

OFFICE OF PERSONNEL MANAGEMENT

5 CFR Part 591

RIN 3206-AK29

Cost-of-Living Allowances (Nonforeign Areas); Methodology Changes

AGENCY: Office of Personnel Management.

ACTION: Proposed rule.

SUMMARY: The Office of Personnel Management (OPM) is proposing technical changes in the methodology used to determine nonforeign area cost-of-living allowances (COLAs). The changes would correct minor drafting errors; provide consistent treatment of sale prices; allow the use of non-housing price data collected on St. John, U.S. Virgin Islands; correct and clarify the definition of COLA survey areas; and allow a one-time prospective index adjustment for the Caribbean and Alaska areas concurrent with the effective date of any COLA rate changes resulting from the 2004 Pacific COLA surveys. OPM is proposing these changes in large part as the result of experience gained in the 2002 COLA surveys and upon various recommendations of the Survey Implementation Committee, the Technical Advisory Committee, and/or the St. Thomas/St. John COLA Advisory Committee.

DATES: Comments must be received on or before April 9, 2004.

ADDRESSES: Send or deliver written comments to Donald J. Winstead, Deputy Associate Director for Pay and Performance Policy, Strategic Human Resources Policy Division, Office of Personnel Management, Room 7H31, 1900 E Street NW., Washington, DC 20415-8200; fax: (202) 606-4264; or email: COLA@opm.gov.

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SUPPLEMENTARY INFORMATION: Section 5941 of title 5, United States Code, authorizes the payment of cost-of-living allowances (COLAs) to employees of the Federal Government stationed in certain nonforeign areas outside the contiguous 48 States whose rates of basic pay are fixed by statute. Executive Order 10000, as amended, delegates to OPM the authority to administer nonforeign area COLAs and prescribes certain operational features of the program.

The Government pays nonforeign area COLAs to General Schedule, U.S. Postal Service, and certain other Federal employees in Alaska, Hawaii, Guam and

the Commonwealth of the Northern Mariana Islands (CNMI), Puerto Rico, and the U.S. Virgin Islands. The Office of Personnel Management (OPM) conducts COLA surveys in each allowance area to determine whether, and to what degree, local living costs are higher than those in the Washington, DC, area. OPM sets the COLA rate for each area based on the results of these surveys.

On May 3, 2002, OPM published final regulations in the **Federal Register** (67 FR 22339) that significantly modified the current COLA survey methodology consistent with the settlement agreement in *Caraballo, et al. v. United States*, No. 1997-0027 (D.V.I.), August 17, 2000. (*Caraballo* was a class-action lawsuit in which the plaintiffs contested the methodology OPM used to determine COLA rates.) Later in 2002, OPM conducted COLA surveys in Puerto Rico, the U.S. Virgin Islands, and the Washington, DC, area, using the new methodology. OPM is publishing with these proposed regulations the complete "2002 Nonforeign Area Cost-of-Living Allowance Survey Report: Caribbean and Washington, DC, Areas."

While conducting the COLA surveys and analyzing the results, OPM became aware of technical errors in the newly implemented regulations. In addition, OPM received from the Survey Implementation Committee (SIC), the Technical Advisory Committee (TAC), and the St. Thomas/St. John COLA Advisory Committee recommendations for other technical changes. Collectively, the changes would (1) correct minor drafting errors; (2) provide consistent treatment of sale prices; (3) allow the use of non-housing price data collected on St. John, U.S. Virgin Islands; (4) correct and clarify the definition of COLA survey areas; and (5) allow a one-time prospective index adjustment for the Caribbean and Alaska areas concurrent with the effective date of any COLA rate changes resulting from the 2004 Pacific COLA surveys.

Minor Drafting Errors

OPM proposes to correct minor drafting errors. One of these relates to how OPM sets the COLA rate for an area as a whole when OPM combines data from multiple survey areas within the COLA area. For COLA areas with multiple survey areas, OPM uses the number of Federal employees in each survey area as weights to combine the data from each of the survey areas. This process is described in paragraph (b) of section 591.216, title 5, Code of Federal Regulations, but the description is not technically correct. The current regulation states that, to combine survey

data for COLA areas that have multiple survey areas, OPM computes weighted average indexes at the primary expenditure group (PEG), major expenditure group (MEG), and overall level. However, OPM actually computes weighted average indexes at the item, PEG, MEG, and/or overall level, and OPM proposes to change 5 CFR 591.216(b) accordingly.

Another technical error relates to how OPM uses expenditure weights, which are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES). In both the COLA area and in the Washington, DC, area, OPM computes a price index by dividing the average price in the COLA area by the average price in the DC area. OPM uses CES expenditure weights to combine the price indexes in a three-step process. Section 591.222 of the COLA regulations describes that process, but the description of the third step is incorrect. The regulations state that OPM produces an overall price index for the survey area. Instead, OPM produces an overall index for the COLA area. OPM's proposed change to 5 CFR 591.222 will correct this.

Consistent Treatment of Sale Prices

One of the changes OPM is proposing relates to the prices it collects in the survey. Section 591.213 of the regulations prescribes the prices OPM collects, which include sale prices. The survey of sale prices is a change from the way OPM priced items in previous surveys. OPM adopted the survey of sale prices pursuant to the *Caraballo* settlement.

The regulation provides for certain exceptions in the collection of sale prices, including going-out-of-business prices and area-wide distress sale prices. The reason OPM does not collect these prices is because unlike most sale prices, which are recurring, going-out-of-business prices and area-wide distress prices are one-time events. In the case of going-out-of-business prices, for example, if OPM conducted the survey earlier, the business would not be discounting its prices, and if OPM conducted the survey later, the business would not be surveyed because it would not be in business.

During the 2002 COLA surveys, OPM encountered clearance prices on items that were being discontinued and/or were seasonal. OPM concluded these clearance prices were similar to going-out-of-business prices. If OPM had conducted the survey earlier, the item would not have been offered as a discontinued item, and if OPM had conducted the survey later, the item would not have been available.

Furthermore, if OPM were to use clearance prices, it would be difficult or impossible to time the surveys to collect prices when the same items are in clearance in all areas.

OPM consulted with the Survey Implementation Committee concerning this issue. The SIC was established under the *Caraballo* settlement and is composed of representatives of the parties in *Caraballo*. The SIC is advised by the Technical Advisory Committee, which was also established under the *Caraballo* settlement and is composed of three economists with expertise in living-cost comparisons. The TAC agreed that clearance prices were similar to going-out-of-business prices and that if clearance prices were used, survey timing would be compromised. Therefore, SIC and the TAC concurred with OPM that clearance prices should not be used, and OPM proposes to amend 5 CFR 591.213(b) to include clearance prices in the list of prices that OPM does not collect.

St. John Non-Housing Price Data

OPM is proposing to amend the definition of the St. Thomas/St. John, U.S. Virgin Islands survey area to allow the survey of non-housing price data on St. John. The St. Thomas/St. John COLA Advisory Committee (CAC) recommends the change. Current regulations provide that OPM only surveys housing data on St. John.

As provided by 5 CFR 591.240, OPM established CACs in Puerto Rico and in the U.S. Virgin Islands prior to the 2002 survey. Each CAC is composed of agency and employee representatives from the survey area and representatives from OPM, and one of the principal functions of the CACs is to advise and assist OPM in planning COLA surveys. In planning the St. Thomas/St. John survey, the CAC for that area recommended that OPM survey selected establishments on the island of St. John and include that data with the St. Thomas data. OPM regulations provide for the survey of housing on St. John but not for the collection of non-housing data. OPM agreed to conduct a test survey on St. John and collected data from the establishments that the CAC identified for the 2002 survey. OPM used the St. John data on a test basis with the St. Thomas data by weighting each island's price data by the number of Federal employees stationed on the island. OPM found it was feasible to collect and use these data in the manner described and believes it is appropriate to continue to survey St. John in future surveys. Therefore, OPM is proposing to change the definition of the St. Thomas/

St. John survey area in 5 CFR 591.215(a) accordingly.

Other Survey Area Definitions

OPM is proposing changes and clarification to other survey area definitions. During the 2002 survey, OPM discovered that some of the geographic definitions of the survey areas in 5 CFR 591.215(a) were incomplete. For example, the Washington, DC, area is defined as specific cities and counties, but consistent with OPM's practice in previous surveys, OPM surveys a few items in areas outside this geographic boundary. For example, OPM surveys the price of air travel from all three airports in the Washington, DC, area: Ronald Reagan Washington National Airport, Washington Dulles International Airport, and Baltimore/Washington International Airport (BWI). OPM also surveys the price of a 5-mile taxi ride originating at these airports. Both Dulles and BWI are outside the geographic boundary shown in section 591.215(a). Nevertheless, these airports are commonly used by residents of the DC area for air travel.

OPM reviewed all of the survey area definitions in consultation with the SIC and TAC and found that other area definitions were inaccurate or incomplete. Therefore, OPM proposes technical changes in the survey area boundary definitions in 5 CFR 591.215(a) to expand the definition of the DC area to allow the survey of selected items in additional geographic locations and to incorporate the recommendations of the SIC and TAC. OPM also proposes a related change in the definition of the Washington, DC, area in 5 CFR 591.201.

Adjustment To Reflect Augmented Housing Data

OPM is proposing a change to allow OPM to make a one-time prospective adjustment in the COLA index based on additional housing data that OPM anticipates collecting by the end of next year's surveys. The SIC and the TAC recommend this change because shelter is the single most important COLA survey item in terms of its expenditure weight and because OPM is accumulating additional housing data and experience analyzing such data during the first survey cycle, *i.e.*, the first 3 years of COLA surveys under the new methodology that OPM adopted pursuant to the *Caraballo* settlement. OPM concurs with the SIC and TAC recommendation.

Under the new methodology, OPM surveys the COLA areas once every 3 years on a rotating basis but surveys the

DC area, which is the base or reference area, every year. The TAC recommends that OPM pool the DC area rental data across years, updating previous years' rental data as appropriate, and thereby increasing the quantity of DC area data. Because shelter price comparisons that use this larger data base might be different from those that use each year's data separately, the TAC and the SIC recommend a one-time prospective COLA index adjustment based on housing data analyses.

In addition, OPM is currently examining the feasibility of collecting additional rent and rental equivalence information in a cost effective manner for research purposes. Under the *Caraballo* settlement, the parties agreed to adopt a rental equivalence approach similar to the one BLS uses for the Consumer Price Index. Rental equivalence compares the shelter value (rental value) of owned homes rather than total owner costs because the latter are influenced by the investment value of the home (*i.e.*, influenced by what homeowners hope to realize as a profit when they sell their homes). As a rule, living-cost surveys do not compare how consumers invest their money.

Currently, OPM surveys rents and uses that as a surrogate for rental equivalence. The SIC and TAC recommend that OPM research and compare market rents and homeowner estimated rents for comparable dwellings. If the research proves feasible and the results are available, the TAC recommends that OPM consider using these results in the one-time adjustment as well. The proposed change to 5 CFR 591.224 would allow such an adjustment.

Executive Order 12866, Regulatory Review

This rule has been reviewed by the Office of Management and Budget in accordance with Executive Order 12866.

Regulatory Flexibility Act

I certify that these regulations would not have a significant economic impact on a substantial number of small entities because they would affect only Federal agencies and employees.

List of Subjects in 5 CFR Part 591

Government employees, Travel and transportation expenses, Wages.

Office of Personnel Management.

Kay Coles James,

Director.

Accordingly, the Office of Personnel Management proposes to amend subpart B of 5 CFR Part 591 as follows:

PART 591—ALLOWANCES AND DIFFERENTIALS

Subpart B—Cost-of-Living Allowance and Post Differential—Nonforeign Areas

1. The authority citation for subpart B of 5 CFR part 591 continues to read as follows:

Authority: 5 U.S.C. 5941; E.O. 10000, 3 CFR, 1943–1948 Comp., p. 792; and E.O. 12510, 3 CFR, 1985 Comp., p. 338.

2. In § 591.201, revise the definition of “Washington, DC, area or DC area” to read as follows:

§ 591.201 Definitions.

In this subpart—

* * * * *

Washington, DC, area or DC area means the District of Columbia; Montgomery County, MD; Prince Georges County, MD; Arlington County, VA; Fairfax County, VA; Prince William County, VA; and the independent cities of Alexandria, Fairfax, Falls Church, Manassas, and Manassas Park, Virginia; and in the context of certain survey items, these jurisdictions and additional geographic locations beyond these jurisdictions.

3. In § 591.213, revise paragraph (b)(1) to read as follows:

§ 591.213 What prices does OPM collect?

* * * * *

(b) * * *

(1) OPM does not collect coupon prices, clearance prices, going-out-of-business prices, or area-wide distress sale prices.

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4. In § 591.215, revise paragraph (a) to read as follows:

§ 591.215 Where does OPM collect prices in the COLA and DC areas?

(a) *Survey areas.* Each COLA area has one survey area, except Hawaii County, HI, and the U.S. Virgin Islands COLA areas. Hawaii County has two survey areas: the City of Hilo and the Kailua-Kona area. The U.S. Virgin Islands also has two survey areas: the Island of St. Croix and the Islands of St. Thomas and St. John. The Washington, DC, area has three survey areas: the District of Columbia, the Maryland suburbs of the District of Columbia, and the Virginia suburbs of the District of Columbia. OPM collects non-housing data

throughout the survey area; and for selected items such as golf, snow skiing, and air travel, OPM collects non-housing data in additional geographic locations. OPM may collect housing data throughout the survey area or in specific housing data collection areas. The following table shows the survey areas:

SURVEY AND DATA COLLECTION AREAS

COLA areas and reference areas	Survey area
Anchorage	City of Anchorage. ¹
Fairbanks	Fairbanks/North Pole area. ¹
Juneau	Juneau/Mendenhall/Douglas area. ¹
Rest of Alaska	See paragraph (c) of this section.
Honolulu	City and County of Honolulu.
Hawaii County	City of Hilo, Kailua-Kona area.
Kauai	Kauai Island.
Maui	Maui Island.
Guam & CNMI	Guam.
Puerto Rico ...	San Juan/Caguas area and eastern Puerto Rico. ²
U.S. Virgin Islands.	St. Croix, St. Thomas/St. John area. ²
Washington, DC—DC.	District of Columbia. ¹
Washington, DC—MD.	Montgomery County and Prince Georges County. ¹
Washington, DC—VA.	Arlington County, Fairfax County, Prince William County, City of Alexandria, City of Fairfax, City of Falls Church, City of Manassas, and City of Manassas Park. ¹

¹ For selected items, such as golf, snow skiing, and air travel, these survey areas include additional geographic locations beyond these jurisdictions.

² OPM collects housing data in St. John and eastern Puerto Rico. OPM may also collect non-housing data from selected outlets in St. John and combine such data with St. Thomas data as provided in § 591.216(b).

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5. In § 591.216, revise paragraph (b) to read as follows:

§ 591.216 How does OPM combine survey data for the DC area and for COLA areas with multiple survey areas?

* * * * *

(b) *COLA areas with multiple survey areas.* OPM computes weighted average indexes at the item, PEG, MEG, and/or overall level by using the corresponding indexes and Federal employment

weights from each survey area within the COLA area.

6. In § 591.219, revise paragraph (b) to read as follows:

§ 591.219 How does OPM compute shelter price indexes?

* * * * *

(b) OPM then uses these characteristics and rental prices and/or estimates in hedonic regressions (a type of multiple regression) to compute for each COLA survey area the price index for rental and/or rental equivalent units of comparable quality and size between the COLA survey area and the Washington, DC, area. Exception: OPM does not compute separate rental and/or rental equivalence price indexes for St. John or eastern Puerto Rico.

7. In § 591.222, revise paragraph (c) to read as follows:

§ 591.222 How does OPM use the expenditure weights to combine price indexes?

* * * * *

(c) *Step 3.* OPM repeats the process described in Step 2 at each level of aggregation within the PEG to produce a price index for the PEG, at the PEG level to produce an index for the MEG, and at the MEG level to produce the overall price index for the COLA area.

8. In § 591.224, revise paragraph (b) and add paragraph (c) to read as follows:

§ 591.224 How does OPM adjust price indexes between surveys?

* * * * *

(b) Paragraph (a) of this section applies beginning with the effective date of the results of the second survey conducted in Puerto Rico and the U.S. Virgin Islands under these regulations.

(c) Based on additional housing data that may be collected before the second survey conducted in Puerto Rico and the U.S. Virgin Islands, OPM will adjust as warranted the price indexes and COLA rates for Puerto Rico, the U.S. Virgin Islands, and the COLA areas in the State of Alaska. OPM will implement any such adjustments on a one-time basis on the effective date of the results of the first surveys conducted in Hawaii and Guam/CNMI under these regulations, and subject to § 591.228. OPM will publish such adjustments as provided in § 591.229.

[FR Doc. 04–2225 Filed 2–6–04; 8:45 am]

BILLING CODE 6325–39–P