



Federal Register

**Wednesday,
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Part V

Department of Housing and Urban Development

**24 CFR Parts 905 and 990
Use of Public Housing Capital and
Operating Funds for Financing Activities;
Proposed Rule**

**DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT**
24 CFR Parts 905 and 990

[Docket No. FR-4843-P-01]

RIN 2577-AC49

**Use of Public Housing Capital and
Operating Funds for Financing
Activities**

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

ACTION: Proposed rule.

SUMMARY: This proposed rule would allow public housing agencies (PHAs) to use proceeds under either the Capital Fund or Operating Fund programs for financing activities, including payments of debt service and customary financing costs for the modernization and development of public housing, including public housing in mixed-finance developments. The pledge of public housing projects and other property generally involves the long-term commitment of public housing funds. This proposed rule would support HUD's objective to enhance PHA capital improvement planning and the public housing program transition to asset management decision-making by establishing program requirements, submission requirements, and the approval process for PHAs to request authorization from HUD to pledge either capital or operating funds for debt service payments.

DATES: *Comment Due Date:* September 17, 2007.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Office of General Counsel, Rules Docket Clerk, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0001. Communications should refer to the above docket number and title.

Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at <http://www.regulations.gov>. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the <http://www.regulations.gov> Web site can be viewed by other commenters and interested members of the public.

Commenters should follow the instructions provided on that site to submit comments electronically.

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

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

FOR FURTHER INFORMATION CONTACT: Jeffrey Riddel, Director, Office of Capital Improvements, Office of Public and Indian Housing, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-8000; telephone number (202) 708-1640, extension 4999 (this is not a toll-free number). Hearing- or speech-impaired individuals may access this number through TTY by calling the toll-free Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:
I. Legislative Background

Section 519 of the Quality Housing and Work Responsibility Act of 1998 (Pub. L. 105-276, approved October 21, 1998) amended the U.S. Housing Act of 1937 (1937 Act), to merge former sections 9 and 14 of the 1937 Act into a single section 9 providing for the capital fund (the Capital Fund) and the operating fund (the Operating Fund) (codified at 42 U.S.C. 1437g). The Capital Fund is established at section 9(d) of the 1937 Act and provides funding for, among other activities, the development, financing, and modernization of public housing projects. The Operating Fund is established at section 9(e) and provides funding for the operation and management of public housing. Section 9(e)(1)(I) provides that operating funds may be used for, among other purposes, "the costs of repaying * * * debt incurred to finance the rehabilitation and development of public housing units, which shall be subject to such reasonable requirements as the

Secretary may establish." Additionally, section 519 of the Quality Housing and Work Responsibility Act of 1998 added section 30 to the 1937 Act, and provides HUD the discretion, upon such terms and conditions as it may prescribe, to authorize a PHA to mortgage or otherwise grant a security interest in any public housing project or other property of the PHA.

A study for HUD entitled "Capital Needs of the Public Housing Stock in 1998" (Abt Associates, March 2000) estimated a \$22 billion capital needs backlog for public housing properties. The study also noted a \$2 billion annual accrual in capital costs for ongoing repairs and replacements beyond ordinary maintenance for all public housing units. Annual appropriations for public housing capital expenses, which range from \$2 billion to \$3 billion, cannot by themselves address the backlog and accruing replacement and repair capital needs. Given the large amount of capital needs that PHAs have, the use of capital or operating funds for financing activities provides a mechanism for PHAs to leverage private sector financing for improvements with existing public housing assets. Therefore, this proposed rule proposes to expand the financial leveraging options available to PHAs. The rule would enable PHAs to use either the Capital Fund or the Operating Fund programs to service debt payments and, thereby, leverage additional funds to more fully address capital needs. This proposed rule would support HUD's objective to enhance PHA capital improvement planning and the public housing program transition to asset management decision-making.

The use of capital funds or operating funds to construct new public housing units is limited by section 9(g)(3) of the 1937 Act. PIH's Information Center (PIC) shall be used to determine compliance with section 9(g)(3) of the 1937 Act. The statute states that, with two specific exceptions, a PHA may not use capital or operating funds to construct new units if such construction would result in a net increase from the number of public housing units owned, assisted, or operated by the PHA on October 1, 1999, including any units demolished as part of a revitalization effort. The exceptions to this limitation are: (1) The PHA may use the Capital Fund or Operating Fund programs to construct units beyond this limitation; however, the Capital Fund and the Operating Fund formulas, except as stated in (2), shall not include these units for purposes of calculating the formulas; or (2) the formulas may provide, subject to limitations imposed by the Secretary,

for additional funding of units in excess of the limit if the units are part of a mixed-finance project or otherwise leverage private funds, and the estimated cost of the useful life of the project is less than the estimated cost of Section 8 assistance for the same period of time.

In addition, where a PHA seeks to pledge future appropriations of capital or operating funds for debt repayment, such an arrangement is subject to the Antideficiency Act (31 U.S.C. 1341), which states that the federal government may not obligate amounts in excess of appropriated funds. Therefore, any pledge of future capital or operating funds is subject to future appropriations, and a lack of future appropriations could result in a lack of capital or operating funds to cover the obligation. PHA obligations issued pursuant to this proposed rule, and that are secured by a pledge of capital or operating funds, are not obligations of, nor guaranteed by, the U.S. Government. In the event of default, whether due to the lack of appropriations or other reasons, the PHA will be solely responsible for the debt. The proposed rule establishes a debt coverage ratio that is higher than the debt coverage ratio used for traditional multifamily financing. This higher debt coverage ratio is related to the appropriations risk associated with capital and operating funds.

II. This Proposed Rule

This proposed rule would revise HUD's regulations for the Capital Fund at 24 CFR part 905, and add a new subpart K to HUD's regulations for the Operating Fund at 24 CFR part 990. The new subparts would allow PHAs to use the Capital Fund and Operating Fund programs for financing activities, including payments of debt service and of customary financing costs for the modernization and development of public housing, including public housing in mixed-finance developments.

Further, the proposed rule would establish specific program requirements, submission requirements, and approval processes for PHAs to request authorization from HUD to pledge a portion of their annual capital fund grant or operating fund subsidies for debt service payments. To a great extent, the proposed rule would establish similar regulatory requirements for the Capital Fund and the Operating Fund. However, there would be several differences between the two programs, and interested persons should carefully review the proposed regulatory changes for both the Capital Fund and the

Operating Fund. For example, pledges of operating funds shall be project specific. This section of the preamble presents a brief overview of the regulatory amendments that would be made by the proposed rule.

The proposed rule would describe requirements incumbent upon a PHA that wants to use capital or operating funds for debt service or financing payments. Among other requirements, the PHA should have a non-troubled Public Housing Assessment System (PHAS) score overall and must be a standard performer or higher on the financial condition indicator. The proposed rule would also require that the PHA make certain showings in order to be eligible. For example, the PHA would be required to list the planned capital improvements and associated costs in an approved PHA plan. PHAs would also need to complete Physical Needs Assessments that cover their entire public housing portfolio for the term of the financing. The PHA must also provide independent reviews satisfactory to HUD demonstrating the PHA's management capacity, the reasonableness of the terms and conditions of the financing, and overall feasibility of the venture.

While, at the option of the PHA, the Capital Fund Financing Plan (CFFP) allows for the possibility of direct payment to creditors so that debt service payments do not have to flow through the PHA, HUD does not consider it feasible to disburse pledged operating subsidy directly to creditors.

As PHAs are transitioning into asset management and project-based accounting, it may be difficult to enter into Operating Fund Financing Program (OFFP) transactions based on operating cash flow (a project's annual revenue less expenses) as opposed to financing transactions secured and paid by excess cash flow (a project's unrestricted net assets or "reserves"). By way of example, in regard to OFFP transactions based on cash flow, for PHAs with a fiscal year ending on June 30th: audits for the period ending June 30, 2008, will be the first audits completed for most PHAs pursuant to the new project-based accounting requirements. This proposed rule would require PHAs to be under project-based accounting, and would require PHAs to submit audits on a project level in order to obtain OFFP financing. Since OFFP financing is to be project-based, HUD invites comments on how it might otherwise determine the approvability of an OFFP proposal, given that historic financial data (non-project based) will be of limited applicability.

Pursuant to 24 CFR part 968, PHAs may use up to 10 percent of their capital fund grants for administrative costs (or management fees under the asset management rules). This proposed rule would not permit PHAs to use the financing proceeds for additional administrative or central office cost center fees or costs. However, HUD encourages PHAs to leverage their CFFP or OFFP proceeds. PHAs that pursue mixed-finance development or modernization with CFFP or OFFP proceeds may use CFFP or OFFP proceeds, tax credit equity, or other sources for administrative costs. Furthermore, PHAs may use CFFP or OFFP proceeds to pay for staff salaries associated with construction management and allocable to fees and costs.

The proposed rule would also describe HUD's review and approval process. HUD will review all complete Capital and Operating Fund Financing Program proposals for compliance with the regulatory requirements. HUD may require the PHA to make modifications to the proposal, and may require the PHA to re-submit all or any portion of the proposal. HUD will notify the PHA of its approval and any conditions of the approval. Within 60 days of closing, unless the time has otherwise been extended by HUD in writing, the PHA must submit to HUD a complete set of fully executed documents pertaining to the financing. Failure to provide the required documents to HUD within the required time period may result in HUD rescinding its approval.

HUD is prohibited from using operating subsidies appropriated for a current fiscal year for prior year obligations. The proposed rule would clarify that operating subsidy made available in a fiscal year may be used for the costs of repaying debt that was incurred to finance the rehabilitation and development of public housing units. The payment of the debt service that becomes due in the current calendar year is not a "prior year obligation" under the meaning of the above appropriations language.

The requirements of this proposed rule would become effective for requests submitted to HUD for approval on or after the effective date of the final rule. Requests submitted prior to the effective date of the final rule would continue to be reviewed on a case-by-case basis as they have been in the past. Program requirements under this rule do not preclude PHAs from pledging other non-public housing properties owned by a PHA to secure private loan or bond financing.

III. Development and Implementation of Financing Plans

PHAs may consider a range of options when borrowing private capital, including bank loans, bond issuances, and other similar vehicles. For borrowing large sums, bond issuances can offer access to a wide market, but can be complex to assemble and issue. Bank loans are less complex and may be quicker to secure, particularly for limited borrowing for small PHAs. PHAs, particularly small PHAs, may form pools to take advantage of access to larger markets that might not otherwise be available. Pools also have some economies of scale. In addition, capital borrowing may be accomplished through a state housing and finance agency or local associations.

Capital or operating fund financing requires a significant amount of advance planning and preparation by the PHA. A number of factors must be considered prior to submission of a request to HUD. These factors include, but are not limited to, the amount of its current capital or operating fund, current interest rates, the term of the borrowing,

the condition of the PHA's inventory, criticality of individual work items, and the experience and expertise of the PHA in transactions of the size and nature contemplated. Any one or a combination of these factors can significantly affect the amount to be borrowed and work to be performed. PHAs are encouraged to obtain technical assistance (e.g., PHA counsel, financial advisors, architectural and engineering) early in the process. PHAs are also encouraged to consider resources available through state and local governments, such as state housing and finance agencies. HUD Headquarters will review all capital and operating fund financing proposals and is the principal point of contact for PHAs. Headquarters will coordinate its review with the local HUD Field Offices on issues involving such matters as PHA capacity and capital fund annual plans, Declarations of Trust, etc. PHAs must consult with the local HUD Field Office early in the development of the financing proposal as it relates to those matters. Particular attention should be given to the relationship of the items

currently in the PHA Plan and the need to amend the Plan to incorporate the work and costs associated in their capital or operating fund financing proposal. Public housing requirements triggered by the use of financing proceeds (such as approval of acquisition or development proposals) would remain unchanged by this proposed rule.

IV. Findings and Certifications

Paperwork Reduction Act

The information collection requirements contained in this rule have been submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information, unless the collection displays a currently valid OMB control number.

The burden of the information collections in this proposed rule is estimated as follows:

REPORTING AND RECORDKEEPING BURDEN

Section reference	Number of parties	Number of responses per respondent	Estimated average time for requirement (in hours)	Estimated annual burden (in hours)
Sections 9 and 30 of the U.S. Housing Act of 1937	50	1 Each (50)	15.45	773

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning this collection of information to:

- (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- (2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;
- (3) Enhance the quality, utility, and clarity of the information to be collected; and
- (4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this rule. Under the provisions of 5 CFR part 1320, OMB is required to make a

decision concerning this collection of information between 30 and 60 days after today's publication date. Therefore, a comment on the information collection requirements is best assured of having its full effect if OMB receives the comment within 30 days of today's publication. This time frame does not affect the deadline for comments to the agency on the proposed rule, however. Comments must refer to the proposal by name and docket number (FR-4843) and must be sent to: HUD Desk Officer, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, Fax number: (202) 395-6974; and Aneita Waites, Office of Public and Indian Housing, U.S. Department of Housing and Urban Development, Room 4116, 451 Seventh Street, SW., Washington, DC 20410-5000.

Regulatory Planning and Review

OMB reviewed this rule under Executive Order 12866 (entitled "Regulatory Planning and Review"). OMB determined that this rule is a "significant regulatory action" as

defined in 3(f) of the order (although not an economically significant regulatory action, as provided under section 3(f)(1) of the order). The docket file is available for public inspection between the hours of 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0500. Due to security measures at the HUD Headquarters building, an advance appointment to review the docket file must be scheduled by calling the Regulations Division at (202) 708-3055 (this is not a toll-free number). Hearing- or speech-impaired individuals may access this number through TTY by calling the toll-free Federal Information Relay Service at (800) 877-8339.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This proposed rule does

not impose any federal mandate on any state, local, or tribal government or the private sector within the meaning of UMRA.

Environmental Impact

A Finding of No Significant Impact with respect to the environment has been 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. 4332(2)(C)). The Finding of No Significant Impact is available for public inspection between the hours of 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0500.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. The proposed regulatory changes will allow PHAs additional flexibility in using their capital and operating funds. However, the decision whether to use this capability is up to each PHA. Although some small entities may participate in the program, the rule does not impose any legal requirement or mandate upon them and, accordingly, will not have a significant impact on them. Therefore, the undersigned certifies that this rule will not have a significant economic impact on a substantial number of small entities, and an initial regulatory flexibility analysis is not required.

Notwithstanding HUD's determination that this rule will not have a significant economic effect on a substantial number of small entities, HUD specifically invites comments regarding any less burdensome alternatives to this rule that will meet HUD's objectives as described in this preamble.

Executive Order 13132, Federalism

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 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.

Catalog of Federal Domestic Assistance Number

The Catalog of Federal Domestic Assistance number for 24 CFR parts 905 and 990 is 14.850.

List of Subjects

24 CFR Part 905

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

24 CFR Part 990

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

For the reasons discussed in this preamble, HUD proposes to amend 24 CFR parts 905 and 990, as follows:

PART 905—THE PUBLIC HOUSING CAPITAL FUND PROGRAM

1. The authority citation for 24 CFR part 905 is revised to read as follows:

Authority: 42 U.S.C. 1437g, 42 U.S.C. 1437z-2, and 3535(d).

2. Redesignate § 905.10 and § 905.120 as subpart A and add a heading for subpart A to read as follows:

Subpart A—General

3. Add and reserve subparts B through F, and add subpart G, consisting of §§ 905.700 through 905.715, to read as follows:

Subpart G—Use of Capital Funds For Financing

Sec.	Purpose and description.
905.700	Purpose and description.
905.705	Program requirements.
905.710	Submission requirements.
905.715	HUD review and approval.

§ 905.700 Purpose and description.

(a) This subpart sets forth the requirements necessary for a PHA to obtain HUD approval to borrow private capital and pledge a portion of its annual capital fund grant or public housing assets and other public housing property of the PHA as security.

(b) Under the Capital Fund, PHAs are permitted to borrow private capital to finance public housing development or modernization activities. A PHA may

use a portion of its capital fund for debt service payments and usual and customary financing costs associated with public housing development or modernization (including public housing in mixed-finance developments). Additionally, a PHA undertaking such financing activities may, subject to HUD's written approval, grant a security interest in its future annual capital fund grants, which shall be subject to the appropriation of those funds by Congress. The PHA's financing activities are not obligations or liabilities of the federal government. The federal government does not assume any liability with respect to any such pledge of future appropriations, and the federal government neither guarantees nor provides any full faith and credit for these financing transactions.

§ 905.705 Program requirements.

(a) A PHA shall obtain written HUD approval for all capital fund financing transactions that pledge, encumber, or otherwise provide a security interest in public housing assets or other property, including capital funds, and use capital funds for the payment of debt service or other financing costs. HUD approval shall be based on:

(1) The ability of the PHA to complete the financing transaction along with the associated improvements and to repay the debt;

(2) The reasonableness of the provisions in the capital fund financing proposal considering the other pledges or commitments of public housing assets, as well as the pledge being proposed; and

(3) Whether the PHA meets the requirements of this subpart.

(b) Any pledge of future year capital funds under this section is subject to the availability of appropriations by Congress for that year.

(c) *Conditions on Use*—(1) *Development.* Any new public housing developed using amounts under this Part (including proceeds from financing authorized under this Part) shall be operated under the terms and conditions applicable to public housing during the 40-year period that begins on the date on which the project becomes available for occupancy, except as otherwise provided in the 1937 Act.

(2) *Modernization.* Any public housing or portion thereof that is modernized using amounts under this Part (including proceeds from financing authorized under this Part) shall be maintained and operated during the 20-year period that begins on the latest date on which the modernization is

completed, except as otherwise provided in the 1937 Act.

(3) *Operation.* Any public housing project operated using operating fund amounts may not be disposed of before the expiration of the 10-year period beginning upon the conclusion of the fiscal year for which such amounts were provided, except as otherwise provided in the 1937 Act.

(4) *Applicability of latest expiration date.* Public housing subject to these use conditions, or to any other provision of law mandating the operation of housing as public housing for a specific length of time, shall be maintained and operated as required until the latest such expiration date.

(5) Any public housing rental projects upon which the financing proceeds will be used must show evidence of an effective declaration of trust being recorded in first position.

(d) *Public Housing Assessment System (PHAS) designation.* Generally, a PHA shall be designated a Standard Performer or High Performer under PHAS, and must be a standard performer or higher on the management and financial condition indicators. HUD will consider requests from PHAS designated as Troubled under PHAS when the PHA is able to show that it has developed appropriate management and financial capability and controls that demonstrate its ability to successfully undertake the capital fund financing proposal.

(e) *Management capacity.* A PHA shall have the capacity to undertake and administer private financing and construction or modernization of the size and type contemplated. In order to determine capacity, HUD may require the PHA to submit a Management Assessment conducted by an independent third party, in a form and manner prescribed by HUD.

(f) *Existing financing.* A PHA shall identify the nature and extent of any existing encumbrances, pledges, or other financing commitments of public housing funds undertaken by the PHA.

(g) *Need for financing.* A PHA must complete a physical needs assessment at the project level, in the form and manner prescribed by HUD, that covers the PHA's entire public housing portfolio for the term of the financing and takes into consideration existing needs and the life cycle repair and replacement of major building components. For modernization, the activity to be financed must be identified as a need in the physical needs assessment. Based on the physical needs assessment, the PHA must demonstrate its ability to maintain its entire public housing portfolio in

accordance with the physical conditions standards prescribed by HUD. In making this demonstration, PHAs must reduce any projected future capital fund program grants to account for planned or anticipated activities that would have the effect of reducing or otherwise limiting the availability of future capital fund program grants. Notwithstanding the above, PHAs that pledge and use only Replacement Housing Factor Funds (RHF) in their capital fund financing transactions are not required to complete physical needs assessments.

(h) *Capital plans.* (1) The PHA's annual and 5-year capital plans shall identify:

(i) How the proceeds of the financing will be used; and

(ii) The amount of capital fund assistance that will be used annually for debt service and any other costs related to the financing.

(2) The work described in the plan will be based on the physical needs assessment. The plans shall detail work items (e.g., roof replacement, window replacement) by development. These work items will constitute performance measures upon which the PHA's performance will be evaluated. A general representation of the work (e.g., rehabilitation of Sunshine Homes development) is not sufficient.

(3) The capital plan submission to the Field Office shall include a copy of the physical needs assessment described in § 905.705(g).

(4) Financing proceeds under this part may not be used for administration or central office cost center costs (except for mixed-finance projects), management improvements, or upon non-viable projects, such as those subject to required conversion. Other than predevelopment costs, proceeds may not be used to reimburse costs already incurred.

(i) *Amount of capital fund for debt service.* (1) In general, a PHA shall not pledge more than 33 percent of its annual capital fund grant for debt service payments, assuming level capital fund Congressional appropriations over the term of the debt obligation and any reduction attributable to activities projected by the PHA to occur during the term of the financing, such as demolition, disposition, or conversion of public housing units or other occurrences that could limit the availability of capital fund program funds, including a voluntary compliance agreement.

(2) A PHA may be able to pledge more than 33 percent of its annual capital fund grant for debt service payments when the PHA is able to demonstrate, to HUD's satisfaction, that the remainder

of its annual capital fund grant is sufficient to meet other capital improvement needs during the term of the financing. This demonstration shall be at a project level and include cost estimates to maintain each project on an annual basis.

(3) In general, a PHA may pledge up to 50 percent, but use up to 100 percent of any RHF grants for debt service payments. A RHF grant shall be used only to develop replacement public housing rental units in accordance with § 905.10 and 24 CFR part 941.

(j) *Terms and conditions of financing.* The terms and conditions of all financing shall be reasonable based on current market conditions. The financing documents shall include the following, as applicable:

(1) *Term.* The term of the capital fund financing transaction shall not be more than 20 years. A longer term may be approved based on compelling circumstances identified by the PHA. All capital fund financing transactions shall be fully amortizing.

(2) *Acceleration.* The financing documents shall provide that no acceleration is permitted.

(3) *Public housing assets.* A PHA may not pledge any public housing assets unless specifically approved by HUD. PHAs seeking approval of a pledge of public housing assets must submit documentation to HUD that details the nature and priority of the pledge.

(4) *Variable interest rate.* Variable interest rates may be approved subject to any conditions HUD may determine appropriate.

(5) *Other Pledges or Commitments.* PHAs seeking approval of a pledge of public housing assets must describe the nature and extent of existing commitments or pledges of public housing assets, providing documentation of such other commitments or pledges to the extent required by HUD.

(6) Financing documents must include any other terms and conditions as required by HUD.

(k) *Fairness opinion.* The PHA shall provide an opinion, in a form and manner prescribed by HUD, from a qualified, independent, third-party financial advisor attesting that the terms and conditions of the proposed financing transaction are reasonable given current market conditions with respect to such matters as interest rate, fees, costs of issuance, call provisions, and reserve fund requirements.

(l) Construction management and financial controls. (1) The PHA shall have a plan describing how the PHA will ensure that:

(i) Adequate controls are in place regarding the use of capital fund financing proceeds; and

(ii) The improvements will be developed and completed in a timely manner consistent with the contract documents.

(2) This plan shall contain protocols and financial control mechanisms that address the design of the improvements, construction inspections, construction draws, and requisition approval checks and balances. A PHA that is designated Troubled under PHAS, or other PHAs as determined by HUD, may be required to institute risk mitigation measures to ensure that the funds are used properly and for the purposes intended.

(m) *Work items.* To the extent any changes in work items financed by capital fund financing proceeds meet or exceed the following threshold requirements determined by HUD, PHAs must obtain written approval of amendments to their capital fund financing proposal from HUD:

(1) A change in the type of activity being financed (e.g., if the approved proposal contemplated the proceeds being used for modernization, but after the proposal is approved, the PHA decides instead to pursue development);

(2) A change in the project being modernized or developed with the proceeds;

(3) A reduction of 20 percent or more in the number of public housing units being modernized; or

(4) An increase of 20 percent or more of the cost of nondwelling space.

(n) *Applicability of other federal requirements.* The proceeds of capital fund financing are subject to all laws, regulations, and other requirements applicable to the use of capital fund grants made under 24 CFR part 905, unless otherwise approved by HUD in writing.

(o) *Performance measures.* In its annual capital plans, the PHA is required to identify specific items of work that will be accomplished using the proceeds of the proposed financing. The items, which shall be quantifiable, shall be the basis on which HUD evaluates a PHA's performance. Failure to meet the performance measures may result in:

(1) Failure to receive HUD approval for future financing transactions;

(2) Failure to be considered for future competitive grant programs; and

(3) Other sanctions HUD deems appropriate and authorized by law or regulation.

(p) *Reporting requirements.* (1) The PHA shall submit a performance and evaluation report on a quarterly basis within 30 days of the end of each

quarter, as well as annually in the PHA plan, until a Cost Certification has been accepted by HUD.

(2) A Cost Certification for a capital fund financing transaction must be included in a PHA's annual audit.

§ 905.710 Submission requirements.

(a) All requests for HUD approval of capital fund financing transactions shall be submitted to the Assistant Secretary for Public and Indian Housing or the Assistant Secretary's designee. The PHA shall provide an original and two copies of each submission. The PHA also shall submit a copy to its local HUD Field Office.

(b) Each financing proposal shall be tabbed and presented with the following information in the order listed:

(1) *PHA transmittal letter.* A letter signed by the PHA Executive Director (or Chief Executive Officer, if applicable) transmitting the request for HUD approval of the Capital Fund financing transaction.

(2) *Term sheet.* The HUD-prescribed Term Sheet describing the basic terms of the transaction and financing structure, including the amount of the financing, the term, interest rates, security, and reserve requirements.

(3) *Financing documents.* A complete set of the financing documents that the PHA will execute in connection with the financing transaction. The financing documents must identify the nature and extent of any security being provided, as well as the position of any security interest. The financing documents are to be submitted to HUD only after they have been negotiated and agreed upon by the other parties to the transaction. HUD will not review preliminary documents that are still under negotiation.

(4) *Specific requests.* A description of any specific HUD approvals, representations, or assurances required for closing.

(5) Other documents as required by HUD.

§ 905.715 HUD review and approval.

(a) After receipt of a capital fund financing proposal, HUD shall review it for completeness. HUD will return all incomplete or unapprovable proposals, identifying the deficiencies, and will not take any further action. HUD will also return proposals submitted by entities other than the PHA (e.g., the PHA's consultants). HUD shall review all complete proposals for compliance with the requirements set forth above. HUD may require the PHA to make modifications to any of the items submitted and may require the PHA to resubmit all or any portion of the

proposal. After HUD determines that a proposal complies with all requirements, HUD shall notify the PHA in writing of its approval and any condition(s) of the approval.

(b)(1) As applicable, with the approval letter HUD shall include two copies of a capital fund financing Amendment to Consolidated ACC ("Financing Amendment").

(2) Within 60 days of the closing, unless the time has otherwise been extended by HUD in writing, the PHA must submit:

(i) Closing documents as directed by HUD; and

(ii) All documents that require HUD to take certain actions, such as initiate debt service payments through HUD's automated systems.

(3) Failure to provide the required documents to HUD within 60 days of HUD approval of the financing transaction may result in HUD rescinding its approval.

PART 990—THE PUBLIC HOUSING OPERATING FUND PROGRAM

4. The authority citation for 24 CFR part 990 is revised to read as follows:

Authority: 42 U.S.C. 1437g, 42 U.S.C. 1437z-2, and 3535(d).

5. Add subpart K, consisting of §§ 990.400 through 990.415, to read as follows:

Subpart K—Use of Operating Funds for Financing

Sec.	
990.400	Purpose and description.
990.405	Program requirements.
990.410	Submission requirements.
990.415	HUD review and approval.

§ 990.400 Purpose and description.

(a) This subpart sets forth the requirements necessary for a PHA to obtain HUD approval to borrow private capital and pledge a portion of its annual operating subsidy or other public housing assets as security.

(b) Subject to HUD approval, PHAs may pledge operating cash flow from a project or excess cash from a project that exceeds 3 months of operating expenses. Operating cash flow from a project may be used to pay debt service associated with a mixed-finance project. Where such debt service is received by a PHA, those funds must be treated as operating subsidy. Under the Operating Fund, PHAs are permitted to borrow private capital to finance public housing development or modernization activities. Additionally, a PHA undertaking such financing activities may, subject to HUD's written approval, pledge and grant a security interest in

its property, including future annual operating subsidy, which shall be subject to the appropriation of those funds by Congress. In all circumstances, the PHA's financing activities are not obligations or liabilities of the federal government. The federal government does not assume any liability with respect to any such pledge of future appropriations, and the federal government neither guarantees nor provides any full faith and credit for these financing transactions.

§ 990.405 Program requirements.

(a) A PHA must obtain written HUD approval for all operating fund financing transactions. HUD approval shall be based on:

(1) The ability of the PHA to complete the financing transaction along with the associated improvements;

(2) The reasonableness of the provisions in the operating fund financing proposal considering the other pledges or commitments of public housing assets, as well as the pledge being proposed;

(3) The Capital Fund must be used first before any financing from the Operating Fund;

(4) The ability of the PHA to maintain and operate the financed project(s), as well as repay debt service; and

(5) Whether the PHA meets the requirements of this subpart.

(b) All public housing projects for the PHA must be in compliance with this part, must be under project-based accounting, and must have submitted an audited financial statement for each project being financed.

(c) Any pledge of future year operating subsidy under this section is subject to the availability of appropriations by Congress for that year.

(d) *Conditions on Use*—(1)

Development. Any new public housing developed using amounts under this program (including proceeds from financing authorized under this Part) shall be operated under the terms and conditions applicable to public housing during the 40-year period that begins on the date on which the project (or stage of the project) becomes available for occupancy, except as otherwise provided in the 1937 Act.

(2) *Modernization.* Any public housing or portion thereof that is modernized using amounts under this Part (including proceeds from financing authorized under this Part) shall be maintained and operated during the 20-year period that begins on the latest date on which the modernization is completed, except as otherwise provided in the 1937 Act.

(3) *Operation.* Any public housing project operated using amounts provided under this part may not be disposed of before the expiration of the 10-year period beginning upon the conclusion of the fiscal year for which such amounts were provided, except as otherwise provided in the 1937 Act.

(4) *Applicability of latest expiration date.* Public housing subject to these use conditions, or to any other provision of law mandating the operation of housing as public housing for a specific length of time, shall be maintained and operated as required until the latest such expiration date.

(5) Any public housing rental projects upon which the financing proceeds will be used must show evidence of an effective declaration of trust being recorded in first position.

(e) *Public Housing Assessment System (PHAS) designation.* Generally, a PHA shall be designated a Standard Performer or High Performer under PHAS and must be a standard performer or higher on the management and financial condition indicators. HUD will consider requests from PHAs designated as Troubled under PHAS when the PHA is able to show that it has developed appropriate management and financial capability and controls that demonstrate its ability to successfully undertake the Operating Fund financing proposal.

(f) *Management capacity.* A PHA shall have the capacity to undertake and administer private borrowing and construction or modernization of the size and type contemplated. In order to determine capacity, HUD may require the PHA to submit a Management Assessment conducted by an independent third party, in a form and manner prescribed by HUD.

(g) *Existing financing.* A PHA shall identify the nature and extent of any existing encumbrances, pledges, or other financing commitments of public housing funds undertaken by the PHA.

(h) *Need for financing.* A PHA must complete a physical needs assessment at the project level, in the form and manner prescribed by HUD, that covers the PHA's entire public housing portfolio for the term of the financing and takes into consideration the life cycle repair and replacement of major building components. For modernization, the activity to be financed must be identified as a need in the physical needs assessment. Based on the physical needs assessment, the PHA must demonstrate that the capital improvements to be financed cannot be addressed through the Capital Fund program due to the needs and priorities at other projects.

(i) *Capital plans.* The PHA must submit an annual capital plan for the use of proceeds from operating fund financing in the same manner as if it were a grant under the Capital Fund Program (see 24 CFR part 905).

(1) The PHA's annual plans shall identify how the proceeds of the financing will be used.

(2) The work described in the capital plan will be based on the physical needs assessment described in § 990.405(h). The annual capital plan shall detail work items (e.g., roof replacement, window replacement) by development. These work items will represent Performance Measures upon which the PHA's performance will be evaluated. A general representation of the work (e.g., rehabilitation of Sunshine Homes development) is not sufficient.

(3) The capital plan submission to the Field Office shall include a copy of the physical needs assessment described in § 905.405(h) of this chapter.

(4) Financing proceeds under this part may not be used for administration or central office cost center costs (except for mixed-finance projects), management improvements, or non-viable projects, such as those subject to required conversion. Other than predevelopment costs, proceeds may not be used to reimburse costs already incurred.

(j) *Amount of Operating Fund for debt service.* To be approved for financing activities under the Operating Fund program, the PHA must demonstrate that the project has sufficient resources to meet the financing obligations. Generally, the project being financed must demonstrate debt service coverage of 3.0. Additionally, each project must set aside, in a restricted account, 12 months of debt service payments.

(k) *Independent Feasibility Analysis.* As part of its submission package requesting HUD approval for its financing, the PHA must submit a financial feasibility analysis of each affected project, prepared by an independent party, in a manner to be prescribed by HUD. This feasibility analysis must demonstrate the ability of the subject project to support the debt service payments, other financing costs, and operating costs.

(l) *Terms and conditions of financing.* The terms and conditions of all financings shall be reasonable based on current market conditions. The financing documents shall include the following, as applicable:

(1) *Term.* The term of the operating fund financing transaction shall not be more than 10 years. A longer term may be approved based on compelling circumstances identified by the PHA.

All Operating Fund financing transactions shall be fully amortizing.

(2) *Acceleration.* The financing documents shall provide that acceleration is not permitted.

(3) *Pledge of public housing assets.* A PHA may not pledge any public housing assets, unless specifically approved by HUD. PHAs seeking HUD approval of a pledge of public housing assets must submit documentation to HUD that details the nature and priority of the pledge.

(4) *Variable interest rate.* Variable interest rates may be approved subject to any conditions HUD may determine appropriate.

(5) *Other Pledges or Commitments.* PHAs seeking approval of a pledge of public housing assets must describe the nature and extent of existing commitments or pledges of public housing assets, providing documentation of such other commitments or pledges to the extent required by HUD.

(6) Financing documents must include any other terms and conditions as required by HUD.

(m) *Fairness opinion.* The PHA shall provide an opinion, in a form and manner prescribed by HUD, from a qualified, independent, third-party financial advisor attesting that the terms and conditions of the proposed financing transaction are reasonable given current market conditions with respect to such matters as interest rate, fees, costs of issuance, call provisions, and reserve fund requirements.

(n) *Construction management and financial controls.* (1) The PHA shall have a plan describing how the PHA will ensure that:

(i) Adequate controls are in place regarding the use of the operating fund financing proceeds; and

(ii) The improvements will be developed and completed in a timely manner consistent with the contract documents.

(2) This plan shall contain protocols and financial control mechanisms that address the design of the improvements, construction inspections, construction draws, and requisition approval checks and balances. A PHA that is designated Troubled under PHAS, or other PHAs as determined by HUD, may be required to institute risk mitigation measures, as approved by HUD, to ensure that the funds are used properly and for the purposes intended.

(o) *Work items.* To the extent any changes in work items financed by operating fund financing proceeds meet the following threshold requirements determined by HUD, PHAs must obtain written approval of amendments to their

operating fund financing proposal from HUD:

(1) A change in the type of activity being financed (e.g., if the approved proposal contemplated the proceeds being used for modernization, but after the proposal is approved, the PHA decides instead to pursue development);

(2) A change in the project being modernized or developed with the proceeds;

(3) A reduction of 20 percent or more in the number of public housing units being modernized; or

(4) An increase of 20 percent or more of the cost of nondwelling space.

(p) *Applicability of other federal requirements.* The proceeds of the operating fund financing shall be treated as capital funds under 24 CFR part 905, and are subject to all laws, regulations, and other requirements applicable to the use of capital fund grants made under 24 CFR part 905, unless otherwise approved by HUD in writing.

(q) *Performance measures.* The PHA is required to identify in its annual capital plans specific items of work that will be accomplished using the proceeds in the proposed financing proposal. The items, which shall be quantifiable, shall be the basis on which HUD evaluates a PHA's performance. Failure to meet the performance measures may result in:

(1) Failure to receive HUD approval for future financing transactions;

(2) Failure to be considered for future competitive grant programs; and

(3) Other sanctions HUD deems appropriate and as authorized by law or regulation.

(r) *Reporting requirements.* (1) The PHA shall submit a performance and evaluation report that includes, in addition to information on capital expenses and expenditures, a narrative describing the progress that has been made to date with the improvements associated with the operating fund financing transaction. At a minimum, the narrative shall discuss the progress of the construction against the schedules, any problems encountered, cost overruns, and any associated claims or litigation. The performance and evaluation report should be submitted to the HUD Field Office on a quarterly basis within 30 days of the end of each quarter, as well as annually in the PHA plan, until a Cost Certification has been accepted by HUD.

(2) A Cost Certification for an operating fund financing transaction must be included in a PHA's annual audit.

(s) *Type of Security Interest Pledged.* As part of its submission package, the

PHA must state the type/nature of the security interest that will be pledged.

(t) *Eligibility of Operating Subsidy for Costs of Repaying Debt.* Operating subsidy made available in a fiscal year may be used for the costs of repaying debt incurred to finance the rehabilitation and development of public housing units. Current operating subsidy may be used for the costs of repaying debt for prior rehabilitation and development of public housing units that become due in the current calendar year.

§ 990.410 Submission requirements.

(a) All requests for HUD approval of operating fund financing transactions shall be submitted to the Assistant Secretary for Public and Indian Housing or the Assistant Secretary's designee. The PHA shall provide an original and two copies of each submission. The PHA also shall submit a copy to its local HUD Field Office.

(b) Each financing proposal shall be tabbed and presented with the following information in the order listed:

(1) *PHA transmittal letter.* A letter signed by the PHA Executive Director (or Chief Executive Officer, if applicable) transmitting the request for HUD approval of the operating fund financing transaction.

(2) *Term sheet.* The HUD-prescribed Term Sheet describing the basic terms of the transaction and financing structure, including the amount of the financing, the term, interest rates, security, and reserve requirements.

(3) *Financing documents.* A complete set of the financing documents that the PHA will execute in connection with the financing transaction. The financing documents must identify the nature and extent of any security being provided, as well as the position of any security interest. The financing documents are to be submitted to HUD only after they have been negotiated and agreed upon by the other parties to the transaction. HUD will not review preliminary documents that are still under negotiation.

(4) *Specific requests.* A description of any specific HUD approvals, representations, or assurances required for closing.

(5) Other documents as required by HUD.

§ 990.415 HUD review and approval.

(a) After receipt of an operating fund financing proposal, HUD shall review the proposal for completeness. HUD will return all incomplete proposals, identifying the deficiencies, and will not take any further action. HUD will also return proposals submitted by

entities other than the PHA (*e.g.*, the PHA's consultants). HUD shall review all complete proposals for compliance with the requirements set forth above. HUD may require the PHA to make modifications to any of the items submitted and may require the PHA to resubmit all or any portion of the proposal. After HUD determines that a proposal complies with all requirements, HUD shall notify the PHA in writing of its approval and any condition(s) of the approval.

(b)(1) As applicable, with the approval letter HUD shall include two copies of an operating fund financing Amendment to Consolidated ACC ("Financing Amendment").

(2) Within 60 days of the closing, unless the time otherwise has been extended by HUD in writing, the PHA must submit:

(i) Closing documents as directed by HUD; and

(ii) All documents that HUD requires as a condition for it to take certain actions, such as initiate debt service

payments through HUD's automated systems.

(3) Failure to provide the required documents to HUD within 60 days of HUD approval of the financing transaction may result in HUD rescinding its approval.

Dated: June 8, 2007.

Orlando J. Cabrera,

Assistant Secretary for Public and Indian Housing.

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