614 Grand Avenue, Suite 320
Oakland, California 94610
Telephone: 510-251-9400
Fax: 510-451-2300
nhlp@nhlp.org
www.nhlp.org

COMMENTS ON
REVISIONS TO THE PUBLIC HOUSING OPERATING FUND PROGRAM
NATIONAL HOUSING LAW PROJECT
JUNE 13, 2005

Introduction

These comments are submitted by the National Housing Law Project, the National Low Income Housing Coalition, Wayne Sherwood, ENPHRONT, the Massachusetts Union of Public Housing Tenants, and members of the Housing Justice Network, including Greater Boston Legal Services, the Legal Aid Society of Minneapolis, the Legal Aid Society of Cleveland, California Rural Legal Assistance, the Public Justice Center (Baltimore, MD), and the Oregon Law Center.

These comments object to changes that HUD unilaterally made to the operating subsidy rule prior to its publication in proposed form. We also recommend changes that should be made to the rule and support certain select provisions of the proposed rule.

By Congressional mandate, HUD convened a second Public Housing Operating Fund Negotiated Rulemaking Committee in the spring of 2004. The Committee reached consensus on a draft rule at its final meeting in June 2004. The proposed rule published in April 2005, however, departed significantly from the proposed rule agreed to by Committee consensus. The Negotiated Rulemaking Committee did not agree to these changes. As a result, these changes should not be included in the proposed rule, should not have been published for comment, and should not be adopted. The rule that came out of the negotiated rulemaking process should be published for notice and comment.

Although we are urging HUD to publish the rule that was agreed to by the Negotiated Rulemaking Committee, we do not support all the provisions of that rule and believe that it has substantial flaws. Some of those flaws are highlighted below in our comments.

Background: The Harvard Cost Study

When a negotiated rulemaking committee first met on this issue in 1999, it determined that further data were required. Congress therefore commissioned the Harvard Graduate School of Design to study the cost of administering well-run public housing. The Public Housing Operating Cost Study, hereinafter the Harvard Cost Study, sought to estimate how much

operating public housing ought to cost by examining the cost of operating FHA-assisted housing, which operates in the free market, so its operators must seek to minimize costs. By looking at the costs of the FHA-assisted housing rather than the cost of operating public housing, the Harvard Cost Study failed in its mission. Therefore the Harvard Cost Study should not form the basis of the operating subsidy rule.

Public housing advocates have also objected that the Harvard Cost Study underestimates the cost differences between public housing and FHA-assisted housing because it fails to account for several crucial differences between the two. First, the public housing stock is older than the FHA-assisted stock, so the FHA stock is not able to estimate the segment of operating costs of many public housing properties that is due to age. Indeed, the very definition of property age is contested: FHA properties were dated from their date of first mortgage, whereas Harvard recommended that public housing properties be dated from their date of modernization.[1] Also, some have cited the Millennial Housing Commission Report that the estimated costs for existing rehabilitation needs are two or three times as high for public housing as for FHA-assisted properties. Second, many object that the study did not adequately account for the social service function of public housing or the costs of regulation; field tests did not account for additional costs related to being a public entity. Some object that the study's endorsement of asset-based management also fails to accommodate this reality. The Harvard Cost Study estimates also ignore all of the unique aspects of particular buildings that are critical to determining the true cost of operating units that serve a critical need. Finally, included in any cost study of public housing should be an evaluation of the cost to the community and to affected families if that housing is abandoned. A development should not be abandoned due to insufficient funding merely because it cannot be self-sustaining with funding calculated by a formula designed to determine the costs of running a public housing unit. Externalized costs to community and residents must be considered.

I. Objections to the Execution of Negotiated Rulemaking Procedure

HUD's decision to make nine substantive changes to the consensus[2] proposals of the duly-constituted Operating Fund Negotiated Rulemaking Committee violates the purposes of the statute under which the Committee was organized and the parameters and expectations of the Committee itself, indicating bad faith that may place HUD in violation of the Negotiated Rulemaking Act, 5 U.S.C. §§ 561-570 (2005).

---

1 Many public housing developments have not been modernized, and a number have had only certain systems modernized. Thus there are many apartments that still have electrical systems, kitchens, bathrooms, etc., built in the 1930s, 1940s or 1950s that have not been upgraded to modern standards.

2 The Negotiated Rulemaking Act establishes "consensus" as the aim of the negotiated rulemaking committee. *See* 5 U.S.C. § 566(f). The statute defines "consensus" as "unanimous concurrence among the interests represented on a negotiated rulemaking committee … unless such committee … agrees upon another specified definition." 5 U.S.C. § 562(2). In this Operating Fund Negotiated Rulemaking, the Committee decided that "consensus" would be defined as "the concurrence of the HUD representatives plus at least 2/3rd of Committee members present." *U.S. Department of Housing and Urban Development Operating Fund Negotiated Rulemaking Advisory Committee, Protocols for Negotiated Rulemaking*, at 1 (Mar. 30, 2004).

A. HUD Decision is Contrary to Congressional Intent.

The legislative history of the Negotiated Rulemaking Act of 1990 (hereinafter "NRA") indicates that Congress did not envision substantive changes to a regulation proposed by a negotiated rulemaking committee before the publication of that rule for notice and comment. HUD's decision to make such changes to the Operating Fund Negotiated Rulemaking Committee consensus is contrary to Congress' intent in mandating a negotiated rulemaking process for this rulemaking.

1. HUD Decision is Contrary to the Purposes of the NRA.

The process authorized by the NRA was "designed to reduce transaction costs while ensuring a well-founded policy decision."[3] HUD's decision to make substantial changes to the proposed operating subsidy regulations developed by a duly-established negotiated rulemaking committee before publishing them for notice and comment runs contrary to both of these congressional intentions.

a. HUD's action neither reduces transaction costs nor enhances acceptance of new rule.

A primary congressional purpose of the NRA is to provide a means of including affected parties in the development of proposed rules so as to enhance acceptance of and to avoid litigation over new regulation. Congressional findings appended to the public law version of the NRA included the following:

> (2) Agencies currently use rulemaking procedures that may discourage the affected parties from meeting and communicating with each other, and may cause parties with different interests to assume conflicting and antagonistic positions and to engage in expensive and time-consuming litigation over agency rules. …
>
> (4) Negotiated rulemaking, in which the parties who will be significantly affected by a rule participate in the development of the rule, can provide significant advantages over adversarial rulemaking.[4]
>
> (5) Negotiated rulemaking can increase the acceptability and improve the substance of rules, making it less likely that the affected parties will resist

---

3 H.R. REP. 101-461, at 6699 (1990).

4 Significantly, the composition of the Second Negotiated Rulemaking Committee for the operating fund included one representative from a tenant organization and one public housing resident from the Jacksonville Resident Management Corporation. The other members of the committee were 20 PHAs, including national PHA trade organization representatives and four other interested parties. In contrast in 1999, the Negotiated Rulemaking Committee had at least four members out of 23 non-HUD members, representing tenant and tenant advocates. These were representatives from the National Low Income Housing Coalition, Center for Community Change, the Massachusetts Union of Public Housing Tenants and the New Jersey Association of Public and Subsidized Residents.

> enforcement or challenge such rules in court. It may also shorten the amount of time needed to issue final rules.[5]

Floor debate on the NRA similarly emphasized the collaborative aspect of negotiated rulemaking, bringing "important voices" such as consumer, industry, environmental and labor groups into the process to "encourag[e] cooperation, rather than confrontation," according to Senate cosponsor William Cohen.[6] Senate sponsor Carl Levin went so far as to introduce into the record a *Washington Post* article describing a successful negotiated regulation process and emphasizing its cooperative and "horse-trading" aspects.

Senator Levin described the NRA as "a regulatory reform based upon the concepts of fairness and common sense. In essence, it allows the people who will be required to live by Federal regulations to have a hand in drafting them."[7] Substantially altering the negotiated rulemaking committee's consensus proposals before publishing them for comment is inconsistent with the goals of promoting fairness and developing "buy-in" for new regulations from affected parties – indeed, it militates against such "buy-in" – and thus does not reduce the possibility of costly and time-consuming litigation as Congress intended.

b. HUD's action enfeebles rather than enriches policymaking.

The NRA was also plainly intended to enhance the regulatory process by incorporating the knowledge of affected parties as well as the expertise of the agency into new rulemaking; Congress found that:

> (3) Adversarial rulemaking deprives the affected parties and the public of the benefits of face-to-face negotiations and co-operation in developing and reaching agreement on a rule. It also deprives them of the benefits of shared information, knowledge, expertise, and technical abilities possessed by the affected parties.[8]

Substantive unilateral agency changes to the consensus Rule proposed by a negotiated rulemaking committee do not reflect the shared expertise of the interested parties and therefore place the HUD action in opposition to the congressional finding.

2. HUD Decision is Contrary to Congressional Understanding of the Negotiated Rulemaking Process.

In accord with the stated goals of the NRA, nowhere in the legislation or in the legislative history does Congress appear to have contemplated major alterations between the work of a negotiated rulemaking committee and the publication of a proposed rule, nor does the role of the Office of Management and Budget in the process of regulation trump the NRA

5 Pub. L. 101-648, § 2 (1990).
6 135 CONG. REC. S843-02 (1989).
7 136 CONG. REC. S14582-83 (1990).
8 Pub. L. 101-648, § 2 (1990).

requirement that agencies be willing to use negotiated rulemaking committee consensus "to the maximum extent possible consistent with the legal obligations of the agency."[9]

a. HUD's substantive agency revision represents an additional stage in the negotiated rulemaking process unapproved by Congress.

Committee report and floor debate alike contemplate little change between negotiated rulemaking committee and proposed rule publication. The House Judiciary Committee report does not indicate any interim step: "If the negotiators reach consensus, a proposed rule is drafted. … Once consensus is achieved, the proposed rule is published by the agency and is still subject to the notice and comment provisions of the [Administrative Procedures Act]."[10] Senator Carl Levin described the process similarly on the floor of the Senate as the NRA approached passage: "In a negotiated rulemaking session, the people who will be significantly affected by a proposed rule sit down with the Government, and they jointly draft the regulation. The proposed rule is then published in the Federal Register under normal procedures for notice and comment."[11] At most, Congress expected minor agency adjustments to follow committee consensus: as Senator Levin described the process when initially introducing the bill in 1989, "The agency reviews the draft, makes any *needed adjustments*, and then publishes it in the Federal Register as a proposed rule for public notice and comment under existing rulemaking procedures."[12] Senator William Cohen, cosponsoring the bill, similarly described that interim step as comprised of "any *necessary* revisions."[13] Certainly Congress did not contemplate major substantive changes, such as those HUD has made here, between negotiated rulemaking committee consensus and Federal Register publication.

The stated purpose of the NRA is "to establish a framework for the conduct of negotiated rulemaking" from beginning to end: in Senator Levin's words, the "basic procedures on how to establish, operate and terminate a rulemaking committee."[14] On the floor of the Senate, Senator Levin noted that the bill had "undergone intense scrutiny by the [negotiated rulemaking] community and emerged with a carefully constructed set of provisions whose content is the product of many expert reviews."[15] If Congress, after considering the views of experts in the field, intended negotiated rulemaking committee consensus to be subject to extensive agency revision, it surely would have incorporated such a stage in the "step-by-step guide" it designed to encourage and guide agencies in negotiated rulemaking.[16]

---

9 5 U.S.C. 562(a)(7) (2005).
10 H.R. REP. 101-461, at 6699 (1990).
11 136 CONG. REC. S14583 (1990).
12 135 CONG. REC.S843-02 (1989) (emphasis added).
13 135 CONG. REC. S843-02 (1989) (emphasis added).
14 135 CONG. REC. S10063 (1989).
15 135 CONG. REC. S843-02 (1989).
16 136 CONG. REC. S14583 (1989) (statement of Mr. Levin); *see* Pub. L. 101-648, § 2 (1990).

b. HUD's Obligations to OMB Do Not Negate Its Obligations to the Negotiated Rulemaking Process.

The statute lists the agency's willingness to use the consensus of the committee as the basis for the rule published for notice and comment – "to the maximum extent possible consistent with the legal obligations of the agency" – as the final of seven criteria used to determine when it is appropriate to engage in a negotiated rulemaking process.[17] Major discretionary changes such as those HUD has made to the Operating Fund Negotiated Rulemaking Committee consensus do not reflect such intent and are therefore essentially contrary to Congress' vision of negotiated rulemaking.

This is true even if OMB, not HUD, is the source of the nine changes to the Committee consensus. HUD claims to have altered the Committee consensus after "further HUD and [other] executive branch review" under the authority of Executive Order 12866, "Regulatory Planning and Review."[18] The process outlined in the executive order provides for the review of all "significant regulatory actions" by the Office of Management and Budget (OMB)'s Office of Information and Regulatory Affairs (OIRA) to "ensure that regulations are consistent with applicable law, the President's priorities, and the principles set forth in this Executive order, and that decisions made by one agency do not conflict with the policies or actions taken or planned by another agency."[19] In the process established by the executive order, OIRA may return a proposed regulation to the regulating agency "for further consideration of some or all of its provisions."[20] To permit it to mandate unilateral, major substantive changes to negotiated rulemaking committee consensus would in effect make a nullity of the NRA; it would turn negotiated rulemaking into the mere pretense of stakeholder participation. HUD's obligation to submit draft regulations to OMB for review under Executive Order 12866 does not restrain its capacity to publish a proposed Rule consistent with Committee consensus.

3. HUD's Decision is Contrary to Congressional Mandate to Use Negotiated Rulemaking to Develop the New Public Housing Operating Fund Formula.

Because HUD has acted contrary to the basic tenets of negotiated rulemaking as envisaged by Congress, it has violated a specific congressional charge to engage in cooperative rulemaking on this issue. Although negotiated rulemaking is usually optional, in certain circumstances Congress has mandated negotiated rulemaking procedures. This is one of those circumstances. Indeed, Congress twice mandated that HUD engage in negotiated rulemaking

---

17 5 U.S.C. 562(a)(7) (2005).
18 70 Fed. Reg. 19858, 19859 (April 14, 2005) (citing 58 Fed. Reg. 51735 (October 4, 1993)).
19 58 Fed. Reg. 51735, 51737 (October 4, 1993).
20 *Id.* at 51742.

to establish a new operating subsidy formula before HUD convened this Committee in 2004.[21] By violating Congress' vision of the negotiated rulemaking process generally, HUD has also contravened its specific intent that HUD employ cooperative means to craft the new operating fund regulations.

B. HUD's Decision Violates Reasonable Committee Expectations.

By sins of both commission and omission, HUD misled Committee members about how its consensus report would be used in the development of the proposed new Rule.

1. HUD action violates the Committee's negotiated ground rules.

At the beginning of its first session, the Committee negotiated a set of protocols for this negotiated rulemaking, including provisions to ensure that its consensus report would form the substantive foundation of the proposed Rule. These ground rules, to which HUD, represented by counsel, and the rest of the Committee members agreed, include:

> **DECISION MAKING**
>
> a) **Consensus.** The Committee will operate by consensus of Committee members present. Consensus must include the concurrence of the HUD representatives plus at least 2/3rd of Committee members present. …
>
> **PRODUCT OF NEGOTIATIONS**
>
> HUD intends to promulgate a rule consistent with the Committee's written agreement, unless new information or comments submitted in response to the rule require changes in the rule. The preamble to the rule will explain any changes to the consensus agreements reached by the Committee.[22]

These protocols commit HUD to a proposed rule that is "consistent" in policy with the Committee consensus report, which from the first took the form of a draft rule. As a HUD General Counsel's Office representative stated to the Committee: "while there may be necessary technical chan[g]es, definition changes, cross-references, etc., substance [*sic*] policy issues will not be revised."[23] Yet the nine enumerated changes in the proposed rule published in the Federal Register are plainly inconsistent with the Committee's proposed rule. The Preamble to the proposed Rule does not name any new information necessitating these substantive alterations, and because there can be no comments until the regulation is published for notice and comment, the nine changes cannot have been made in response to

---

21 *See* Act of Oct. 21, 1998, Pub. L. 105-276 (Veterans' Affairs and HUD appropriations act); Act of Jan. 23, 2004, Pub. L. 108-199 (consolidated appropriations act for fiscal year 2004).

22 *U.S. Department of Housing and Urban Development Operating Fund Negotiated Rulemaking Advisory Committee, Protocols for Negotiated Rulemaking*, at 1, 4 (Mar. 30, 2004).

23 *Minutes of Fourth Session – Day Two*, at 21 (June 9, 2004).

comments. Because the negotiated protocols do not establish any other reason for substantive alterations to the Committee consensus, HUD's unilateral changes have violated the Committee's reasonable expectations.

2. HUD and Office of Management and Budget representatives did not indicate that OMB review could result in major changes to the Committee consensus.

At no time did HUD or Office of Management and Budget (OMB) officials who were present throughout Committee deliberations indicate that changes substantively inconsistent with Committee consensus could be made at the OMB review stage. In his review of the next steps in the rulemaking process, HUD OGC representative Ariel Pereira stated that the Committee consensus would go first through HUD internal clearance before passing to OMB review, congressional review, and then Federal Register publication.[24] Pereira's description of OMB review did not mention the possibility of substantive change at this stage, and he stated that HUD expected OMB review of the draft Operating Fund regulation to be shorter than the maximum 90 days.[25] Since members of the Committee representing HUD consulted with OMB officials throughout the negotiations, the rest of the Committee members had a reasonable expectation that no substantive changes would be forthcoming from either of these bodies in the balance of the rulemaking process.

C. HUD's Action May Reflect Actionable Bad Faith Negotiation.

HUD's actions in this negotiated rulemaking process may constitute bad faith, which may form the basis for invalidating the rule which is finally adopted. In the proposed rule, HUD creates a sub set of PHAs that are adversely affected by the proposed rule but which would not have been adversely affected by the rule that came out of the negotiated rule making process.[26] Those PHAs have an advantage that other PHAs that are adversely affected by the proposed rule do not have. The newly created sub set of PHAs can take advantage of key benefits of the formula created in the negotiated rulemaking process. Those PHAs are entitled to claim the $2 public entity fee, the ten percent nonprofit coefficient, a vacancy factor of up to three percent and an inflation factor that takes into account increases in salaries as well as benefits.[27] We do not object to that formula or to PHAs which are eligible. We do not understand, however, why all PHAs or all PHAs who would have been losers under the proposed rule cannot take advantage of those elements of the formula plus the stop-loss.[28] HUD's motivation for creating this sub group also may be called into question as it does not appear to be even handed.

---

24 *Minutes of Fourth Session – Day Two*, at 21-22 (June 9, 2004).

25 *Id.* at 22.

26 70 Fed. Reg. 19860 (April 14, 2005)

27 24 C.F.R. § 990.190(i) at 70 Fed. Reg. 19869.

28 In the following sections of these comments, we urge HUD to reinstate these provisions for all PHAs and issue the rule as it emerged from the Negotiated Rulemaking Committee for notice and comment.

In addition, in at least one instance, HUD moved in negotiations to exclude an item (sanctions against public housing authorities for failure to convert to asset-based management) which it has now included in the published proposed rule. HUD is claiming that "[t]he Committee sessions did not make a recommendation regarding sanctions for PHAs not in compliance with asset management."[29] Withdrawing an issue from Committee consensus discussions and then claiming that the Committee was silent on the issue strongly suggests bad faith negotiation that may invalidate the resulting rule.

II. Unilateral HUD Changes to the Negotiated Rulemaking That Should Be Rejected.

A. Discontinuation of Subsidy Reduction Through Demonstration of Successful Conversion to Asset Management (Also Referred to as Stop-Loss)

As a result of the First Negotiated Rulemaking for public housing operating subsidies, Congress directed HUD to carry out a study and produce a report on how much it actually costs to run well-managed public housing. As a result of that study, the Harvard Cost Study, HUD did not determine the total amount of money needed for public housing. As the Second Negotiated Rulemaking committee met to work on the public housing operating subsidy formula, HUD was noncommittal about how much it would request from Congress. During the process, however, the committee members were supplied with figures assuming an increase in funding for public housing operating subsides of approximately $300 million. This figure was used and applied to make determinations during the committee's deliberations as to the effect of the new operating subsidy formula for individual PHAs. HUD is now proposing to dramatically alter the formula developed by the Second Negotiated Rulemaking Committee.

As pointed out in the HUD Regulatory Impact Analysis of "Revisions to the Public Housing Operating Fund Program" (FR–4874-P01), under the newly proposed formula for the operating subsidy fund, some of the PHAs are scheduled to receive extremely hefty reductions. These reductions are large in both total dollar value and percentages of the affected PHAs' operating subsidy funding. Some of the percentage and total dollar cuts are so large that two distinct mechanisms were proposed to deal with the problem. These mechanisms include 1) a phase-in of any reduction over a period of time and, most significantly, 2) a procedure that would allow a PHA to stop the losses. Without such protections, the impact on affected tenants as well as PHAs will be catastrophic.

To deal with the consequences of such large reductions, the initial proposal was to allow for a five-year phase-in. When that was not sufficient to deal with the problem, HUD staff, who were members of the committee, introduced a proposal which would allow a PHA to be eligible for a discontinuation of a subsidy reduction if it successfully transitioned to project-based budgeting and accounting (PBB) and project-based management (PBM). Whether a PHA had successfully transitioned to PBB and PBM would be determined by an outside

---

29 *Compare Minutes of Fourth Session – Day Two*, at 16 (June 9, 2004) *with* 70 Fed. Reg. 19860 (Apr. 14, 2005).

independent professional assessment. This provision was designed to accomplish two goals: 1) allowing PHAs that would lose funding a mechanism to "stop the losses," while 2) simultaneously promoting the HUD goal of a swift transition to PBB and PBM.

The reason for the proposal was transparent. HUD offered the proposal in "good faith"[30] as a "deal."[31]

Even in light of the possibility of additional funds, the committee recognized that there would be PHAs that would lose funding and others that would gain funding. In recognition of that substantial possibility, HUD asked "the committee to consider ways to make the transition for the losers easier and . . . the gainers to give up some money to lessen their losses."[32] The stop-loss provision was the mechanism proposed to allow for the sharing of the burden between the winning and losing PHAs. The compromise proposal passed by the required supermajority for consensus consisting of HUD and 2/3 of those present and voting.

Logic dictates that key members of the committee only agreed to accept the new operating fund formula because they were assured that they had the potential of cutting their losses, if they could convert quickly to project-based budgeting and accounting and management. It would seem that the New York City Housing Authority and the Housing Authority of Albany, both members of the committee and potentially big losers under the formula adopted by the committee, would not have agreed to the compromise without the stop-loss provision.

HUD is now proposing to eliminate the stop-loss provision, arguing that the Harvard "Cost Study methodology should be equally applied to all PHAs and that providing for discontinuation of subsidy reductions would weaken implementation of the Cost Study."[33] This rationale misses the point of the negotiated rule making process, which is to find "constructive, creative and acceptable solutions to difficult problems."[34] This provision constructively and creatively addresses a solution to a difficult problem and was endorsed by

---

30 Minutes of Second Session–Second Day, April 14, 2004, p. 25; Minutes of Fourth Session—Day Two, June 9, 2004, p. 11 (HUD staff states that "This is a very positive agreement that was reached by the committee.")
31 *Id.* at 20. A HUD staff person, Mr. William Russell, Deputy Assistant Secretary, stated:

> The goal is to find a transition policy that is affordable and that meets a significant portion of the concerns around the table and for those that are anxious to get at the money they need to run public housing. We are searching for a workable solution and we are willing to consider a lot of things.
>
> *Id.* at 23; *see also infra* Part I.A.1.a.

32 *Id.* at 22.
33 71 Fed. Reg. 19860 (Apr. 14, 2005). Moreover, the claim that the Harvard Cost Study should be strictly followed appears to be disingenuous in light of the fact that, in the proposed rule, a special class of PHAs is created who will receive more subsidies (an add-on) than the new formula, if evenly applied, would allow. The rationale for this new group is that these PHAs were expecting an increase in operating subsidies and now would experience a reduction in operating subsidies between the formula in the current Operating Fund Program regulations and the formula contained in the proposed rule. 70 Fed. Reg. 19860 (Apr. 14, 2005)
34 65 Fed. Reg. 42488 (July 10, 2000).

the supermajority of the Second Negotiated Rulemaking Committee. The stop-loss provision should be reinstated as it was developed, as intended by Congress, through negotiations.

B. Reduction of the Non-Profit Ownership Coefficient

The negotiated rulemaking committee, which included HUD members, agreed to a 10 percent non-profit ownership coefficient. In the proposed rule, HUD slashed the coefficient to four percent to reflect "inefficiencies that currently exist in the delivery of housing services." The alleged "inefficiencies" are not defined, explained or listed. Nevertheless, the proposed rule reduced the nonprofit coefficient to four percent. There is no basis for the reduction.

The Harvard Cost Study found that non-profit ownership for the federally subsidized housing stock was 12 percent higher than the cost of for profit ownership. Despite the fact that these costs were field tested, the Harvard Cost Study reduced the figure to ten percent. The members of the Second Negotiated Rulemaking Committee did not agree with the reduction, but accepted it as a compromise. HUD's further reduction of the non-profit coefficient of four percent should be rejected. There is no basis for the proposal; it is in effect a two-thirds reduction of the actual costs that the Harvard Cost Study found, and it is contrary to the agreement reached by the Negotiated Rulemaking Committee.

The proposed regulations do not list the nonprofit coefficient for the typical PHA. It should be listed in 990.165(e). The ten percent coefficient was listed in the rule agreed to by the Negotiated Rulemaking Committee.[35] The ten percent coefficient is also mentioned in the proposed rule with respect to adjustment for certain PHAs.[36] We recommend that the coefficient for all PHAs should be, at least ten percent and should be specifically listed in the published regulations. Failure to publish the precise amount may lead to HUD changing the coefficient without notice and comment by PHAs and housing advocates. As noted in other sections of these comments, HUD should not be permitted to change basic elements of the formula without notice and comment.

C. Elimination of the $2 per unit per month public entity fee

The negotiated rulemaking committee recognized that, because PHAs are public entities, they have costs that are in excess of costs provided for in the Harvard Cost Study. In the proposed rule, HUD unilaterally decided to remove the $2 PUM public entity fee. The purported justification set forth in the preamble of the rule is that "the expenses to be covered by the additional subsidy from this public entity fee were already adequately addressed through other means in the proposed rule."[37]

---

35 See section 990.155(e) Computation of Projected Expense Level of the proposed regulations dated 6/10/04: Post 4th Session Draft Interim-Final Rule.

36 Proposed 24 C.F.R. § 990.190(i), at 70 Fed. Reg. 19,870.

37 70 Fed. Reg. 19,859

Some of the expenses that PHAs as public entities have include: costs related to state purchasing requirements and public entity laws such as open meeting and open records acts. In addition, public housing tends to serve a tenant population with a profile that is substantially more disadvantaged than the population served by other local operators of assisted housing. The Harvard Cost Study did not refute that claim but stated instead that it did not have the means to substantiate or to repudiate the claim.[38] PHAs also have costs attributed to regulations with which federally-assisted housing owners are not required to comply. These "costs generally ranged from about $1 PUM to $4 PUM."[39] The Harvard Cost Study declined to provide for a $2 PUM because PHAs are public entities. However, the Negotiated Rulemaking Committee concluded that a $2 PUM for a public entity fee was reasonable and appropriate, and there is ample authority for that determination.

Thus we recommend that the $2 PUM public entity fee should be reinstated and specifically listed in the published regulations setting for the formula for calculating the PEL.

D. Calculating the vacancy rate

1. The Negotiated Rulemaking Committee's Recommendation that PHAs' Funding Include Factoring in a 3% Vacancy Rate Should Be Retained as Consistent with Longstanding Practice and Common Sense.

The Negotiated Rulemaking Advisory Committee had recommended, consistent with long-standing practice, that PHAs receive operating subsidy for a limited number of vacancies if the annualized vacancy rate is less than or equal to three percent. In the proposed rule, HUD has recommended departure from this recommendation and long-standing practice, saying that it is "contradictory to the goals of subsidized housing and asset management and comparability with subsidized market-based units."[40] Under the proposed rule, a PHA is only eligible for operating subsidy for occupied dwelling units and for dwelling units with approved vacancies, but not for any units within an acceptable vacancy rate.[41] HUD should retain both the Rulemaking Committee's recommendation and its long-standing practice of incorporating an acceptable vacancy rate of 3% in the calculation of operating subsidy.

HUD has long used a 97% occupancy rate in determining operating subsidy.[42] Prior to 1985, however, the operating subsidy rule was structured in a manner which HUD found acted as a financial disincentive to reduction of vacancies, since projected expenses were based upon all units, occupied as well as vacant, while operating income was only based on occupied units. HUD issued a proposed rule, restricting the payment of full operating subsidy to only occupied units and vacant units falling within an allowable vacancy rate, equal to the lesser of

---

38 Harvard Cost Study, p. 50.

39 Harvard Cost Study, p. 30.

40 70 Fed. Reg. 19,859 (April 14, 2005).

41 See proposed 24 C.F.R. §§ 990.125, 990.130, 990.140, and 990.145, at 70 Fed. Reg. 19,866.

42 See 50 Fed. Reg. 25,951 (June 24, 1985) (discussing existing rule).

the PHA's actual vacancy rate or 3%, with some limited funding available for certain types of vacancies.[43] HUD noted that these figures were arrived at after careful examination and:

> …the Department believes that a well-managed PHA could operate effectively within the Allowable Vacancy Rate which is being proposed. The majority of PHAs already operate within this rate.[44]

In 1985, following the receipt of public comments on the proposed rule, HUD revised the formula for the payment of operating subsidy for vacant units somewhat. HUD noted that the revised rule "creates an incentive to reduce high vacancy rates while avoiding the problems in the proposed rule that have been identified by the public commenters."[45] HUD noted that many members of Congress and their staffs had participated in the development of the interim rule, and that their thorough analysis and recommendations of alternative strategies to resolve PHA vacancy problems greatly assisted HUD.[46] Some commenters suggested using the 94% standard which was already used by HUD as a gross indicator for identifying operationally and financially troubled PHAs; others said that a 95% standard was the norm for the private market. HUD stuck to the 97% standard as generally being adequate, while pointing out how the interim rule added flexibility by allowing certain vacancies to not be counted and by permitting PHAs to submit a comprehensive occupancy plan which could avoid adverse operating fund impacts as long as its vacancy reduction goals were met.[47]

When HUD issued a final rule on vacant units and operating subsidy in 1986, some commenters again argued that an occupancy rate of 95% or less should be used. HUD stated, in response:

> The Department continues to believe that the 97% standard is preferable. It is important that Federal funds provided to house lower income families be used efficiently. The rule is intended to encourage maximum utilization of available units. That purpose is better achieved by having a PHA focus on vacancy problems when there is a vacancy rate in excess of 3%.[48]

HUD thus recognized that it is not realistic to expect any PHA to achieve 100% occupancy; routine turnover and preparation of vacant units result in some gap. However, as long as a PHA had its vacancy rate at 3% or lower (excluding units in modernization), it should expect that it could have all of its units funded.

HUD has given no reasoned explanation for its departure from its well-reasoned 97% occupancy rule or from the recommendation of the Negotiated Rulemaking Advisory Committee. Recognizing that there will always be some degree of vacancies, and providing

43 See 49 Fed. Reg. 22,663 (May 31, 1984).

44 *Id.*

45 50 Fed. Reg. 25,951.

46 *Id.*

47 *Id.*

48 51 Fed. Reg. 16835 (May 7, 1986).

PHAs funding based on an accepted vacancy level, is not contradictory to either the goals of subsidized housing nor sound asset management, nor will it result in a standard at variance with subsidized market-based units.[49] Therefore, the Negotiated Rulemaking Committee's recommendation should be retained.

2. The proposed rule defining units with approved vacancies should be retained.

The proposed rule defines three groups of units with approved vacancies.[50] These units are eligible for operating subsidies.[51] These include: 1) units undergoing modernization; 2) special use units which are used for resident services, resident organization offices and related activities; and 3) units that HUD may approve for a specified period as vacant. This last group of units includes litigation units, units vacant due to disasters and units vacant due to delays in settling insurance claims. We support the inclusion of these as vacant units as units for which a PHA is eligible to receive operating subsidies. We believe that it is particularly important to include units that are used for resident services and resident organizations offices and related activities. Paying operating subsidies on behalf of these units is critical for supporting resident organizations and resident services. Failure to provide operating subsidies for these units will undercut resident organizations and services.

E. Employee benefits in the AEL (or PEL) inflation factor

During the Second Negotiated Rulemaking Committee meetings for the operating fund rule, the committee agreed that the inflation factor used to adjust the allowable expense level (AEL) was inadequate because it failed to account for employee benefits, such as health and dental benefits. As a result the committee agreed that the AEL should be based on Bureau of Labor Statistics (BLS), which accounted for increases in cost of living and wages, salaries and for increases in employee benefits. In the proposed rule, HUD abandoned the agreement reached by the committee stating that "[r]etaining the current inflation factor will provide PHAs with continuity and an inflation factor that has adequately served to adjust the AEL for many years." HUD's justification unsupported, is completely contrary to the determination of the committee and is not acceptable.

The issue of employee benefits was discussed at length in the first round of negotiated rulemaking in 1999 as well as the second round in 2004.

---

49 For project-based Section 8 developments, owners may submit vacancy loss claims for up to a 60-day period from the time that the unit is available for occupancy; this "claim period" does not include the time from the time of the prior tenant's move-out until cleaning and preparation of the unit for re-offer is completed. See HUD Handbook 4350.3, REV-1, Chapter 9. Depending on the size of a PHA's portfolio and its turn-over rate, factoring in a 60-day average turn-over period, plus an additional unit clean-up and preparation period, may often result in a vacancy rate of 3%.

50 24 C.F.R. § 990.145, at 70 Fed. Reg 19,866.

51 *Id.* at § 990.125.

Since the early 1980s, HUD has based 60% of the AEL inflation factor on the cost of wages and salaries paid by local governments. To make this calculation as accurate as possible, HUD has used wage and salary statistics aggregated at the county level (rather than at state or national levels). However, the statistical series HUD has been using does not include employee benefits such as health and dental benefits. Since the early 1980s, these benefits have grown at a substantially higher annual rate than the growth of wages and salaries alone. Yet HUD has never adjusted the AEL inflation factor to reflect those cost increases.

During the 1999 negotiated-rulemaking, HUD acknowledged that the difference in 1997 between using "wages & salaries plus employee benefits" compared to using only "wages & salaries" amounted to $13.49 Per Unit Month (PUM) at the national level, which would have been $210 million more in operating subsidy funding in 1997 alone. At this rate, over every five-year period PHAs are being underfunded by $1 billion due to this discrepancy. Since employee benefits must be paid, these unfunded increases result in de facto cuts in other areas of PHAs' budgets, such as administration and maintenance.

At the request of the negotiated rulemaking committee in 1999, HUD calculated the shortfall in PHAs' AEL since 1974 that has resulted from the fact that the AEL inflation factor that has been used by HUD is partially based upon wages and salaries paid to local government employees, but this inflation factor has never included employee benefits.

Based upon an analysis of actual PHA budget data, HUD reported to the committee in July 1999 that PHAs, on the average nationwide, were paying $4.95 per unit month (PUM) for employee benefits in 1974. Inflating that figure forward to 1997, 23 years later, using the annual inflation factors that HUD has applied to the AEL, would result in an hypothetical employee benefits PUM of $19.51 in 1997, when adjusted slightly upward for FICA add-ons. This was $13.49 PUM lower than PHAs actual expense in 1997, which was $33.00 PUM.

Eight years have passed since the data HUD used for 1997. It is likely that this discrepancy has increased since then, and is probably approximately $20 PUM today.

We therefore make the following recommendations concerning employee benefits:

(1) begin by increasing PHA expense levels by $20 PUM for the employee benefits shortfall that has developed over the period 1974 to 2005. This action does nothing to compensate PHAs for the funding lost each year for those 30 years, but at least it would bring the expense level up to where it should be now.
(2) determine employee benefits as a separate line item, and apply an inflation factor to that line item based upon a BLS indicator related to employee benefits paid by state and local governments; and
(3) allow HUD to continue to determine the "wages and salaries" item the way it does now, i.e. based upon the BLS "wages and salaries paid by local governments" factor.

The system has the benefit of allowing HUD to continue to use the inflator it has used in the past for wages and salaries. This inflation factor would allow local area specificity. In

addition, this system requires HUD to use the BLS inflator for employee benefits which is available at a more generalized geographical level, and apply it to the employee benefits line item.

III. Need for Notice and Opportunity to Comment on Significant Future Policy Changes

A. Review of Methodology by Advisory Committee

The proposed rule provides that in 2009 HUD will convene a meeting with representatives of appropriate stakeholders to review the methodology to evaluate the PEL based on actual cost data.[52] We support the concept of negotiated rulemaking. Therefore, we urge HUD to honor its commitment made during the Second Negotiated Rulemaking process and to commit to a process in the next phases of the operating subsidy rulemaking of working with all the interested parties to obtain a regulation that is supported by a substantial number of the interested parties. To the extent that the reference in the proposed rule to the Federal Advisory Committee Act (FACA) represents a commitment to a process that is more advisory and less of an obligation to work through the problems and reach an agreement or negotiated rule, we object. The group that HUD convenes at this next phase should be more than an advisory group. Moreover, it should be clear that a negotiated rulemaking process will also be followed again in 2011 or at an appropriate latter date which is prior to the determination of appropriate funding levels for each project.

Thus, we urge that the proposed rule be amended to state that HUD will in the next phases of the process comply with the Negotiated Rulemaking Act of 1990, 5 U.S.C. § 561-570. Also, the rule should be clear that the Negotiated Rulemaking process will be applicable in the review of the methodology to evaluate the PEL and to the phase of determining the formulas and setting the funding levels for each project. Finally, we urge HUD to include in the next reconvened Negotiated Rulemaking Committee greater representation of residents and groups that represent residents in proportion to the total number of members of the committee.

The proposed rule contemplates that the data will be reviewed in 2009 and that appropriate funding levels will be established by 2011. We believe that it is important to schedule an interim review of the data. However, our major concern is that by 2009, HUD may not have sufficient data to evaluate the PEL. By 2009, at best PHAs will only be phasing in the new funding increases and decreases. The data that will be available for review will not accurately reflect the effects of the new formula and the experience of PHAs to transition to PBB and PBM. Thus, it should be clearly stated that this review will be an interim review and that determinations made pursuant to that review will be modified based upon actual experience. With respect to the statement that HUD will determine funding levels for each project by 2011, we have similar concerns. To the extent that HUD should set funding levels based upon the experience of the PHAs with the new formula, it will not be in a position in 2011 to make such

52 24 C.F.R. § 990.165(i) at 70 Fed. Reg. 19,867.

determinations. These determinations should be put off, for at least three to four years beyond 2011 so that the impact of the new formula can be evaluated. In particular, we are concerned that there are units of public housing that are serving a beneficial and substantial public purpose, housing families in safe, decent, and sanitary housing and that cannot be self-supporting without substantial housing subsidies. This housing should not be "abandoned"[53] without an assessment of the cost to the community of the loss of such housing.

B. Other changes to the rule that should require notice and comment

Another problematic aspect of the proposed rule are several provisions that provide for changes to be made in the basic formula by HUD's sole discretion, without going through any kind of formal rule-making process with advance public notice and comment opportunity. These include the following:

1. At proposed 24 C.F.R. § 990.110(c), HUD has included a provision for non-codified secondary formula elements that will be used in the revised Operating Fund Formula. HUD says it will provide this information in "non-codified guidance, such as a Handbook, Federal Register notice, or other non-regulatory means that HUD determines appropriate."[54] HUD states that these elements "include the coefficients used to adjust the variables for

> calculating the new PEL, the units of measurement and round-off conventions that will be used in the formula, and the determination of the geographic variable used in the PEL calculation."[55]

HUD argues that regulatory codification of these formula elements and use of notice and comment rulemaking would delay HUD's ability to update the formula as new and more accurate data become available. The problem with dispensing with all notice and comment is that errors in the secondary elements cannot be challenged and adjusted except through the appeals process provided for in Subpart G. Some of the errors that may be identified may not readily fit within appeal categories, or may be broader than specific local conditions. It is clear, for example, that there can be serious disagreement about geographic variables, as is shown by the significant comment HUD received last fall over changes in the Section 8 Fair Market Rent geographic areas. A better approach may be for HUD to implement secondary formula elements by interim rule-making, so that new and allegedly more accurate data can be used, but that PHAs and others with an interest in the impact of the changed factors can explain to HUD any flaws that may exist with the approach, and can request appropriate modifications.

2. At proposed 24 C.F.R. § 990.190(j), HUD states that if it determines that enactment of a federal law or revision in HUD or other federal regulations has caused or will cause a

---

53 Regulatory Impact Analysis of "revisions to the Public Housing Operating Fund Program" (FR-4874-P_01), p. 6.
54 70 Fed. Reg. 19,865.
55 70 Fed. Reg. 19,861.

significant change in expenditures of a continuing nature above the PEL and UEL, HUD may, in its sole discretion, decide to prescribe a procedure under which the PHA may apply for or may receive an adjustment in operating subsidy.[56] Here again, interim rule-making would make sense, so that if PHAs or others with an interest in the change believe that HUD has not fully considered the relevant factors or provided adequate procedures, they can be heard.

3. Proposed 24 C.F.R. 990.195 concerns how formula income will be calculated through fiscal year 2008, and freezes formula income at the 2004 level unless a PHA can show a severe local economic hardship that is impacting the PHA's ability to maintain some semblance of its formula income.[57] The preamble indicates that no later than FY 2008, HUD will analyze the effects of freezing formula income and, based on that analysis, determine whether to extend the applicability of this provision for future fiscal years or to modify the income component. This decision will be announced through handbook, Federal Register notice, or other non-regulatory means, although HUD indicates that it will offer the public "an opportunity to comment" before the policy determination takes effect.[58] "An opportunity to comment" to a Federal Register or handbook notice, however, is far different than notice and comment rulemaking. The notice period may be extremely short, and PHAs and others with an interest in the provision may not have sufficient time to review the information and prepare meaningful comment. Since this policy determination may have a long-lasting effect, and will be a major opportunity to review what has occurred between the present and FY 2004, there should be a significant opportunity for comment, with a sufficiently long notice and comment period, so that HUD's policy recommendations can be fully assessed.

IV. Recognizing the Transition Costs and Costs of New Information Systems and Factoring in Delays If Systems Are Not In Place

During the Negotiated Rulemaking Process, many members pointed out that PHAs would incur substantial costs transitioning from project-based accounting and project-based management. Despite the substantial agreement of the committee members, HUD would not agree to support a provision to permit funding of those transition costs. We believe that it will cause a substantial hardship on residents if these transition costs are not funded. These costs will have to come from the PHAs' budgets and if there are no additional funds to cover the costs, the effect will be reduced maintenance, diminished tenant services or delayed capital improvements. Thus, we urge HUD to amend the regulations and to provide a formula for funding for the transition to PBB and PBM. We recognize that the rule cannot dictate a funding level but the formula should be in place on the assumption that funding may be provided.

HUD recognizes, in the preamble and proposed regulatory text, that changes to the Operating Fund Formula will require changes to the information systems and reporting of PHAs as well

56 *See* 70 Fed. Reg. 19,870.

57 *See* 70 Fed. Reg. 19,970.

58 70 Fed. Reg. 19,862.

as HUD. HUD indicates that it will be required to update its automated information systems to accommodate the new data collections, and that it will notify each PHA when HUD has automated systems capacity to receive the information required by the rule.[59] To the extent that significant additional costs may be imposed on PHAs in purchasing software or hardware to maintain and report information, HUD should factor this in as a cost of implementation of this rule, and should not require PHAs to take money from other limited sources which are already stretched thin (such as modernization). Moreover, to the extent that any portions of the rule rely on what turns out to be unrealistic expectations about when HUD could have its own systems updated, HUD should not penalize any PHAs' operating subsidy as a result, but should hold those PHAs harmless.

V. Other provisions of the proposed rule

The proposed rule retains as an add-on a requirement that each operating subsidy calculation include $25 per unit per year.[60] For residents, this provision is a key element of the operating subsidy rule. It is a provision that was strongly supported by the resident members of the committee. This provision has supported resident participation and leadership development and should be retained.

Section 990.270 Asset Management

This section sets forth the responsibilities of PHAs with respect to asset management that are above and beyond property management activities. The list of responsibilities should be expanded to recognize that the PHA has special responsibilities regarding resident organizations and involvement of and consultation with residents in the PHA planning process. Thus we suggest that the following language be added to the regulation.

> These responsibilities include . . . responding to and supporting independent resident organizations, consulting with residents and the Resident Advisory Board (RAB) in the development of and any amendments to the PHA's annual and 5 year plans.

Sections 990.2.85 Records and Reports and 990.315 Submission and approval of operating budgets

Section 990.285(b) states that each PHA shall distribute the project based budgets and year end statements to the PHA Board. These documents should also be given to the RAB and to any resident organization representing residents for the development and to the city-wide organization, if one exists. We urge you to amend the regulation to insert such requirements. The regulation should be further amend to provide that if there is any public body with oversight or monitoring responsibilities for the PHA, that entity should also receive copies of the documents.

---

59 70 Fed. Reg. 19,861.

60 24 C.F.R. § 990.190 at 70 Fed. Reg. 19869.

Section 990.315(a) also provides that key budget documents must be approved by the PHA's Board and submitted to HUD. These documents should also simultaneously be given to the RAB, the affected resident organizations and any public body with monitoring responsibilities for the PHA.

Conclusion

The rule as proposed by the Negotiated Rulemaking Committee should be published for notice and comment. No significant changes should be made to the rule prior to publication for notice and comment. The rule as agreed to by the Negotiated Rulemaking Committee is not without flaws; some of the flaws in the rule as proposed by the Negotiated Rulemaking Committee are pointed out in these comments. As noted above, however, there are provisions in the rule that we support. The public should have a chance to comment on the rule as proposed by the Committee.

Catherine M. Bishop
National Housing Law Project

James McCreight
Greater Boston Legal Services

Wayne Sherwood
Sherwood Research Associates

Linda Couch
National Low Income Housing Coalition

Peter M. Iskin
Legal Aid Society of Cleveland

Edward Williams
ENPHRONT
Everywhere and Now Public Housing Resident Organizing Nationally Together

Dorinda L. Wider
Legal Aid Society of Minneapolis

Ilene J. Jacobs
California Rural Legal Assistance

Debra Gardner
Public Justice Center

John Cooper
Massachusetts Union of Public Housing Tenants

Micky Ryan
Oregon Law Center