the HUD Field Office's annual review of PHA budgets it is important to determine the eligibility of proposed activities in the PHA Plan. The latest guidance on management improvements is found in Comprehensive Grant Program Handbook 7485.3, dated March 1992. (See Section 3, pages 4-9 to 4-11of Comprehensive Grant Program handbook 7485.3 and 24 CFR Part 968.)

Since the Comprehensive Grant Program Handbook 7485.3 was issued several major legislative and regulatory changes have occurred including the passage of the Quality Housing and Work Responsibility Act (QHWRA) and the Housing and Economic Recovery Act (HERA) which authorized changes to the modernization program and established the Capital Fund Program and the eliminating of major funding for drug elimination. New regulations including 24 CFR Part 903, PHA Plan and 24 CFR Part 905 and 24 CFR Part 990 Subpart H (i.e., asset management) directly impact on modernization activities under the Capital Fund.

Again, the modification of eligible management improvements activities might be a hardship for large PHAs that appear to rely more on this line item under the Capital Fund Five Year Action Plan.

Selection of Proposed Policy:

Using the data available from extracts from the Line of Credit Control System (LOCCS) we were able to determine that the average budgeted and expended for management improvements over a 5 year period was approximately 7 percent for small PHAs and 9 percent for large PHAs.

Interestingly, in relation to another eligible soft cost, operations (BLI 1406) small PHAs budgeted larger amounts for operations (between 23 – 33 percent than large PHAs which budgeted between 7 - 12 percent.[5]

Consequently, of the alternatives considered we determined that reduction of threshold for management improvements from up to 20 percent to up to 10 percent would have the least negative impact on PHAs since the average PHA budgets approximately 8 percent for this budget line item. A slow phase down from up to 20 percent to up to 10 percent should give large PHAs that utilized the management improvements BLI to a greater extent adequate time to find other sources of funding for these activities and revise the PHA's Five Year Action Plan. Finally, the statutory and regulatory authority to use up to 20 percent of a Capital Fund Grant for Operations will give large PHAs some additional flexibility to assign soft costs currently previously funded under management improvements to Operations.

b. **Elimination of emergency reserve set-aside**

The proposed rule removes any reference to an emergency reserve or set aside in the formula calculation because the statutory provision with specifically designated funds for emergency and other disasters, former section 9(k) of the U.S. Housing Act of 1937,was repealed by HERA. However, the rule retains the procedures for awarding any recaptured emergency and natural disaster funds from prior fiscal years. The HUD appropriations acts subsequent to HERA have continued to require HUD to fund emergencies, but have excluded Presidentially Declared natural disasters. In 2008, out of the 3,138 PHAs, the Department funded 2 emergency grants for a total of $4,521,477 and 18 disaster grants for a total of $11,760,479. The elimination of the emergency reserve would create some transfers, but no significant economic impact.

[5] The statute allows small PHAs to transfer 100 percent of their Capital Fund grant to operations, where there is no outstanding moderation need, but large PHAs are limited to transferring up to 20 percent for operations

c. **Capital Fund Formula**

This proposed rule proposes three changes to the capital fund formula calculation.

The phase-down of Replacement Housing Factor (RHF)

Section 905.400(j) proposes a transition from a 10-year long RHF Program to a 5 year RHF Program for PHAs that remove units from the inventory based on demolition or disposition.

In 2008, a total of 294 PHAs received RHF funds. 251 PHAs received a \$98 million RHF first increment, and 123 PHAs received a \$113 million RHF second increment. Five years after the implementation of the RHF phase down, the \$113 million second increment funding would be eliminated and redistributed by formula to all eligible 3,138 PHAs. This action would create a transfer between PHAs. However, it should be noted that HUD has already funded over 10 years of RHF funding to assist PHAs that demolished over 100,000 units of severely distressed public housing, thus the need for RHF funding has significantly decreased. This phase-down also grandfathers all PHAs that are already receiving first or second increment RHF funding as of FFY 2010.

Alternatives Considered for the RHF:

Alternative A – Eliminate RHF from the Capital Fund Formula (CFF) for PHAs that removed units from the inventory because of HUD approved demolition or disposition. As a result, these PHAs would have a reduced Capital Fund award in the fiscal year immediately following the reduction of units.

Complete elimination of RHF would result in a significant change to the CFF. It is not clear whether the complete elimination of RHF would trigger the requirement for another negotiated rulemaking.

Elimination of RHF funds for development would be a hardship for large PHAs such as Atlanta, Boston, Chicago, and Philadelphia that have successfully utilized RHF to develop replacement housing.

Without a transition from the current formula, PHAs with planned development and mixed finance projects that anticipated additional RHF funding would be underfunded. Consequently, these proposed new developments would most likely be jeopardized.

Alternative B: Eliminate RHF and replace it with a three-year phase down of the amount of CFF share for PHAs that remove units from the inventory because of HUD approved demolition or disposition.

Prior to QHWRA, the Comprehensive Grant Program (24 CFR Part 968) grants had a 3 year phase down. One possibility considered would be to fund the former units at 100 percent the first year, 66 percent the second year, and 33 percent the third year. In the fourth year the PHA would absorb the full impact of their loss of units in the CFF. Using a phase down scenario would align the CFF phase down to the phase down used for the Operating Subsidy Program 24 CFR Part 990.

Complete elimination of RHF would result in a significant change to the CFF. It is not clear whether the complete elimination of RHF would trigger the requirement for another negotiated rulemaking.

Elimination of RHF funds for development would be a hardship for large PHAs such as Atlanta, Boston, Chicago, and Philadelphia that have successfully utilized RHF to develop replacement housing.

A three year phase down instead of 10 years of RHF would significantly reduce the amount of funds used to transition PHAs that completed demolition or disposition. As a result, more funds would be provided to small and medium PHAs through the CFF.

Alternative C- Fully fund 10 years of RHF in 5 years for PHAs that remove units from the inventory because of HUD approved demolition or disposition.

Fully funding 10 years of RHF in a shorter period of time would allow HUD to retain a great deal of the components contained in the negotiated rulemaking.

Without a Congressional set aside it would require an additional appropriation or approximately $1 billion of the $2.3 billion Capital Fund appropriation devoted to pay off the remaining RHF first and second increment for PHAs that are already receiving RHF the year prior to the implementation of the proposed rule.

Small and medium PHAs not receiving RHF would be unduly penalized because almost half of the Capital Fund appropriations would go RHF funding the first year.

PHAs would be better able to fund planned development and mixed finance projects if the RHF funds were provided to the PHA within 5 years.

The proposed budget for FY 2011 is significantly reduced from the $2.3 billion received in the last two fiscal years. As a result, it is unlikely that the Department could support this approach without a

Congressional set-aside.

PHAs would be so seriously underfunded they would not be able to aggressively pursue their 5 year action plans for Capital needs. As required by the regulations these plans were presented to the public in public hearings and discussed with the residents.

Selection of Proposed Policy:

HUD contemplated the alternatives discussed above, but is proposing the reduction of RHF from 10 years to 5 years as the most practical policy. This policy is the least likely to interfere with planned development and mixed finance projects proposed by larger PHAs that control the majority of the public housing inventory. Using the proposed policy small and medium PHAs will not be underfunded or otherwise disadvantaged. By shortening the time frame for funding RHF more funds are made available through the formula to all PHAs.

d. Freezing the calculation of backlog

Section 905.400 (d) (6) establishes FFY 2008 as the last year that HUD will calculate the existing modernization need (i.e., the backlog); however, the calculation will continue to adjust for the actual number of units in the PHA. This action would greatly simplify the administration of the CFP, but only have a marginal distribution effect on program participants.

An alternative to freezing the 1999 backlog is to make substantial changes to the regulation and develop a new formula calculation based on buildings rather than developments. The alternative of calculating the formula based on buildings would increase the complexity of the formula calculation. Furthermore, the clearance process for a regulation is a lengthy and extremely burdensome process.