

**DEPARTMENT OF HOUSING AND  
URBAN DEVELOPMENT**

**24 CFR Part 905**

[Docket No. FR-4423-F-07]

RIN 2577-AB87

**Allocation of Funds Under the Capital  
Fund; Capital Fund Formula; Final  
Rule**

**AGENCY:** Office of the Assistant Secretary for Public and Indian Housing, HUD.

**ACTION:** Final rule.

**SUMMARY:** This final rule implements, as required by statute, a new formula system for allocation of funds to public housing agencies for their capital needs. This final rule follows publication of a proposed rule on September 14, 1999, which was developed through negotiated rulemaking, and takes into consideration, public comment received on the proposed rule.

**DATES:** *Effective Date:* April 17, 2000.

**FOR FURTHER INFORMATION CONTACT:** William Flood, Director, Office of Capital Improvements, Public and Indian Housing, Room 4134, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410-0500; telephone (202) 708-1640 ext. 4185 (this telephone number is not toll-free). Hearing or speech-impaired individuals may access this number via TTY by calling the toll-free federal Information Relay Service at 1-800-877-8339.

**SUPPLEMENTARY INFORMATION:**

**I. Background**

Section 519 of the Quality Housing and Work Responsibility Act of 1998 (Pub.L. 105-276, approved October 21, 1998) (referred to as the "Public Housing Reform Act") amends section 9 of the United States Housing Act of 1937 (the 1937 Act) to provide a "Capital Fund," to be established by HUD for the purpose of making assistance available to public housing agencies (PHAs) to carry out capital and management activities. Amended section 9 requires HUD to develop a formula for determining the amount of assistance provided to PHAs from the Capital Fund for a Federal fiscal year, and the formula is to include a mechanism to reward performance. The statute also requires that the Capital Fund formula is to be developed through negotiated rulemaking procedures.

On September 14, 1999 (64 FR 49924), HUD published the proposed rule developed through negotiated

rulemaking. The preamble to the proposed rule provided background information on the negotiated rulemaking process, the number and dates of meetings, the members of the negotiated rulemaking committee, and the issues considered by the committee during its negotiations. This preamble does not repeat that information.

The September 14, 1999 proposed rule provided a 30-day public comment period. HUD received 10 public comments on this rule. Section III of this preamble presents the issues raised by the public commenters and HUD's responses to these comments. Section II, which follows, highlights the significant changes that are being made by HUD at this final rule stage.

**II. Significant Differences Between This Final Rule and the September 14, 1999 Proposed Rule**

HUD has made the following changes to the proposed rule at this final rule stage.

In § 905.10(d) (Allocation for existing modernization needs under the CFF), HUD removed paragraphs (d)(1)(i) and (d)(1)(ii) which addressed the availability of statistically reliable data, and HUD's determination of existing modernization need based on that data. The estimates of existing modernization need will be determined as provided in the methods established by paragraph (d). With the removal of paragraph (d)(1) of the proposed rule, paragraph (d)(2) of the proposed rule (determination of existing modernization need for PHAs greater than or equal to 250 or more units in FFY 1999) is redesignated paragraph (d)(1) at the final rule stage.

In § 905.10(d)(1)(i)(C) of the rule (§ 905.10(d)(2)(i)(C) at the proposed rule stage) which addresses the proportion of units in a development in building completed in 1978 or earlier, HUD revised this paragraph at the final rule stage to provide that the proportion of units in such a development are those as of Federal Fiscal Year 1998.

In § 905.10(d)(1)(i)(D) of the rule (§ 905.10(d)(2)(i)(D) at the proposed rule stage), which addresses the cost of rehabilitating property in the PHA's area, HUD removed the reference to "rolling three year average" of the cost. The cost index is simply referred to as the cost index. This change is consistent with the formula agreed upon in negotiated rulemaking, which did not rely upon a rolling three-year average of costs as a basic formula factor. HUD also revised this paragraph to provide that the applicable period is as of Federal Fiscal Year 1999.

In § 905.10(d)(1)(ii)(A) (§ 905.10(d)(2)(ii)(A) at the proposed

rule stage), HUD changed the Date of Full Availability (DOFA) for newly constructed units from 1999 (the DOFA at the proposed rule stage) to 1991 (the DOFA at this final rule stage). The change in dates continues the Comprehensive Grant formula provision (that sets the date at 1991) and was part of the formula considered by the negotiated rulemaking committee.

In § 905.10(d)(1)(ii)(B) (§ 905.10(d)(2)(ii)(A) at the proposed rule stage), HUD made the same change in DOFA for acquired developments. The applicable date is now 1991, not 1999. The change in dates continues the Comprehensive Grant formula provision (that sets the date at 1991) and was part of the formula considered by the negotiated rulemaking committee.

In § 905.10(d), HUD added a new paragraph (d)(2) to address the determination of existing modernization need for the New York City and Chicago Housing Authorities.

In § 905.10(d), paragraph (3) continues to address determination of existing modernization need for PHAs with fewer than 250 units in FFY 1999. In § 905.10(d)(3)(i)(C) and (d) and in § 905.10(d)(3)(ii)(A) and (B), HUD made the same changes to these paragraphs as it did to the similar paragraphs in paragraph (d)(1).

In § 905.10(e) (Allocation for accrual needs under the CFF), HUD removed paragraphs (1)(i) and (ii) which addressed determination of accrual need on the basis of availability of statistically reliable data, for the same reasons that it removed this language from paragraph (d)(1). Paragraph (e)(2) of the proposed rule, which addressed PHAs allocation of accrual needs for PHAs greater than or equal to 250 or more units, is redesignated as paragraph (1) at this final rule stage.

In § 905.10(e)(1)(i)(E) and § 905.10(e)(3)(i)(E) which address the cost index of rehabilitating property, HUD made the same revisions to these subsections that were made to this language in paragraph (d).

In § 905.10(e), HUD added a new paragraph (2) to address the allocation of accrual needs for the New York City and Chicago Housing Authorities.

In § 905.10(f) (Calculation of number of units), HUD added a new paragraph (2) that addresses replacement units. Paragraph (2) of the proposed rule that addressed conversion of units is redesignated paragraph (3) and revised by removing paragraphs (i) and (ii). Paragraph (i) provided that increases in the number of units resulting from conversion of existing units will be added to the overall unit count so long as the units are under ACC amendments

by the reporting date. Paragraph (ii) provided that for purposes of calculating the number of converted units, HUD shall regard the converted size unit as the appropriate unit count.

HUD retained paragraph (iii) but made revisions. The revised paragraph (iii) provides that for purposes of calculating the estimated need of converted units, HUD shall treat conversion in a development so that the total estimated need (total units times need per unit) of the development is unchanged by the conversion.

In § 905.10(f)(4) (§ 905.10(f)(3) at the proposed rule stage) which addresses reduction of units, HUD removed reference to conversion. Reduction of units is now based only on demolition or disposition.

In § 905.10(h)(2), regarding retention of current formula shares for some Moving to Work communities whose agreements in that program provide for this, HUD has added the modifier "approximately" to "the formula share". This is done in recognition that the replacement housing factor would not duplicate the prior calculation, but instead would be calculated annually in the same manner as the replacement factor provided under this rule. (In addition, the prior formula's replacement housing factor was for five years.) This change must occur for purposes of efficient formula administration and should not make a significant financial difference. Under the overall formula system, the share of a PHA with an MTW grant agreement under the new formula system (including the replacement housing component) may be the PHA's share under the old formula system (including the replacement housing component) for comparable units, if the PHA's MTW agreement provided for that share.

In § 905.10(i) (Replacement housing factor), HUD revised paragraph (i) at this final rule stage to remove all reference to conversion. The replacement housing factor is only applicable to demolition and disposition.

In § 905.10(j) (Performance reward factor), HUD revised this paragraph to reflect the status of implementation of the Public Housing Assessment System (PHAS).

A new paragraph (k) was added to clarify the PHAs' authority to undertake collateralization, as provided under section 14(a) of the 1937 Act, and to address the statutorily eligible expenses in section 9(d)(1) of the U.S. Housing Act of 1937. This new paragraph is discussed in more detail in Section IV of this preamble.

In addition to these changes, HUD also made several editorial and

organizational changes throughout the rule for purposes of clarity.

### III. Discussion of Public Comments

This section presents HUD's responses to the significant issues raised by the individuals and entities who submitted comments on the September 14, 1999 proposed rule. The heading "Comment" states the comment made by a commenter or commenters and the heading "HUD Response" presents HUD's response to the issue or issues raised by the commenter or commenters.

#### General Comments

*Comment. The data collected by the consultant study was flawed.* The preamble to the September 14, 1999 proposed rule notes that "[a]s part of its deliberation of formula models and formula components, the committee considered at length a study conducted on capital needs in public housing by a consulting firm" (64 FR 49924). Two commenters were highly critical of the study. The concerns of the commenters included that the study did not look at true capital needs, but only at the cost of restoring items to their original condition, the study did not adequately take into account different housing types, the study only looked at observable conditions, and there were flaws in the methods by which site costs were estimated. Another commenter stated that the preamble did not properly reflect that the negotiated rulemaking committee spent considerable time debating the merits of the study and the committee, overall, was critical of the study.

*HUD Response.* HUD recognizes the limitations of the study used by the committee and the preamble to the proposed rule described these limitations. The study, however, was the best study available at the time, and HUD believes that the committee, cognizant of the limitations that the study presented, was able to address formula issues knowledgeably and appropriately. For example, as the preamble stated, given the limitations of the study, the committee decided to limit any reduction in funding in going from the old to the new formula to six percent of a PHA's Federal Fiscal Year 1999 formula share for comparable units.

*Comment. The rule should reflect the concern of the committee to base a performance bonus solely on the PHA's PHAS score.* One commenter stated that the proposed rule did not adequately convey the opposition of many committee members to a performance

bonus based exclusively on a PHA's PHAS score.

*HUD Response.* The preamble to a negotiated rule need not (and in the majority of cases does not) relay every disagreement that committee members had during the deliberations of the rule. The minutes of the committee meetings accurately reflect all discussions, and are available for review by the public. The preamble should reflect any nonconsensus items, however. The committee reached consensus on all rule provisions, including the performance bonus.

*Comment. HUD should use FY 2000 appropriation numbers to conduct a "test run" of the formula and make the results available to each PHA.* Two commenters suggested that the final rule should provide a sample application of the formula using dollar figures. One of the commenters stated that PHAs cannot submit informed comments on the proposed rule without "having at least estimates of what the formula would mean to them." The commenter further recommended that HUD extend the due date for the submission of public comments until such numbers are made available to the public.

*HUD Response.* Provision of a sample application of the formula and an extension of the public comment period are not necessary, in view of the prior work of the negotiated rulemaking committee. The sample formula amounts that HUD provided to the committee for PHA size and geographic categories and for some representative PHAs were sufficient to guide the committee's decisions have been available through committee members (including national public housing organizations). Additionally, to safeguard against any possible dramatic changes in going from the old formula to the new, the rule limits funding reductions to six percent of a PHA's Federal Fiscal Year 1999 formula share for comparable units.

*Comment. The final rule should contain a definition section.* One commenter suggested that the final rule contain a definitions section in order to clarify the meaning of several terms used throughout § 905.10. The commenter recommended that the final rule provide definitions for the following terms: existing modernization needs; relative needs; accrual needs; calibration of existing modernization need; rolling three-year average; cost index; calibration of accrual need; total estimated existing modernization need; total accrual need; and "Moving to Work."

*HUD Response.* Many of the terms are described within the formula itself or

are terms carried over from the previous formula and, as a result, are terms that are familiar to PHAs.

*Comments on the Proposed Rule Provisions*

*Comment. What constitutes statistically reliable data?* Two commenters expressed concern about the proposed rule language that provided for a determination of existing modernization need or accrual need based on the availability or unavailability of statistically reliable data. One commenter asked how PHAs would be assured that HUD is using statistically reliable data. The other commenter stated that HUD should accept that statistically reliable data generally are not available.

*HUD Response.* The data used for this formula are from the consultant study referenced above. Thus, as noted earlier in this preamble, language that implied that the data relied upon for the formula might change in the future has been removed at the final rule stage.

*Comment. How will HUD determine the rolling three year average cost index for each area?* One commenter questioned how this index would be determined.

*HUD Response.* HUD has removed any reference to a three-year rolling average of the cost index. The current practice is to make annual adjustments in the formula based on annual changes in the cost index, and HUD's expectation is to continue current practice.

*Comment. Determination of non-metropolitan area.* One commenter asked whether, in determining the extent to which units of a development were in a non-metropolitan area, HUD will make this determination based on each development and each scattered site home.

*HUD Response.* The determination will be based on the location of each development. If a scattered site development has units in both metro and non-metro areas (as determined in FFY 1996), then the majority of units will decide the metro or non-metro designation of the development.

*Comment. The formula must provide for capital funding after the date of full availability (DOFA).* Proposed § 905.10(d)(2)(ii)(A) provided that "[d]evelopments acquired by a PHA with a DOFA date of October 1, 1999 or thereafter will be considered by HUD to have a zero existing modernization need." One commenter asked whether this date would be revised each year. The commenter stated that while it is understandable that a development with a DOFA in the current fiscal year would

not need much, if any, modernization that year, the commenter thought it is unrealistic to say that this development will not require modernization in the future.

*HUD Response.* As noted earlier in this preamble, HUD has revised the rule to continue the current application of this provision, for which the date is October 1, 1991. The formula agreed upon in negotiated rulemaking has this basis. The agreed-upon formula is static except for changes in units and annual calibration of costs based on inflation in local areas. Thus, this provision will not change from year to year.

*Comment. HUD should provide examples regarding the application of the accrual formula.* One commenter stated that the accrual need formula is too complex. The commenter stated that it would be difficult, if not impossible, to determine from the formula description how this will effect an actual housing authority.

*HUD Response.* The accrual need formula should not be unfamiliar to PHAs. This formula is similar to the accrual need formula of the Comprehensive Grant Program.

*Comment. Replacement housing factor is unclear.* The proposed rule provides that the replacement housing factor "will be added for an additional 5 years if the planning, leveraging, obligation and expenditure requirements are met." The proposed rule also provides that, as "a prior condition of a PHA's receipt of additional funds for replacement housing \* \* \* for the second 5-year period or any portion thereof, a PHA must obtain a firm commitment of substantial additional funds other than public housing funds for replacement housing, as determined by HUD." A few commenters stated that this language was vague, and that HUD should clarify this provision at the final rule stage. The commenters stated that HUD needs to explain what it means by "firm commitment," "planning," and "leveraging", among other terms used in this section.

*HUD Response.* This language was negotiated specifically in negotiated rulemaking, and HUD will not add to it in the regulation. HUD will provide the necessary guidance before the beginning of the second five-year term.

*Comment. PHAs that receive HOPE VI or MROP funds should not be prevented from receiving funds under the replacement housing factor.* One commenter requested that the Capital Fund formula not penalize PHAs that "have taken the initiative to access additional HUD funding" under programs such as the HOPE VI program

or the Major Reconstruction of Obsolete Public Housing (MROP) program. The commenter recommended the removal of § 905.10(i)(5)(iv) from the final rule.

*HUD Response.* HUD and the committee determined it equitable to exclude under the replacement housing factor those units funded under HOPE VI, MROP, or other PIH development programs, because funding under these programs is sufficiently generous to outweigh formula funding under the Capital Fund. Thus, replacement factor funds will not be provided for public housing units fully funded from such sources. If the PHA obtains funding from HOPE VI, MROP, or other PIH development programs during the 10-year period for the replacement housing factor, future funding for the replacement housing factor covering the number of units funded under these other programs would cease. HUD also notes that, since replacement housing factor funds can be used only for replacement housing, such funding would cease if the PHA already had received funding from any source to replace all housing previously demolished or disposed of.

*Comment. HUD should aggressively invoke its authority to recapture and reallocate funds; Replacement housing factor should only be made available to PHAs committing to provide replacement units.* Two commenters urged HUD to strengthen the recapture and reallocation provisions of the proposed rule. The commenters stated that PHAs that do not use the money for its designated purpose should not benefit from the funds. The commenters suggested that the language in the rule that HUD "may" recapture and reallocate replacement housing funds should be changed to HUD "shall" recapture and reallocate replacement housing funds. The commenters also suggested that a PHA's failure to obligate replacement housing funds on a timely basis should not result merely in a reduction of funding to the PHA for the second 5-year period of application of the replacement housing factor, but in elimination of those funds.

Another commenter was concerned about perceived deficiencies in the proposed rule that would excuse PHAs receiving replacement factor funds from actually providing replacement housing. The commenter objected to the provision permitting a PHA to defer the obligation of replacement factor funds until the accumulation of adequate funds. The commenter stated that, since replacement factor funds will never cover all development costs, PHAs that do not diligently seek out additional resources will qualify for the 24-month

extensions provided in the rule. The commenter also expressed concern about proposed § 905.10(i)(2), which (according to the commenter) only requires "PHAs seeking the second five years of funding \* \* \* to demonstrate \* \* \* that they have the funds to develop the replacement housing." The commenter stated that this provision would undermine the entire concept that a PHA that qualifies for the first five years of funding is one that seriously intends to replace demolished units.

*HUD Response.* The requirements imposed in this regulation for obligating and expending replacement housing funds are an addition to the requirements generally applicable to obligation and expenditure of capital funds, and are designed to provide additional assurance that replacement housing factor funds are obligated and expended in a timely fashion. HUD will enforce the requirements accordingly.

*Comment. PHAs designated as standard and standard performers under PHAS should not have funding reduced as a result of a performance bonus to high performing PHAs.* One commenter objected to reducing formula funding for standard and standard PHAs as a result of the performance bonus for high performing PHAs. The commenter stated that these PHAs desperately need Capital Funds for repairs and modernization in order to meet the "stringent requirements" of the PHAS.

*HUD Response.* HUD does not agree that the PHAS imposes overly stringent requirements on PHAs. The requirements imposed on PHAs are those imposed by statute and public housing program regulations, and are requirements directed to ensuring that PHAs use federal funds to provide decent, safe and sanitary housing to public housing residents. The PHAS assesses, among other things, whether PHAs are meeting this requirement.

The negotiated rulemaking committee recognized that providing a bonus to high performing PHAs from the Capital Fund would necessarily mean a reduction in funding to PHAs that are not designated high performing. Nevertheless, the committee agreed that it was important and consistent with the requirements of the Public Housing Reform Act to reward high performing PHAs with a monetary incentive. Although there was criticism of the PHAS and objections were voiced and the issue debated, the committee reached consensus that the performance bonus would be based on the PHA's designation of high performer under the PHAS. That final rule was published, after an extensive additional

consultation process with affected entities and their representatives, on January 11, 2000. In any event, PHAS is the performance evaluation system for PHAs, and thus it is proper to base the performance bonus on PHAS.

*Comment. Performance bonus should not be based on PHAS scores.* Four commenters strongly objected to the use of high performing designation under PHAS for purposes of determining the performance bonus. The commenters stated that the "current state of the PHAS shows it to be inaccurate and inconsistent, and it is still questionable whether it really measures what it is intended to measure." The commenters stated that it is premature to implement PHAS at this time and, therefore, it is premature to implement a Capital Fund formula bonus based on PHAS.

*HUD Response.* HUD believes that much of the concern of the commenters about the PHAS was based on the PHAS advisory scores. The purpose of issuance of PHAS advisory scores during the transition period following publication of the PHAS final rule published on September 1, 1998 (63 FR 46596) was to test the PHAS, commence training on the PHAS, and solicit additional input from PHAs before the PHAS was scheduled to take effect on October 1, 1999. On October 21, 1999 HUD published a notice (64 FR 56676) that recognized the PHAS transition period needed to be extended for PHAs with fiscal years ending on September 30, 1999, or before December 31, 1999. In that notice, HUD advised that PHAs with fiscal years ending after December 31, 1999, would be the first PHAs to be issued PHAS scores. PHAs with fiscal years ending September 30, 1999 or December 31, 1999, will be issued PHAS advisory scores and be assessed (as HUD is required to do by statute) on the PHA's management operations under the criteria in 24 CFR part 902, subpart D of the PHAS regulation. The notice recognized that these PHAs needed additional time to prepare for the transition to PHAS.

In that notice, HUD also advised that it was continuing to work on the PHAS final rule and that HUD would issue a consensus-based final rule that would address the public comments and describe all changes to the PHAS regulation made as a result of the public comment and review process.

*Comment. Timeframes for performance bonus should be extended due to deficiencies with the PHAS.* Two commenters suggested that due to the perceived deficiencies with PHAS, the time frame for implementation of the performance bonus is unrealistic. The commenters suggested that the time

frame be extended in order to permit the PHAS to be finalized.

*HUD Response.* As noted in Section II of the preamble and in the response to the preceding comment, HUD has revised the rule to provide that the performance bonus does not take effect until an entire year of the first PHAS scores have been issued.

*Comment. Final rule should clarify relationship between performance bonus and Capital Fund cap.* Section 905.10(h) of the proposed rule provides that "no PHA's [Capital Fund formula] share for units funded under the [Capital Fund formula] can be less than 94% of its formula share had the [Fiscal Year] 1999 formula system been applied to these eligible units." Section 905.10(j) provides that "no PHA will lose more than 5% of its base formula amount as a result of the redistribution of funding from non-high performers to high performers." One commenter asked whether this 5% "hold harmless" provision is inclusive or exclusive of the 94% cap provided in § 905.10(h). The commenter recommended that no PHA "should receive a cut of more than 6 percent of its formula share for any reason, including bonuses to others."

*HUD Response.* The final agreement of the negotiated rulemaking committee is that the performance bonus computation is separate from (or exclusive of) the funding formula computations. A PHA could lose up to six percent of its original formula amount for comparable units under the funding formula computations (again, exclusive of the performance bonus computation) and then lose up to an additional five percent under the performance bonus computations. Some PHAs that lose the full six percent under the formula computation might benefit from the performance bonus computation.

#### IV. Eligible Expenses

As HUD's Notice on Status of Implementation of the Public Housing Reform Act, published on December 22, 1999 (64 FR 71799), noted, upon the effective date of this final rule, PHAs may begin to undertake the eligible activities listed in section 9(d)(1) of the Act. Section 522(c)(2) of the Public Housing Reform Act states that despite the Act's repeal of section 14 of the United States Housing Act of 1937 (1937 Act), PHAs may continue to use the authority provided under section 14(q) of that Act before implementation of the formula. In addition to the eligible expenses under section 9(d)(1), section 14(q) includes authorization for drawdown of funds on a schedule commensurate with construction draws

for deposit into an interest-bearing account to serve as collateral or credit enhancement for bonds issued by a public agency, for the construction or rehabilitation of a development. New section 35 of the 1937 Act, added by the Public Housing Reform Act, provides somewhat broader authority of the same nature, to be used in accordance with regulations issued by HUD.

HUD soon will issue proposed rules on the nonformula aspects of the Capital Fund and on mixed finance, which will address these provisions. For example, in the preamble to the proposed rule published on September 14, 1999 (64 FR 49925, first column), HUD stated that measures to promote more effective resident participation will be categorized as eligible Capital Fund management improvement expenses under appropriate regulations and provided examples of such eligible expenses. These rules also will cover such topics as the timing of expenditure of funding.

To provide clarity and assure that there is no temporary lapse in PHAs' authority to undertake collateralization as they could do under section 14(q), however, HUD is adding a new paragraph (k) to this final rule that repeats the statutorily eligible expenses in section 9(d)(1) and adds a sentence identical to the collateralization authority in section 14(q)(1). This paragraph may be repealed, amended or moved once the referenced regulatory processes are completed.

## V. Findings and Certifications

### *Environmental Impact*

A Finding of No Significant Impact with respect to the environment was made in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4223), at the proposed rule stage. That Finding of No Significant Impact remains applicable and is available for public inspection between the hours of 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC.

### *Regulatory Planning and Review*

The Office of Management and Budget has reviewed this rule under Executive Order 12866 (captioned "Regulatory Planning and Review") and determined that this rule is a "significant regulatory action" as defined in section 3(f) of the Order (although not an economically significant regulatory action under the

Order). Any changes made to this rule as a result of that review are identified in the docket file, which is available for public inspection during regular business hours (7:30 a.m. to 5:30 p.m.) at the Office of the General Counsel, Rules Docket Clerk, Room 10276, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410-0500.

### *Regulatory Flexibility Act*

The Secretary has reviewed this rule before publication and by approving it certifies, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), that this rule would not have a significant economic impact on a substantial number of small entities. The rule would implement a new system for formula allocation of funds to PHAs for their capital needs. The new system is established to provide minimum impact on all PHAs, small and large. The new formula provides that no PHA can lose more than 6% of its formula share for comparable units in going from the old to the new formula. Accordingly, the formula will not have a significant economic impact on any PHA.

### *Federalism Impact*

Executive Order 13132 (entitled "Federalism") prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on State and local governments and is not required by statute, or preempts State law, unless the relevant requirements of section 6 of the Executive Order are met. This final rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive Order.

### *Unfunded Mandates Reform Act*

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) requires Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and on the private sector. This rule does not impose, within the meaning of the UMRA, any Federal mandates on any State, local, or tribal governments or on the private sector.

### **List of Subjects in 24 CFR Part 905**

Grant programs—housing and community development, Modernization, Public housing, Reporting and recordkeeping requirements.

## Catalog

The Catalog of Federal Domestic Assistance number for the program affected by this rule is 14.850.

For the reasons discussed in the preamble, part 905 is added to title 24 of the Code of Federal Regulations as follows:

## **PART 905—THE PUBLIC HOUSING CAPITAL FUND PROGRAM**

**Authority:** 42 U.S.C. 1437g and 3535(d).

### **§ 905.10 Capital Fund formula (CFF).**

(a) *General.* This section describes the formula for allocation of capital funds to PHAs. The formula is referred to as the Capital Fund formula (CFF).

(b) *Emergency reserve and use of amounts.* (1) In each Federal fiscal year after Federal Fiscal Year (FFY) 1999, from amounts approved in the appropriation act for funding under this part, HUD:

(i) Shall reserve an amount not to exceed that authorized by 42 U.S.C. 1437g(k) for—

(A) Use for assistance in connection with emergencies and other disasters, and

(B) Housing needs resulting from any settlement of litigation; and

(ii) May reserve such other amounts for other purposes authorized by 42 U.S.C. 1437g(k).

(2) Amounts set aside under paragraph (b) of this section may be used for assistance for any eligible use under the Capital Fund, Operating Fund, or tenant-based assistance in accordance with section 8 of the U.S. Housing Act of 1937 (42 U.S.C. 1437f).

(3) The use of any amounts as provided under paragraph (b) of this section relating to emergencies (other than disasters and housing needs resulting from settlement of litigation) shall be announced subsequently through **Federal Register** notice.

(c) *Formula allocation based on relative needs.* After determining the amounts to be reserved under paragraph (b) of this section, HUD shall allocate the amount remaining in accordance with the CFF. The CFF measures the existing modernization needs and accrual needs of PHAs.

(d) *Allocation for existing modernization needs under the CFF.* HUD shall allocate one-half of the available Capital Fund amount based on the relative existing modernization needs of PHAs, determined in accordance with this paragraph (d) of this section.

(1) *For PHAs greater than or equal to 250 or more units in FFY 1999, except*

the New York City and Chicago Housing Authorities, estimates of the existing modernization need will be based on the following:

(i) Objective measurable data concerning the following PHA, community and development characteristics applied to each development:

(A) The average number of bedrooms in the units in a development. (Equation co-efficient: 4604.7);

(B) The total number of units in a development as of FFY 1999. (Equation co-efficient: 10.17);

(C) The proportion of units, as of FFY 1998, in a development in buildings completed in 1978 or earlier. In the case of acquired developments, HUD will use the Date of Full Availability (DOFA) date unless the PHA provides HUD with the actual date of construction. When provided with the actual date of construction, HUD will use this date (or, for scattered sites, the average dates of construction of all the buildings), subject to a 50-year cap. (Equation co-efficient: 4965.4);

(D) The cost index of rehabilitating property in the area as of FFY 1999. (Equation co-efficient: -10608);

(E) The extent to which the units of a development were in a non-metropolitan area as defined by the Census Bureau during FFY 1996. (Equation co-efficient: 2703.9);

(F) The PHA is located in the southern census region, as defined by the Census Bureau. (Equation co-efficient: -269.4);

(G) The PHA is located in the western census region, as defined by the Census Bureau. (Equation co-efficient: -1709.5);

(H) The PHA is located in the midwest census region as defined by the Census Bureau. (Equation co-efficient: 246.2)

(ii) An equation constant of 13851.

(A) *Newly constructed units.* Units with a DOFA date of October 1, 1991, or thereafter, will be considered to have a zero existing modernization need.

(B) *Acquired developments.* Developments acquired by a PHA with a DOFA date of October 1, 1991, or thereafter, will be considered by HUD to have a zero existing modernization need.

(2) *For New York City and Chicago Housing Authorities, based on a large sample of direct inspections.* For purposes of this formula, prior to the cost calibration in paragraph (d)(4) of this section, the number used for the existing modernization need of family developments is \$16,680 in New York, and \$24,286 in Chicago, and the number for elderly developments is \$14,622 in New York, and \$16,912 in Chicago.

(i) *Newly constructed units.* Units with a DOFA date of October 1, 1991, or thereafter, will be considered to have a zero existing modernization need.

(ii) *Acquired developments.* Developments acquired by a PHA with a DOFA date of October 1, 1991, or thereafter, will be considered by HUD to have a zero existing modernization need.

(3) *For PHAs with fewer than 250 units in FFY 1999,* estimates of the existing modernization need will be based on the following:

(i) Objective measurable data concerning the following PHA, community and development characteristics applied to each development:

(A) The average number of bedrooms in the units in a development. (Equation co-efficient: 1427.1);

(B) The total number of units in a development as of FFY 1999. (Equation co-efficient: 24.3);

(C) The proportion of units, as of FFY 1998, in a development in buildings completed in 1978 or earlier. In the case of acquired developments, HUD will use the DOFA date unless the PHA provides HUD with the actual date of construction, in which case HUD will use the actual date of construction (or, for scattered sites, the average dates of construction of all the buildings), subject to a 50-year cap. (Equation co-efficient: -1389.7);

(D) The cost index of rehabilitating property in the area, as of FFY 1999. (Equation co-efficient: -20163);

(E) The extent to which the units of a development were in a non-metropolitan area as defined by the Census Bureau during FFY 1996. (Equation co-efficient: 6157.7);

(F) The PHA is located in the southern census region, as defined by the Census Bureau. (Equation co-efficient: 4379.2);

(G) The PHA is located in the western census region, as defined by the Census Bureau. (Equation co-efficient: 3747.7);

(H) The PHA is located in the midwest census region as defined by the Census Bureau. (Equation co-efficient: -2073.5)

(ii) An equation constant of 24762.

(A) *Newly constructed units.* Units with a DOFA date of October 1, 1991, or thereafter, will be considered to have a zero existing modernization need.

(B) *Acquired developments.* Developments acquired by a PHA with a DOFA date of October 1, 1991, or thereafter, will be considered by HUD to have a zero existing modernization need.

(4) *Calibration of existing modernization need for cost index of*

*rehabilitating property in the area.* The estimated existing modernization need, as determined under paragraphs (d)(1), (d)(2) or (d)(3) of this section, shall be adjusted by the values of the cost index of rehabilitating property in the area.

(e) *Allocation for accrual needs under the CFF.* HUD shall allocate the other half of the remaining Capital Fund amount based on the relative accrual needs of PHAs, determined in accordance with paragraph (e) of this section.

(1) *For PHAs greater than or equal to 250 or more units, except the New York City and Chicago Housing Authorities,* estimates of the accrual need will be based on the following:

(i) Objective measurable data concerning the following PHA, community and development characteristics applied to each development:

(A) The average number of bedrooms in the units in a development. (Equation co-efficient: 324.0);

(B) The extent to which the buildings in a development average fewer than 5 units. (Equation co-efficient: 93.3);

(C) The age of a development as of FFY 1998, as determined by the DOFA date. In the case of acquired developments, HUD will use the DOFA date unless the PHA provides HUD with the actual date of construction, in which case HUD will use the actual date of construction (or, for scattered sites, the average dates of construction of all the buildings), subject to a 50-year cap. (Equation co-efficient: -7.8);

(D) Whether the development is a family development. (Equation co-efficient: 184.5);

(E) The cost index of rehabilitating property in the area, as of FFY 1999. (Equation co-efficient: -252.8);

(F) The extent to which the units of a development were in a non-metropolitan area as defined by the Census Bureau during FFY 1996. (Equation co-efficient: -121.3);

(G) PHA size of 6600 or more units in FFY 1999. (Equation co-efficient: -150.7);

(H) The PHA is located in the southern census region, as defined by the Census Bureau. (Equation co-efficient: 28.4);

(I) The PHA is located in the western census region, as defined by the Census Bureau. (Equation co-efficient: -116.9);

(J) The PHA is located in the midwest census region as defined by the Census Bureau. (Equation co-efficient: 60.7)

(ii) An equation constant of 1371.9,

(2) *For New York City and Chicago Housing Authorities, based on a large sample of direct inspections.* For purposes of this formula, prior to the

cost calibration in paragraph (e)(4) of this section the number used for the accrual need of family developments is \$1,395 in New York, and \$1,251 in Chicago, and the number for elderly developments is \$734 in New York, and \$864 in Chicago.

(3) For PHAs with fewer than 250 units, estimates of the accrual need will be based on the following:

(i) Objective measurable data concerning the following PHA, community and development characteristics applied to each development:

(A) The average number of bedrooms in the units in a development. (Equation co-efficient: 325.5);

(B) The extent to which the buildings in a development average fewer than 5 units. (Equation co-efficient: 179.8);

(C) The age of a development as of FFY 1998, as determined by the DOFA date. In the case of acquired developments, HUD will use the DOFA date unless the PHA provides HUD with the actual date of construction. When provided with the actual date of construction, HUD will use this date (or, for scattered sites, the average dates of construction of all the buildings), subject to a 50-year cap. (Equation co-efficient: -9.0);

(D) Whether the development is a family development. (Equation co-efficient: 59.3);

(E) The cost index of rehabilitating property in the area, as of FFY 1999. (Equation co-efficient: -1570.5);

(F) The extent to which the units of a development were in a non-metropolitan area as defined by the Census Bureau during FFY 1996. (Equation co-efficient: -122.9);

(G) The PHA is located in the southern census region, as defined by the Census Bureau. (Equation co-efficient: -564.0);

(H) The PHA is located in the western census region, as defined by the Census Bureau. (Equation co-efficient: -29.6);

(I) The PHA is located in the midwest census region as defined by the Census Bureau. (Equation co-efficient: -418.3)

(ii) An equation constant of 3193.6.

(4) Calibration of accrual need for the cost index of rehabilitating property in the area. The estimated accrual need, as determined under either paragraph (e)(2) or (e)(3) of this section, shall be adjusted by the values of the cost index of rehabilitation.

(f) Calculation of number of units. (1) General. For purposes of determining the number of a PHA's public housing units, and the relative modernization needs of PHAs:

(i) HUD shall count as one unit:

(A) Each public housing and section 23 bond-financed unit under the ACC,

except that it shall count as one-fourth of a unit each existing unit under Turnkey III program. Units receiving operating subsidy only shall not be counted.

(B) Each existing unit under the Mutual Help program.

(ii) HUD shall add to the overall unit count units that are added to a PHA's inventory so long as the units are under ACC amendment and have reached DOFA by the date that HUD establishes for the Federal Fiscal Year in which the CFF is being run (hereafter called the "reporting date"). Any such increase in units shall result in an adjustment upwards in the number of units under the CFF. New units reaching DOFA after the reporting date will be counted for CFF purposes as of the following Federal Fiscal Year.

(2) Replacement units. Replacement units newly constructed as of and after October 1, 1998 that replace units in a development funded in FFY 1999 by the Comprehensive Grant formula system or the Comprehensive Improvement Assistance Program (CIAP) formula system will be given a new ACC number as a separate development and will be treated as a newly constructed development.

(3) Conversion of units. The total estimated need (total units times need per unit) of the development is unchanged by conversion of unit sizes within buildings.

(4) Reduction of units. For developments losing units as a result of demolition and disposition, the number of units on which capital funding is based will be the number of units reported as eligible for capital funding as of the reporting date. Units are eligible for funding until they are removed due to demolition and disposition in accordance with a schedule approved by HUD.

(g) Computation of formula shares under the CFF. (1) Total estimated existing modernization need. The total estimated existing modernization need of a PHA under the CFF is the result of multiplying for each development the PHA's total number of formula units by its estimated existing modernization need per unit, as determined by paragraph (d) of this section, and calculating the sum of these estimated development needs.

(2) Total accrual need. The total accrual need of a PHA under the CFF is the result of multiplying for each development the PHA's total number of formula units by its estimated accrual need per unit, as determined by paragraph (e) of this section, and calculating the sum of these estimated accrual needs.

(3) PHA's formula share of existing modernization need. A PHA's formula share of existing modernization need under the CFF is the PHA's total estimated existing modernization need divided by the total existing modernization need of all PHAs.

(4) PHA's formula share of accrual need. A PHA's formula share of accrual need under the CFF is the PHA's total estimated accrual need divided by the total existing accrual need of all PHAs.

(5) PHA's formula share of capital need. A PHA's formula share of capital need under the CFF is the average of the PHA's share of existing modernization need and its share of accrual need (by which method each share is weighted 50%).

(h) CFF capping. (1) For units that are eligible for funding under the CFF (including replacement housing units discussed below) a PHA's CFF share will be its share of capital need, as determined under the CFF, subject to the condition that no PHA's CFF share for units funded under CFF can be less than 94% of its formula share had the FFY 1999 formula system been applied to these CFF eligible units. The FFY 1999 formula system is based upon the FFY 1999 Comprehensive Grant formula system for PHAs with 250 or more units in FFY 1999 and upon the FFY 1999 Comprehensive Improvement Assistance Program (CIAP) formula system for PHAs with fewer than 250 units in FFY 1999.

(2) For a Moving to Work PHA whose agreement provides that its capital formula share is to be calculated in accordance with the previously existing formula, the PHA's CFF share, during the term of the agreement, may be approximately the formula share that the PHA would have received had the FFY 1999 formula funding system been applied to the CFF eligible units.

(i) Replacement housing factor to reflect formula need for developments with demolition and disposition occurring on or after October 1, 1998—(1) Replacement housing factor generally. PHAs that have a reduction in units attributable to demolition and disposition of units during the period (reflected in data maintained by HUD) that lowers the formula unit count for the CFF calculations qualify for application of a replacement housing factor, subject to satisfaction of criteria stated in paragraph (i)(5) of this section.

(2) When applied. The replacement housing factor will be added, where applicable:

(i) For the first 5 years after the reduction in units described in paragraph (i)(1) of this section, and

(ii) For an additional 5 years if the planning, leveraging, obligation and expenditure requirements are met. As a prior condition of a PHA's receipt of additional funds for replacement housing provided for the second 5-year period or any portion thereof, a PHA must obtain a firm commitment of substantial additional funds other than public housing funds for replacement housing, as determined by HUD.

(3) *Computation of replacement housing factor.* The replacement housing factor consists of the difference between the CFF share without the CFF share reduction of units attributable to demolition and disposition, and the CFF share that resulted after the reduction of units attributable to demolition and disposition.

(4) *Replacement housing funding in FFY 1998 and 1999.* Units that received replacement housing funding in FFY 1998 will be treated as if they had received two years of replacement housing funding by FFY 2000. Units that received replacement housing funding in FFY 1999 will be treated as if they had received one year of replacement housing funding as of FFY 2000.

(5) *PHA eligibility for replacement housing factor.* A PHA is eligible for application of this factor only if the PHA satisfies the following criteria:

(i) The PHA requests the application of the replacement factor;

(ii) The PHA will use the funding in question only for replacement housing;

(iii) The PHA will use the restored funding that results from the use of the replacement factor to provide replacement housing in accordance with the PHA's five-year PHA plan, as approved by HUD under part 903 of this chapter;

(iv) The PHA has not received funding for public housing units that will replace the lost units under the public housing development, Major Reconstruction of Obsolete Public Housing, HOPE VI programs, or programs that otherwise provide for replacement with public housing units;

(v) The PHA, if designated troubled by HUD and not already under the direction of HUD or a court-appointed receiver, in accordance with part 902 of this chapter, uses an Alternative Management Entity as defined in part 902 of this chapter for development of replacement housing and complies with

any applicable provisions of its Memorandum of Agreement executed with HUD under that part; and

(vi) The PHA undertakes any development of replacement housing in accordance with applicable HUD requirements and regulations.

(6) *Failure to provide replacement housing in a timely fashion.* (i) A PHA will be subject to the actions described in paragraph (i)(7)(ii) of this section if the PHA does not:

(A) Use the restored funding that results from the use of the replacement housing factor to provide replacement housing in a timely fashion, as provided in paragraph (i)(7)(i) of this section and in accordance with applicable HUD requirements and regulations; and

(B) Make reasonable progress on such use of the funding, in accordance with HUD requirements and regulations.

(ii) If a PHA fails to act as described in paragraph (i)(6)(i), HUD will require appropriate corrective action under these regulations; may recapture and reallocate the funds; or may take other appropriate action.

(7) *Requirement to obligate and expend replacement housing factor funds within specified period.* (i) In addition to the requirements otherwise applicable to obligation and expenditure of funds, PHAs are required to obligate assistance received as a result of the replacement housing factor within:

(A) 24 months from the date that funds become available to the PHA; or

(B) With specific HUD approval, 24 months from the date that the PHA accumulates adequate funds to undertake replacement housing.

(ii) To the extent the PHA has not obligated any funds provided as a result of the replacement housing factor within the times required by this paragraph, or expended such funds within a reasonable time, HUD shall reduce the amount of funds to be provided to the PHA as a result of the application of the second 5 years of the replacement housing factor.

(j) *Performance reward factor.* (1) PHAs that are designated high performers under the Public Housing Assessment System (PHAS) for their most recent fiscal year can receive a performance bonus that is:

(i) 3% above their base formula amount in the first five years these awards are given (for any year in this 5-year period in which the performance reward is earned); and

(ii) 5% above their base formula amount in future years (for any year in which the performance reward is earned).

(2) The performance bonus is subject only to the condition that no PHA will lose more than 5% of its base formula amount as a result of the redistribution of funding from non-high performers to high performers.

(3) The first performance awards will be given based upon PHAS scores for PHA fiscal years ending December 31, 2000, March 31, 2001, June 30, 2001, and September 30, 2001, with PHAS typically having received those PHAS scores within approximately 3 months after the end of those fiscal years.

(k) *Eligible expenses.* (1) Eligible expenses include the following:

(i) Development, financing, and modernization of public housing projects, including the redesign, reconstruction, and reconfiguration of public housing sites and buildings (including accessibility improvements) and the development of mixed-finance projects;

(ii) Vacancy reduction;

(iii) Addressing deferred maintenance needs and the replacement of obsolete utility systems and dwelling equipment;

(iv) Planned code compliance;

(v) Management improvements;

(vi) Demolition and replacement;

(vii) Resident relocation;

(viii) Capital expenditures to facilitate programs to improve the empowerment and economic self-sufficiency of public housing residents and to improve resident participation;

(ix) Capital expenditures to improve the security and safety of residents; and

(x) Homeownership activities, including programs under section 32 of the 1937 Act (42 U.S.C. 1437z-4).

(2) Such assistance may involve the drawdown of funds on a schedule commensurate with construction draws for deposit into an interest earning escrow account to serve as collateral or credit enhancement for bonds issued by a public agency for the construction or rehabilitation of the development.

Dated: March 7, 2000.

**Harold Lucas,**

*Assistant Secretary for Public and Indian Housing.*

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