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Public Housing: Fact Sheet on the New Operating Fund Formula

Maggie McCarty
Analyst in Housing
Social Policy Division

Summary

The local public housing authorities (PHAs) that administer the federal public housing program began receiving their annual federal operating subsidies under a new formula in January 2007. As a result, some PHAs experienced an increase in their eligibility for funding and others experienced a decrease, although both increases and decreases will be phased in (over two and five years, respectively). However, the amount that a PHA qualifies for under the new formula (whether it is an increase or a decrease) will be reduced if Congress appropriates less money than is necessary to fund all agencies at 100% of their eligibility. This fact sheet will be updated.

The federal government supplies subsidies to PHAs to help make up the difference between what low-income tenants pay in rent and the cost of operating low-rent public housing. The formula for providing these operating funds changed in January 2007. Under the new formula, some PHAs are eligible to receive an increase in federal operating funds and others qualify for a decrease. Both increases and decreases will be phased in; PHAs facing decreases will have an opportunity to limit their formula eligibility losses through the adoption of management changes. However, the amount that a PHA qualifies for under the new operating fund formula (whether it is an increase or a decrease) is reduced if Congress appropriates less money than is necessary to fund all agencies at 100% of their eligibility (as Congress has done in most recent years). This report is designed to provide a brief overview of the changes to the public housing operating fund formula that began taking place in January 2007.

Background

Public housing costs are divided into two main categories: capital costs and operating costs. Capital costs are the costs of major renovations or modernizations. Operating costs are the day-to-day costs of running a building, such as utility, administrative, and routine maintenance costs. Operating costs vary based on many factors, including the age of a building, its heating and cooling systems, and its location. In the early years of the public housing program, PHAs were expected to meet their operating costs through the rents they collected. Over time, tenant rents were no longer sufficient to cover public housing operating expenses, in part because tenants became poorer and therefore unable to pay as much in rent, and in part because the costs of maintaining the buildings increased as they aged. In the late 1960s, Congress began providing operating subsidies to PHAs to supplement the low rents paid by tenants.

The system in place for providing those subsidies until 2001 was the Performance Funding System (PFS). In a 1998 public housing reform law, Congress responded to criticisms that the PFS formula was outdated by creating a new Public Housing Operating Fund.[1] The law required the Department of Housing and Urban Development (HUD) to use negotiated rulemaking to develop a new formula for distributing the funds. A negotiated rulemaking committee convened in 1999 involved PHAs and other stakeholder groups. During deliberation, it was agreed that sufficient data were not available to determine the true costs of operating public housing, and that a study should be undertaken.[2] Until the results of the study were available, the committee agreed to use a modified version of the PFS to create an interim operating fund formula. This interim formula took effect in 2001.[3] HUD contracted with the Harvard Graduate School of Design to conduct the public housing operating cost study; its results were published in 2003.[4] Another negotiated rulemaking committee was established to use the results of the study to develop a final formula to replace the interim formula. HUD published a proposed rule in the spring of 2005,[5] but the rule was criticized for differing significantly from the agreements made during negotiated rulemaking. HUD published a final rule in the fall of 2005, which more closely resembled the initial agreement of the negotiated rulemaking committee.[6] The new formula took effect in January 2007.[7]

Operating Fund Formula

The operating fund provides subsidies to PHAs to make up the difference between what it costs to run public housing and what low-income tenants pay in rent. Under the interim formula, the calculation for determining a PHA's operating subsidy eligibility used two components: formula expenses (meant to represent the cost of running public housing) and formula income (meant to represent the amount collected in tenant rents). HUD subtracts a PHA's formula income from its formula expenses and the amount by

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[1] Sec. 519, Quality Housing and Work Opportunity Responsibility Act 1998 (P.L. 105-276).

[2] HUD, "Revisions to the Public Housing Operating Fund Program: Final Rule," 79 Federal Register 54984, September 19, 2005. (Hereinafter referred "Final Rule.") See preamble.

[3] HUD, "Allocation of Operating Subsides under the Operating Fund Formula," 66 Federal Register 17276, March 29, 2001. (Hereinafter referred to as "Interim Rule.")

[4] Harvard University Graduate School of Design, Public Housing Operating Cost Study: Final Report, June 16, 2003.

[5] HUD, "Revisions to the Public Housing Operating Fund Program; Proposed Rule," 70 Federal Register 19858, April 14, 2005. (Hereinafter referred to as "Proposed Rule.")

[6] The Final Rule replaces the existing 24 CFR Part 990 et. seq.

[7] The rule initially scheduled implementation for 2006, but implementation was delayed by the HUD notice "Revisions to the Public Housing Operating Fund Program; Correction to Formula Implementation Date," 70 Federal Register 61366, October 24, 2005.

which the income is short of the expenses is the PHA's operating subsidy eligibility. The new operating fund formula uses the same principle, but a more complex equation with changes to the way certain components are calculated.

Formula Expenses. Formula expenses are the sum of three categories of estimated expenses: non-utility expenses, utility expenses, and other add-ons.

Non-Utility Expense Levels. Non-utility expense levels are per unit estimates of the basic non-utility operating costs of maintaining public housing.[8] Under the old formula, the non-utility expense levels set for a PHA were called Allowable Expense Levels (AELs). They were set for most PHAs under the PFS in 1975 and subsequently updated for inflation. The AELs were modified in 1992 and again in 2001 when the interim rule was adopted.[9] To calculate the non-utility expense component of a PHA's formula expenses under the interim operating fund formula, the number of public housing units in a PHA's inventory[10] was multiplied by the agency's AEL.

The new operating fund formula sets new non-utility expense levels for PHAs based on the data from the Harvard study and adjusted for inflation. These new *project* expense levels (PELs) are not applied at the agency level (as under the interim rule), rather, they differ for each project within a PHA's portfolio based on the characteristics of that project.[11] To calculate the non-utility expense component of a PHA's formula expenses under the new operating fund formula, the number of eligible public housing units[12] in each project in a PHA's inventory is multiplied by each project's PEL and those amounts are then summed.[13] For CY2007, HUD developed weighted average project expense levels (WAPELs) for each PHA, and applied the WAPEL to all PHA units; for CY2008, HUD will use individual PELs.[14]

Utility Expense Levels. Utility expense levels (UELs) are estimates of the utility costs that can be attributed to a unit of public housing. They are calculated for each utility based on a PHA's consumption level and the applicable rates for that utility. The interim formula had aspects designed to encourage PHAs to adopt more energy-efficient practices and reduce consumption. The Harvard Cost Study did not make recommendations for changing utility expense levels, citing a lack of available data.[15] The final rule largely

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[8] Examples of non-utility operating costs include administrative costs (advertising the availability of units, processing of applications), safety and security costs, and routine maintenance.

[9] See Interim Rule, 24 CFR 990.105.

[10] Eligible units were units available for occupancy; long term vacancies and vacancies above 3% are not considered eligible for occupancy. See Interim Rule, 24 CFR 990.102.

[11] Projects are not necessarily individual buildings. Rather, they are groupings of units established by PHAs under 24 CFR 990.665, Final Rule.

[12] Eligible units are occupied units, units with an approved vacancy, and other vacant units (not to exceed 3% of the PHAs inventory). See 24 CFR 990.125, Final Rule.

[13] See 24 CFR 990.165, Final Rule.

[14] Because HUD has experienced technical difficulties with a data system, for the first several months of CY2008, PHAs are receiving funding based on their CY2007 eligibility.

[15] Harvard Graduate School of Design, *Benchmarking Public Housing Utility Funding to Private Norms: A Feasibility Study* (DRAFT), March 22, 2002.

maintains the existing formula for calculating UELs, although the rule does state that HUD will study options for calculating utility costs and will convene a negotiated rulemaking committee in 2009 to come up with a new formula for 2011.[16]

Add-Ons. In addition to basic utility and non-utility expenses, the interim operating fund formula included some add-on costs that PHAs could qualify to include in their formula expenses. Some of these add-ons were flat per-unit per-month or per-unit per-year fees; others were open-ended reimbursements. The new operating fund formula includes several new add-ons, including the reasonable cost of a self sufficiency program; an asset management fee for PHAs in compliance with asset management requirements ($4 per unit per month for PHAs with more than 250 units and $2 per unit per month for PHAs with 250 units or less); information technology fees ($2 per unit per month); asset repositioning fees (for units being removed from the public housing stock that are not eligible for operating funds); reasonable costs for energy conservation measures; and payment in lieu of taxes (PILOT) costs (which were included in the AELs under the old formula).[17]

Formula Income. Formula income represents the income a PHA collects from rents. Under the interim rule, formula income was calculated by computing a PHA's average monthly rental charge per unit, applying an upward trend factor, and multiplying it by the number of units expected to be occupied.[18] Under the new operating fund rule, formula income will be calculated by taking the average rent charged by each PHA in its 2004 fiscal year and multiplying it by the PHA's eligible units.[19] Each PHA's formula income will be frozen at this 2004 level through FY2008.[20] Because tenants in public housing pay an income-based rent, as their incomes rise, so does the amount they pay in rent. With formula income frozen at the FY2004 level under the new rule, PHAs will have an incentive to encourage families to increase their incomes, as the increased revenue from rents will not be used when calculating a PHA's operating fund eligibility until after FY2008.

Phase-In

Under the new formula, some PHAs will be "gainers," meaning that they will be eligible for an increase in funding, while others will be "decliners," meaning that they will qualify for a decrease in funding. A HUD analysis found that 74% of PHAs would have qualified for higher funding if the new operating fund formula had been in place in FY2004; 26% of PHAs would have qualified for less funding.[21] To help ease the transition, losses will be phased in over five years; gains will be phased in over two years (see **Table 1** for the phase-in schedule). To implement the phase-in, HUD has calculated

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[16] See 24 CFR 990.170-185, Final Rule.

[17] See 24 CFR 990.190, Final Rule. For former add-ons, see Interim Rule, 24 CFR 990.108.

[18] See Interim Rule, 24 CFR 990.109.

[19] See 24 CFR 990.195, Final Rule.

[20] A PHA can appeal to have its formula income adjusted if it can show that a severe local economic hardship is affecting its ability to maintain "some semblance" of its formula income.

[21] HUD, *New Operating Fund Formula Rule, Transition Analysis Report,* available at [http://www.hud.gov/offices/pih/programs/ph/am/of/transitionanalys.xls].

a transition amount for each PHA. The transition amount is the difference between a PHA's operating subsidy eligibility in FY2004 and what the PHA's eligibility would have been if the new formula had been in effect. The transition amount for each PHA will be adjusted by each year's phase-in level and then either added or subtracted to each PHA's operating subsidy eligibility level for that year.

For example, if a PHA's operating subsidy eligibility was $500,000 in FY2004, but would have been only $450,000 if the new formula had been in place, the PHA would be considered a decliner, and its transition amount would be $50,000. Under the phase-in schedule, declines are limited to 5% in the first year, and so $47,500 (50,000 x 95%), adjusted for the number of eligible units, would be *added* to the PHA's FY2007 operating subsidy eligibility. If the situation were reversed and the PHA would have gone from $450,000 under the old formula to $500,000 under the new formula, the PHA would be considered a gainer. Its transition amount would still be $50,000, but since gains are limited to 50% in the first year, $25,000, adjusted for the number of eligible units, would be *subtracted* from the PHA's FY2007 operating subsidy eligibility.

Table 1. Phase-in Rates for Operating Subsidy Funding Changes

Year	Phase-in for Declines	Phase-in for Gains
1 (2007)	-5%	50%
2 (2008)	-24%	100%
3 (2009)	-43%	100%
4 (2010)	-62%	100%
5 (2011)	-81%	100%
6 (2012)	-100%	100%

Source: HUD, "Public Housing Operating Fund Program; Revised Transition Funding Schedule for FY2008 Through FY2012: Proposed Rule," 71 Federal Register 68404, November 24, 2006.

PHAs that wish to limit their losses can transition to asset-based management in advance of the 2011 deadline (discussed below).[22] PHAs that transition to asset-based management in the preceding year will stop their losses for the following year and thereafter at that year's phase-in rate.[23] For example, a PHA that has adopted asset-based management by the deadline in the first year will limit its losses to 5%, meaning that HUD will add 95% of its transition amount to its operating subsidy eligibility each year.

Asset-Based Management.[24] One major recommendation of the Harvard study was that PHAs should transition to asset-based management. In the past, PHAs budgeted and were funded on an agency-wide basis, rather than on a project-by-project basis. They were also permitted to manage all of their units from a central office. This system differed from private market multifamily housing norms, where each property is treated

[22] See HUD, "Public Housing Operating Fund Program; Revised Transition Funding Provision for Federal Fiscal Year 2007; Proposed Rule," 71 Federal Register 68408, November 24, 2006.

[23] Initially, HUD stated that PHAs were required to comply before April 15, 2007 to limit their losses to 5% in the first year (HUD Notice PIH 2006-35). HUD later stated that it would extend the deadline to October 15, 2007, for the first year. In the second year, PHAs will have to comply by April 15, 2008, if they wish to stop their losses at 24%. In the third year, PHAs wishing to stop their losses by 43% will have to comply by October 15, 2008.

[24] See 24 CFR 990 Subpart H, Final Rule.

as an individual asset and managed on an individual basis. In the final operating fund rule, HUD directed PHAs to adopt project-based budgeting and project-based accounting by PHA FY2007, and project-based management by PHA FY2011.

Operating Subsidy Funding

The amount of operating subsidy a PHA is *eligible* to receive is not necessarily the amount of funding it will *actually* receive. The amount of funding appropriated by Congress for the operating fund is generally less than the amount necessary to fund all PHAs at 100% of their eligibility. As a result, HUD must apply an across-the-board cut to PHAs' operating subsidy levels in order to stay within the amount appropriated by Congress. The percentage of formula eligibility PHAs receive after the across-the-board cut is referred to as the proration level. As shown in **Table 2**, proration levels have been declining in recent years, meaning that PHAs have been receiving a smaller and smaller share of the total funding for which they are eligible.

Table 2. Operating Fund Prorations, FY1998-2007

FY	Appropriation (in millions of nominal $)	Proration (%)
2007	3,864	83.4
2006	3,564	86.0
2005[a]	2,437	88.8
2004	3,579	98.1
2003	3,577	94.7
2002	3,495	100.0
2001	3,235	99.5
2000	3,138	98.5
1999	2,818	92.5
1998	2,900	100.0

Source: Table prepared by CRS. Appropriation figures are taken from the Office of Management and Budget's public budget database; proration levels are taken from data available on HUD's website: [http://www.hud.gov/offices/pih/programs/ph/am/of/prorationlevels.pdf], [http://www.hud.gov/offices/pih/programs/ph/am/of/2006prorationexpl_sept06.pdf] and [http://www.hud.gov/offices/pih/programs/ph/am/of/2007prorationexplfnl.pdf].

a. In 2005, Congress enacted a budgeting change that led to a one-time appropriations savings, without a corresponding decrease in the program level.

The Harvard Operating Cost study found that, on the whole, the government has been under-funding the operating costs of PHAs. HUD's own transition analysis indicated that if the new formula had been in place in FY2004, PHAs would have been eligible for an additional $264 million. That means that if the new formula had been in place in FY2004, with the same appropriations level, the proration level for FY2004 would have been lower (and PHAs would have received less than 98% of their funding eligibility).

Because, in aggregate, PHAs will qualify for more funding under the new formula than under the old formula, unless appropriations increase, proration levels can be expected to continue to decrease.