

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**[Docket Number FR-5099-N-01]****Public Housing Operating Fund Program; Guidance on Implementation of Asset Management****AGENCY:** Office of the Assistant Secretary for Public and Indian Housing; HUD.**ACTION:** Notice.

SUMMARY: On September 19, 2005, HUD published a final rule entitled, "Revisions to the Public Housing Operating Fund Program," which established a new formula for determining operating subsidies for public housing agencies (PHAs) and requiring that PHAs with 250 or more units convert to asset management. This notice clarifies and provides interim guidance pertaining to various aspects of public housing's conversion to asset management. The interim guidance provided in this notice is intended to assist all PHAs that operate federal public housing. Special provisions are included in the notice to assist small PHAs with less than 250 public housing units that are not subject to asset management conversion. HUD is soliciting public comment on this interim guidance and, based on the comments received, will issue final guidance and commence rulemaking, as appropriate, on the asset-based management requirements. Until such time as final guidance is issued or rulemaking commenced, PHAs should refer to the interim guidance provided by this notice to assist in their conversion to asset-based management.

DATES: *Effective Date:* This notice is effective upon publication.

Comment Due Date: November 6, 2006.

ADDRESSES: Interested persons are invited to submit comments regarding this notice to the Office of the General Counsel, Rules Docket Clerk, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0001. Communications should refer to the above docket number and title and should contain the information specified in the "Request for Comments" section.

Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at <http://www.regulations.gov>. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the

commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the <http://www.regulations.gov> Web site can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

No Facsimile Comments. Facsimile (FAX) comments are not acceptable. In all cases, communications must refer to the docket number and title.

Public Inspection of Public Comments. All comments and communications submitted to HUD will be available, without charge, for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an advance appointment to review the public comments must be scheduled by calling the Regulations Division at (202) 708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at <http://www.regulations.gov>.

FOR FURTHER INFORMATION CONTACT: Elizabeth Hanson, Deputy Assistant Secretary, Departmental Real Estate Assessment Center, Office of Public and Indian Housing, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 2000, Washington, DC 20410; telephone 202-475-7949 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION:**I. Background**

On September 19, 2005, (70 FR 54983), HUD published a final rule amending the regulations of the Public Housing Operating Fund Program at 24 CFR part 990, to provide a new formula for distributing operating subsidy to public housing agencies (PHAs) and to establish requirements for PHAs to convert to asset management. On October 24, 2005 (70 FR 61366), HUD published a correction to the September 19, 2005, final rule to clarify that the revised allocation formula will be implemented for calendar year 2007, and adjusting the related dates specified

in the final rule to reflect the corrected implementation date. The final rule, developed through negotiated rulemaking conducted in 2004, became effective on November 18, 2005.

Subpart H of the revised part 990 regulations (§§ 990.255 to 990.290) establishes the requirements regarding asset management. Under § 990.260(a), PHAs that own and operate 250 or more dwelling rental units must operate using an asset management model consistent with the subpart H regulations. PHAs with fewer than 250 dwelling rental units may elect to transition to asset management, but are not required to do so. PHAs are required to implement property-based management, property-based budgeting, and property-based accounting, which are all defined in the subpart H regulations, which are essential components of asset management.

Additionally, to facilitate and clarify the process of conversion to asset management, the office of Public and Indian Housing (PIH) will be issuing a notice that contains more detailed financial reporting information and guidance to assist PHAs in the near future.

II. This Notice

This notice clarifies and provides interim guidance pertaining to various aspects of public housing's conversion to asset management. The interim guidance provided in this notice is intended to assist all PHAs that operate public housing. Special provisions are included in the notice to assist small PHAs with less than 250 public housing units that are not subject to asset management conversion. Specifically, the notice provides elaboration on the collection and use of fees in the operation and management of properties, the effect of transitioning to asset management on the Public Housing Assessment System (PHAS), property identification, and the connection between asset management and the Capital Fund.

As part of the requirement to convert to asset management, PHAs of 250 or more units must charge a property management fee for the operation of the central office. In addition, PHAs may charge a "fee-for-service" for certain centralized property management services and must prepare property-level financial statements. These and other requirements introduce new financial reporting models; affect the scoring under the PHAS; and raise issues regarding treatment of such fees as "program income." This notice clarifies and provides guidance on key

business decisions related to the implementation of asset management.

HUD is soliciting comments on this notice. Based upon the comments that are received and the experience of PHAs as they begin the conversion to asset management, HUD will issue final guidance and may initiate rulemaking, as may be necessary, to establish more specific requirements. The rulemaking will provide PHAs and the public with an opportunity to comment on any proposed requirements prior to their issuance for effect. Until such time, this notice serves as interim guidance, providing PHAs with an operational framework to assist with their conversion to asset management.

III. Treatment of Fee Income as Non-Program Income

HUD wishes to clarify that reasonable fees charged to properties and programs, as part of the fee-for-service approach, are not considered federal program income for the purposes of 24 CFR part 85. Rather, this fee income is considered local revenue and control over its use is subject only to state or local requirements imposed on individual PHAs.

IV. Excess Cash

The Operating Fund program regulations at § 990.280 establish certain limitations, as well as certain freedoms, on the use of property revenues by PHAs depending on whether a property generates "excess cash." Section 990.255(a) provides that PHAs must manage their properties using an asset management model consistent with management norms of the multifamily management industry. As such, excess cash should be computed using essentially the same method as performed under HUD's multifamily housing programs. The determination of excess cash is based on year-end financial statements using a balance sheet approach.

However, solely for the purposes of the provisions affecting property fungibility (see § 990.280(b)(5)(i)) and payment of an asset management fee (see § 990.280(b)(5)(ii)), a property's excess cash should not be less than one month's operating expenses.

V. Restrictions on Use of Excess Cash for Payment of Central Office Costs

The part 990 regulations establish certain parameters around the use of a property's excess cash (beyond the minimum levels described above). Consistent with § 990.280(c), excess cash may not be used to pay for the operations of the central office cost center. To allow excess cash to fund the

operations of the central office cost center would be inconsistent with § 990.280(c), which states that "central office cost centers shall be funded from the property-management fees received from each project, and from the asset management fees to the extent that they are available." It would also contravene a goal of the September 19, 2005, Operating Fund final rule that PHAs should only be permitted to charge a reasonable fee for the operations of the central office.

VI. Reasonableness of Property Management Fees and Asset Management Fees

Section 990.280 provides for the establishment of "reasonable" property management and asset management fees. Accordingly, fees must be reasonable to be considered as excess cash and not treated as program income. Property management fees, which may include a bookkeeping fee, are to be earned monthly for each occupied unit or approved vacancy, as per 24 CFR 990.140 and 990.145, respectively. In accordance with § 990.140, asset management fees are to be earned based on the total number of units under the Annual Contributions Contract (ACC) for each project.

The following guidelines are offered to assist PHAs in determining whether their fees are reasonable. However, PHAs may establish higher fees other than those provided in these guidelines, as provided in section IX of this notice.

A. Property Management Fee

A PHA may charge a reasonable property management fee based on any of the following:

1. The property management fee schedules established for each HUD Multifamily Field Office. Generally, the Office of Multifamily Housing establishes fee ranges for federally subsidized properties that reflect 120 percent of the mean property management fee for profit-motivated properties that are well managed, in good physical condition, and are managed by independent agents with no identity of interest with the owners; or
2. The 80th percentile property management fee paid by all for-profit and unlimited dividend Federal Housing Administration (FHA) properties, by HUD Field Office, excluding such programs as cooperatives and nursing homes.

The property management fee may include a reasonable bookkeeping fee for the property accounting function. The average bookkeeping fee in HUD's multifamily housing programs is about \$3.50 per unit per month (PUM) (2004

data). Generally, HUD will consider \$7.50 PUM to be a reasonable fee. A higher bookkeeping fee for PHAs reflects higher centralized information technology and human resource costs present in public housing. For financial reporting purposes, this bookkeeping fee, as is standard business practice, is to be presented separately from the property management fee on the PHA's financial statements.

B. Asset Management Fee

HUD will generally consider an asset management fee charged to each property of \$10 PUM as reasonable. Asset management fees are based on all units under an ACC. In multifamily housing, the asset management functions of owners are primarily funded through cash flows. This fee amount was determined based on an examination of cash flows in HUD's multifamily properties and the consideration that certain asset management activities in public housing are also recovered through the Capital Fund management fee.

VII. Assignment of Assets to the Central Office Cost Center and Determination of Initial Working Capital

Section 990.280(b) of the final rule requires PHAs to separate all assets and liabilities between the properties and the central office cost center.

A PHA's central office cost center will operate off of fees and other allowable charge-backs (as well as other revenue sources outside the public housing program). Like any other business area, the PHA's central office cost center will need a reasonable amount of working capital in order to perform its functions properly. As such, PHAs, when assigning assets between properties and the central office cost center, may assign to the central office cost center an amount equal to six months of property management fees, including bookkeeping fees, and asset management fees based on all units under ACC, regardless of unit status. This assignment may take place at the time the PHA assigns its initial balance sheet data, when first converting to property-based accounting. To the extent that a PHA does not have sufficient reserves to make such an assignment, a PHA may accrue these amounts. This working capital, like the fees themselves, will not be considered program income.

VIII. Management Fees for Capital Fund, Housing Choice Voucher and Other Public Housing Grant Programs

In programs where it applies, OMB Circular A-87 allows PHAs to use a fee-

for-service in lieu of allocation systems for the reimbursement of overhead costs. HUD encourages this approach for several reasons. First, it simplifies a PHA's accounting systems. Second, it relieves HUD from the requirement to review overhead allocations and to monitor the spending of such funds. Third, it encourages PHAs to become more businesslike, in that any revenue in excess of expenses can be used to support the mission of the PHA (*i.e.*, retained earnings of the central office cost center are not considered program income). The following guidelines are designed to assist PHAs intending to implement a fee-for-service approach in establishing appropriate management fees.

A. Capital Fund Program

A PHA may charge up to a maximum 10 percent of the annual Capital Fund grant as a management fee. While current program rules (§ 968.112) allow PHAs to charge up to 10 percent of the Capital Fund grant for "Administration," these administrative costs must be specifically apportioned and/or documented. Under a fee-for-service system, the PHA may charge a management fee of 10 percent, regardless of actual costs.

B. Housing Choice Voucher Program

HUD encourages the adoption of a fee-for-service methodology for the Housing Choice Voucher Program (HCV). Existing appropriations language restricts the use of administrative fees to activities related to the provision of tenant-based rental activity authorized under Section 8. Costs directly related to the day-to-day operations of the Section 8 program such as salaries of occupancy specialists or rented space for intake activities clearly qualify under this definition while overhead costs require more stringent documentation. For PHAs that elect to use a fee-for-service methodology for its HCV program, HUD will consider a management fee of up to 20% of the administrative fee or up to \$12 PUM per voucher leased, whichever is higher, as meeting the requirements of the appropriations act. Under this methodology, PHAs can also charge the HCV program a \$7.50 PUM bookkeeping fee for the program accounting function.

PHAs that elect to maintain an allocation system for the recovery of overhead costs under the HCV program cannot charge the HCV program more than the allocated amount and must maintain auditable documentation to support its allocation of costs and their relationship to the provision of tenant-

based rental activity authorized under section 8.

C. PHA Administrative Fee for Mixed Finance Development

A reasonable administrative fee amount paid with Public Housing Funds for the mixed finance development is 3% of the total property budget. This amount is intended to cover PHA administrative costs. Alternatively, an administrative fee of up to 6% is considered reasonable provided the housing authority is able to support that the fee is appropriate in accordance with section IX of this notice.

D. Other Public and Indian Housing Grants

If a fee rate has not been established for a grant, a PHA should charge no more than 15 percent of the grant amount as a management fee for other Public Housing grants. Where administrative cost are set through other notices, regulations and existing grant agreements, for example the ROSS program and the annual NOFA requirements, these policies and agreements are controlling.

IX. Demonstrating Fee Reasonableness

If a PHA considers the fees in this notice to be inadequate to address their individual circumstances, a PHA may use data that reflects conditions of the local or national market. HUD is aware that PHAs are diverse, having different resources and constraints. During this period of interim guidance and prior to any rulemaking that may be initiated on fees, PHAs may document, as support, that a fee charged is appropriate for the scope of work, specific circumstances of the property, and local or national market for the services provided. The data used may include fees paid by the PHA for private management of public housing through effective competition. PHAs should be ready to justify the departure from fees in these guidelines upon inquiry from HUD or other interested parties.

In conformity with standard business practices, PHAs are encouraged to maintain supporting documentation explaining the basis of its fees. PHAs are also encouraged to consult with HUD on fees that may depart from this guidance prior to charging the fees. HUD will provide a PHA with its views on the reasonableness of the fees intended to be charged.

X. PHAS Transition Rules

The move to asset management will require HUD to revise the PHAS. Currently, PHAS is an entity-wide

assessment system whereas asset management utilizes a property-specific focus. As a result, for the first year of compliance with property-based budgeting and accounting, during which time that PHAs are making organizational changes, the PHA will receive a transition score under the revised PHAS. Incentive awards under the Capital Fund during the time that PHAs receive transition PHAS scores will be based on the PHA's latest PHAS score prior to conversion to asset management.

All PHAs that are or will be classified as troubled will continue to be governed by their memorandum of agreements and other pertinent program rules. Moreover, although PHAs will only receive transition scores, PHAs must continue to comply with all rules associated with the public housing program and must continue to manage with economy and efficiency.

XI. Property Identifications

Under § 990.265, PHAs must identify their property for purposes of asset management. Guidance regarding this exercise was contained in PIH Notice 2006-10 (issued February 3, 2006), entitled "Identification of Projects for Asset Management." These new property identifications will become the new measurement and funding focus of HUD. It is not necessary to revise the property numbers on the ACC. A copy of PIH Notice 2006-10 may be downloaded from <http://www.hudclips.org>.

XII. Inter-Relationship With Capital Fund

Section 990.280(a) provides that property-based budgeting and accounting will be applied to all programs and revenues sources that support properties under the ACC, including the Capital Fund. When a PHA transfers funds from the Capital Fund to the Operating Fund, these funds lose their Capital Fund Program identity and are then governed by all Operating Fund rules. All other Capital Fund eligible activities are bound by the Capital Fund Program rules and the Annual PHA Plan requirements. Additionally, where a PHA may use Capital Funds for "management improvements" and "operations," it may only use those amounts to fund "property" expenses and not expenses of the central office cost center.

XIII. PHAs With Fewer Than 250 Units

For PHAs with fewer than 250 units of public housing and which have not elected to convert to asset management, only Sections X, XI, and XII of this

notice are applicable. HUD included in the September 19, 2005, Operating Fund final rule accommodations to enable PHAs with fewer than 250 units to more easily convert to asset management, such as allowing small PHAs to treat all of their units as one property. Section 990.280 of the Operating Fund program regulations provides for the establishment a "HUD-accepted central office cost center" by PHAs converting to asset management. In the case of a small PHA operating as a single property, the establishment of a separate cost center would be contradictory to the streamlining and cost-efficiency goals of the September 19, 2005, final rule. The establishment of a separate cost center would impose financial and administrative burden on the PHA that, because it is operating as a single property, would not stand to benefit from the coordination and centralization of multiple properties. Accordingly, those PHAs with fewer than 250 units choosing to operate as one property

need not establish a central office cost center that is separate from other PHA functions. Those small PHAs with fewer than 250 units that operate as more than one property and choose to convert to asset management, and that believe the establishment of a separate cost center would impose an undue financial or administrative burden, may seek regulatory relief from HUD from the central office cost center requirement; however, during the first two years of property-based budgeting and accounting, these PHAs need not establish a central office cost center.

XIV. Findings and Certifications

Paperwork Reduction Act

The information collection requirements for the Operating Fund Program have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) and assigned OMB Control Number 2577–

0029. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

Environmental Impact

This Notice provides operating instructions and procedures in connection with activities under a **Federal Register** document that has previously been subject to a required environmental review. Accordingly, under 24 CFR 50.19(c)(4), this Notice is categorically excluded from environmental review under the National Environmental Policy Act (42 U.S.C. 4321).

Dated: August 30, 2006.

Paula O. Blunt,

General Deputy Assistant, Secretary for Public and Indian Housing.

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