DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 968

[Docket No. FR–4125–P–01]

RIN 2577–AB71

Replacement Housing Factor in Modernization Funding

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

ACTION: Proposed rule.

SUMMARY: This rule will revise HUD's regulations that govern the formula allocation of modernization funding under the Comprehensive Grant Program (CGP) to add to the formula a factor that will maintain, for five years, a portion of funding that otherwise would be lost by a CGP housing agency (HA) when the number of its public housing units are reduced as a result of demolition, disposition, or conversion. These added funds would be required to be used for approved replacement housing or for the accelerated renovation and reoccupancy of vacant but viable units. The rule would take effect in Federal Fiscal Year (FY) 1998, based on formula characteristics reported as of September 30, 1997.

Such funding will support replacement of about twenty percent of the public housing units lost to demolition, disposition, or conversion and not otherwise replaced. The added funds are needed for construction of replacement units in cities with tight housing markets, to capitalize on opportunities in vacated sites, and to increase community acceptance of demolition. Other possible sources of funding for actual replacement housing units (modernization funding and HOPE VI program grants) will not be able to serve fully the HAs with replacement housing needs that cannot be served fully by vouchers.

DATES: Comment due date: December 9, 1997.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410. Communications should refer to the above docket number and title. Facsimile (FAX) comments are not acceptable. A copy of each communication submitted will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address.

FOR FURTHER INFORMATION CONTACT: William Flood, Director, Office of Capital Improvements, Office of Public Housing Investments, Room 4134, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410, telephone number (202) 708–1640, extension 4185. (This telephone number is not toll-free.) For hearing- and speech-impaired persons, this number may be accessed via text telephone by dialing the Federal Information Relay Service at 1–800–877–8339.

SUPPLEMENTARY INFORMATION:

I. Statutory Basis

The statutory foundation for modernization funding for the public housing program is section 14 of the United States Housing Act of 1937 (42 U.S.C. 1437l, *et seq.*). Using the formula authorized in section 14(k)(2), HUD computes the formula share of modernization funding for each HA eligible to participate in the CGP, i.e., an HA with 250 or more units.

Section 14(k)(2) prescribes certain formula factors and provides that the formula may be amended by the rulemaking process. Currently, the formula factors do not include a factor for replacement housing, which was not an eligible use of modernization funds when these factors were written.

Formerly, each public housing unit that was demolished or disposed of was required to be replaced with another unit. Recent amendments to the Act included suspension of the one-for-one replacement requirement. While this change is necessary, nationwide, by the end of FY 2000, an estimated 100,000 public housing units (of which about 60,000 were occupied as of FY 1996) are planned for demolition and disposition. In some cities, the number of such units can amount to between twenty-five and fifty percent of the city's annual total of vacant units available to low income households.

Traditionally, HUD has received appropriations for public housing development and HAs have used the development funds, in part, for replacement housing. Since FY 1995, however, Congress has not approved funding specifically for new public housing development. Currently, the only available sources of funding for construction of replacement housing are modernization funding and HOPE VI grants. Replacement housing was first authorized as an eligible cost of modernization funding in FY 1995. No change in the formula factors has taken place to reflect this new use of modernization funding; HAs can take advantage of this new flexibility only by diverting funds provided by the formula for developments other than the developments to be demolished. Similarly, HAs with a large backlog of vacant but viable units cannot take advantage of any savings in modernization funding resulting from demolition or disposition to bring additional vacant but viable units into occupancy.

Some HAs will have great difficulty restructuring their inventory and meeting local needs. Adding this replacement factor to the modernization formula will provide a share of modernization funds that is relatively constant that can be used for replacement of a portion of the non-viable units being demolished or sold. The Department is permitting either development of units (through construction or acquisition) or accelerated restoration of vacant units with the additional funding made available as a result of the replacement housing factor to give HAs the maximum amount of flexibility to use the means of replacing units given their own circumstances.

The number of replacement or restored vacant units that this funding will be able to support is about twenty percent of the number of units anticipated to be demolished, disposed of, or converted. Since about one third of the units being removed from an HA's inventory are typically vacant, the twenty percent replacement represents about thirty percent of the HA's occupied units.

Thus far, the Department has been able to provide either vouchers or newly acquired or constructed units, where appropriate, to replace roughly all units demolished or disposed of. However, replacement vouchers do not meet some local needs as well as hard replacement units do.

The Department believes that CGP HAs will be better able to restructure their inventories and more likely to take the needed steps to do so if they have available some funding for construction or acquisition of public housing replacement units irrespective of the HOPE VI process. Therefore, the Department has decided to exercise its authority (under 42 U.S.C. 1437l(2)(A)) to modify the formula for CGP funding, through notice and comment rulemaking, to take into account the need for some replacement units.

II. Need for Change in the Formula

As recently as FY 1994, the public housing stock lost only two thousand units per year from demolition, disposition, and conversions. But from

FY 1997 to FY 2000, the Department estimates a reduction of about twenty thousand units per year from demolition, disposition, and conversions. This large reduction in units is expected to be concentrated among about forty HAs, almost all of which are large HAs, with 1250 or more units and with one or more developments with a high percentage of long-term vacancies. Fewer than ten (or one-quarter) of these forty HAs are expected to have over three-quarters of the reduction in units as a result of demolition, disposition, and conversion. Unless action is taken, the affected communities will not be able to capitalize on opportunities to rebuild at lower densities and in mixed-income settings on current sites. By allowing an HA with reduced public housing units to temporarily stabilize its funding if it uses the funding for replacement housing generated by the modernization replacement housing factor, the proposed rule will remedy these problems (at least in part) and make more acceptable the reduction of units resulting from the demolition, disposition, or conversion of non-viable units.

This proposed revision retains all aspects of the current CGP formula, including the phased-in reduction in units covered by the Annual Contributions Contract that is specifically stated in the statute and is implemented by § 968.103(k)(3). By adding a replacement housing factor to reflect the need for replacement housing following unit reduction, the revision mitigates the adverse impact of the phased-in reduction in units, because it amends the way the underlying formula is calculated and restores some of the formula funding share HAs would have received had no unit reduction occurred after October 1, 1996. Under the proposed revision, an HA cannot receive more than its pre-unit reduction funding share as a result of the replacement housing factor.

III. Description of Replacement Housing Factor

A replacement housing factor is being added to both the backlog and accrual components of the formula for funding modernization activities under the CGP. The current formula provides, in accordance with the statute, that half of the formula is related to backlog needs, and the other half of the formula is related to accrual needs. Subject to the condition that an HA cannot receive more than its funding share before the application of the replacement housing factor, the five year adjustments for backlog and accrual need are calibrated so that an HA with units lost to demolition, disposition, or conversion will be able to fund about twenty percent of the public housing units (and about thirty percent of the occupied units) that will be lost. This percentage represents a significant amount of replacement housing but is low enough to ensure that funds will continue to be directed to pressing replacement housing needs.

The backlog and accrual need elements of the formula are now found at 24 CFR 968.103(e) and 968.103(f). This change is made to offset some of the loss of formula share in capital funding that would result from the described reduction of units that takes place after October 1, 1996. (As part of its CGP formula computations, HUD would compute the share and level of HA funding before the impact of the rule and the share and level of HA funding as a result of the rule that must be used for replacement housing.)

This rule adjusts the backlog need by adding 50 percent of the Total Development Cost (TDC) for a two-bedroom unit in a walk-up structure for the number of units to be demolished, disposed of, or converted, for the first five years after demolition, disposition, or conversion occurs. The rule adjusts the accrual need by adding two percent of the TDC for this type of unit for the number of units to be demolished, disposed of, or converted, for the first five years after demolition, disposition, or conversion. These modifications apply only if the reduced units are not otherwise receiving funding for replacement housing or vacancy renovation and if the funds attributable to this factor are used for approved replacement housing or vacancy renovation. Other modernization funds also may be used for replacement housing, in accordance with HUD Notice PIH 96–56 (HA). It is likely, however, that very few HAs would use modernization funding for this purpose if it would mean depriving other developments of modernization.

Four key features of the replacement housing factor should be noted. First, it does not support the continued operation of non-viable housing, because it is premised on non-viable units being reduced and the funding generated by the modernization replacement housing factor being used for replacement housing. Second, the affected HAs do not receive an additional funding share over their current share and might receive somewhat less, because the formula replacement factor cannot create shares of relative backlog need or relative accrual need that are greater than the relative shares before the removal of the units. Third, the offset is not a permanent hold harmless amount. After five years, the affected HAs will receive a share of funding based upon their reduced shares of backlog and accrual need without any replacement factor. Moreover, those units demolished, disposed of, or converted with replacement housing funds, such as public housing development, Major Rehabilitation of Obsolete Public Housing, or HOPE VI implementation grants, will not benefit from the replacement housing factor. (A demolished development with only partial replacement funding from a HOPE VI grant would get partial help from the modernization replacement housing factor.) Fourth, the replacement housing factor is expected to support replacement and accelerated renovation of vacant units of only a fraction of the original units.

In order to receive funding under the replacement housing factor, an HA must first request such funding when it updates its annual formula characteristics report for the formula run. Only units that are identified on the formula characteristics report as demolished, disposed of, or converted and that lower the number of HA formula units will be units eligible for the replacement factor. In its formula computations, HUD will determine the share and level of Comprehensive Grant formula funding that an HA will receive from the replacement factor. The HA will then budget the funds provided by the replacement factor as a major work category, including an implementation schedule, on the CGP Annual Statement. If the funding generated by the replacement factor is not used for replacement housing in a reasonable time, in accordance with already existing requirements (§§ 968.125 and 968.335(a)(3)), the affected HA will face appropriate corrective action, which ultimately may include recapture of the funds.

The following example shows how the factor would work.

Example for the Formula Replacement Factor

An HA that has 2,000 units is planning to demolish one of its developments. The development to be demolished has 200 units, and the demolition is not being funded by a grant that has a replacement component. The 1800 units that the HA is not going to demolish average a formula backlog need of $20,000 per unit and a formula accrual need of $1250 per unit—values that would have resulted from applying the unit-weighted characteristics of the developments to the backlog and accrual formulas set out in the Comprehensive Grant program. The 200 units to be demolished have, in this hypothetical example, a formula backlog need of $40,000 per unit and a formula accrual need of $1500 per unit. Finally, the HA had total CIAP funding from 1984 to 1991 of $10 million, and the TDC of a two-bedroom walkup in its area is $64,000 per unit.

Before demolition, the HA's unfunded formula backlog need is $34.0 million, or $10 million of CIAP funding deducted from $44.0 million of backlog need (1800 units at $20,000 per unit plus 200 units at $40,000 per unit), and its total formula accrual need is $2.55 million (1800 units at $1250 per unit plus 200 units at $1500 per unit). Without a replacement factor, in accordance with the phased-in reduction of units provision of § 968.103(k)(3), its total formula backlog need within three years would fall to $26 million, or $10 million of CIAP funding deducted from $36.0 million of backlog need (1800 units at $20,000 per unit), and its formula accrual need would fall to $2.25 million (1800 units at $1250 per unit). In short, within three years, its formula backlog need would decline about 23.5 percent and its formula accrual need would decline about 11.8 percent. If it is assumed that the formula characteristics for all other HAs remain unchanged, then by the third year after the approved demolition, its formula share would decline about 17.7 percent relative to the starting point before demolition (the average of 23.5 percent and 11.8 percent).

In this example, a replacement factor for five years would value the demolished units at $32,000 per unit (half of the TDC of $64,000) in the backlog formula and at $1280 per unit (two percent of the TDC of $64,000) in the accrual formula. By the third year of the five year period, the uncapped formula backlog need of the HA with demolition would be $32.4 million, or the $10 million of CIAP funding deducted from $42.4 million of backlog need (1800 units times $20,000 per unit plus 200 units times $32,000 per unit). If the formula backlog need of all other HAs remains the same and if the backlog need falls below the original level (as in this example), the adjusted backlog need does not have to be capped in order that the HA with the demolished units not increase its share of formula backlog as a result of the replacement factor for demolition. By the third year of the five year period, the accrual need of the HA with demolition would be $2.506 million, or less than its amount and share before demolition. No capping for the accrual replacement factor is required in this example. With a replacement factor, the formula share of the HA for the aggregate five years would be somewhat less than its share before demolition. Still, its formula share for five years would be more than what the HA would have received had a replacement factor not been in place for the demolished units.

In the above example, the HA's formula share without a replacement factor for its demolished units would have been reduced 5.9 percent in the first year that the demolition took effect for CGP funding, 11.8 percent in the second year, and 17.7 percent the third through fifth years (and afterward). With a replacement factor, the HA's share would be reduced 1.1 percent the first year, 2.2 percent the second year, and 3.3 percent the third through fifth years, and then 17.7 percent thereafter. Suppose that the HA had received $6 million in CGP funds if no demolitions had occurred during the first through the fifth years. As a result of the replacement factor maintaining some of its share, the funds maintained for replacement housing would be $288,000 in the first year, $576,000 in the second year, and $864,000 in the third through fifth years—for a five-year total of $3,456,000.

IV. Nationwide Impact

The Department estimates that the impact of this rule in the first year will be to maintain for eligible HAs about $20 million in funding for replacement housing that would otherwise be reallocated to other CGP HAs as a result of reduction in the number of the HA's units as a result of demolition, disposition, and conversion of non-viable units. Over the next five years, the impact might average $60 million per year. Of course, if there were no such incentive for HAs with non-viable units to demolish, dispose of, or convert and replace these units, they might not take such action, in which case their modernization funding shares might not have been reduced in the first place. Therefore, the true impact of the rule might be less than the above estimates.

V. Findings and Certifications

A. Public Reporting Burden

This proposed rule contains no new information collection requirements that would require review by the Office of Management and Budget under the Paperwork Reduction Act of 1995 (42 U.S.C. 3501–3520).

B. Impact on Small Entities

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this proposed rule, and in so doing certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities. This proposed rule only affects HAs with 250 or more units, eligible for formula funding under the CGP and primarily affects larger HAs, which have experienced the greatest unit reduction.

C. 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 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332). The Finding of No Significant Impact is available for public inspection and copying during regular business hours (7:30 a.m. to 5:30 p.m.) in the Office of the Rules Docket Clerk, Room 10276, 451 Seventh Street, SW, Washington, DC 20410–0500.

D. Federalism Impact

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, Federalism, has determined that the policies contained in this proposed rule do not have significant impact on States or their political subdivisions, or the relationship between the Federal Government and State and local governments, or on the distribution of power and responsibilities among the various levels of government. As a result, the proposed rule is not subject to review under the Order. The rule merely preserves funding that would otherwise be lost to local housing agencies that have experienced significant loss of units.

E. Unfunded Mandates Reform Act

The Secretary, in accordance with the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 1532, has reviewed this proposed rule before publication and by approving it certifies that this proposed rule does not impose a Federal mandate that will result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year.

F. Regulatory Review

This proposed rule was reviewed by the Office of Management and Budget under Executive Order 12866, not on the basis of impact in excess of $100 million but on the basis of its importance. Any changes made in this rule as a result of that review are clearly identified in the docket file for this rule, which is available for public inspection in the HUD's Office of the Rules Docket Clerk, Room 10276, 451 Seventh Street, SW., Washington, DC 20410–0500.

Catalog

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

List of Subjects in 24 CFR Part 968

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

Accordingly, part 968 of title 24 of the Code of Federal Regulations is proposed to be amended as follows:

PART 968—PUBLIC HOUSING MODERNIZATION

1. The authority citation for part 968 continues to read as follows:

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

2. Section 968.103 is amended as follows:

a. Paragraphs (e)(3) and (e)(4) are redesignated as paragraphs (e)(4) and (e)(5), respectively;

b. New paragraphs (e)(3) and (f)(4) are added; and

c. Paragraph (k)(1) is revised, to read as follows:

§ 968.103 Allocation of funds under section 14.

* * * * *

(e) * * *

(3) *Replacement factor to reflect backlog need for developments with demolition, disposition, or conversion occurring on or after October 1, 1996.* (i) For PHAs that have a reduction in units attributable to demolition, disposition, or conversion of units occurring on or after October 1, 1996, and such reduction lowers the formula unit count for the Comprehensive Grant formula calculations, a factor will be added for the first five years after such reduction that consists of 50 percent of the published Total Development Cost for the period April 3, 1996 through April 30, 1997, for a two-bedroom unit in a walkup type structure, times the number of units to be demolished or disposed of. The total relative backlog need of the PHA resulting from application of this replacement factor cannot exceed the share it would have had if the demolition, disposition, or conversion had not taken place.

(ii) A PHA is eligible for application of this factor only if the PHA satisfies the following criteria:

(A) The PHA is not receiving funding for replacement housing for the reduced number of units under the public housing development, Major Reconstruction of Obsolete Public Housing, or HOPE VI programs; and

(B) The restored funding that results from the use of the replacement factor is used to provide replacement housing or accelerated renovation of vacant but viable units, in accordance with the HA's five-year action plan, approved by HUD (see § 968.315).

(iii) If the PHA does not use the restored funding that results from the use of the replacement factor to provide replacement housing or renovated vacant units in a timely fashion, in accordance with § 968.125, and make reasonable progress on such use of the funding, in accordance with § 968.335(a)(3), HUD may require appropriate corrective action under § 968.335 or may recapture and reallocate the funds.

* * * * *

(f) * * *

(4) *Replacement factor to reflect accrual need for developments with demolition, disposition, or conversion occurring on or after October 1, 1996.* (i) For PHAs that have a reduction in units attributable to demolition or disposition, disposition, or conversion of units occurring on or after October 1, 1996, and such reduction lowers the formula unit count for the Comprehensive Grant formula calculations, a factor will be added for the first five years after such reduction that consists of two percent of the published Total Development Cost for the period April 3, 1996–April 30, 1997, for a two-bedroom unit in a walkup type structure times the number of units to be demolished, disposed of, or converted. The total relative accrual need of the PHA resulting from application of this replacement factor cannot exceed the share it would have had if the demolition, disposition, or conversion had not taken place.

(ii) A PHA is eligible for application of this factor only if the PHA satisfies the following criteria:

(A) The PHA is not receiving funding for replacement housing for the reduced number of units under the public housing development, Major Reconstruction of Obsolete Public Housing, or HOPE VI programs; and

(B) The restored funding that results from the use of the replacement factor is used to provide replacement housing or accelerated renovation of vacant but viable units, in accordance with the HA's five-year action plan, approved by HUD (see § 968.315).

(iii) If the PHA does not use the restored funding that results from the use of the replacement factor to provide replacement housing in a timely fashion, in accordance with § 968.125, and make reasonable progress on such use of the funding, in accordance with § 968.335(a)(3), HUD may require appropriate corrective action under § 968.335 or recapture and reallocate the funds.

* * * * *

(k) *Demolition, disposition and conversion of units.* (1) *General*— (i) *One percent limit.* Where an existing unit under an ACC is demolished, disposed of, or converted into a larger or smaller unit, including the substantial rehabilitation of a Mutual Help or Turnkey III unit, HUD shall not adjust the amount the PHA or IHA receives under the formula, unless more than one percent of the units are affected on a cumulative basis. Where more than one percent of the existing units are demolished, disposed of, or converted, HUD shall reduce the formula amount for the PHA or IHA over a 3-year period to reflect removal of the units from the ACC.

(ii) *When a change in number of units is triggered.* A change in the number of units under ACC is counted when one of the following occurs:

(A) Completion of approved work to convert units to different sizes, resulting in an increase or decrease in the number of units;

(B) Execution of a sales contract for a disposition;

(C) Start of approved work for a demolition; or

(D) Conveyance of a Mutual Help, Turnkey III, or rental unit.

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Dated: September 4, 1997.

Kevin Emanuel Marchman,
Acting Assistant Secretary for Public and Indian Housing.

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