1. What is this request?

The Department requests $4.6 billion for the Public Housing Operating Fund for fiscal year 2016, which is a $160 million increase over the 2015 enacted level. This request, which represents an 86 percent proration against formula eligibility (net of the estimated $93.6 million RAD transfer), will allow the Department to continue to serve 1.1 million households (2.6 million residents) by providing operating subsidy payments to more than 3,100 Public Housing Authorities (PHAs) for the operation, management, and maintenance of publicly owned affordable rental housing throughout the United States and its territories.

This request is necessary to meet the operating needs of critical public housing properties throughout the country. The requested funding reflects inflation adjustments for Project Expense Levels (PELs), Utility Expense Levels (UELs), and changes in tenant incomes and their corresponding rent contributions\(^1\), which offset formula eligibility. This request also reflects a total of $63 million in

\(^1\) The PEL inflation factor (2.98 percent) incorporates economic assumptions from the Office of Management and Budget (OMB) for pay/non-pay cost indices and is based on a weighted average. For utilities, a blended methodology using Consumer Price Index cost data and OMB forecasts yields an inflation factor of 2.84 percent. The inflation factor for tenant income (1.06 percent) was validated against tenant income changes reported in the Public and Indian Housing Information Center (PIC) and found to be reasonable based on recent historical trends. Eligible Unit Months (EUMs) were derived from the most recent Public Housing unit occupancy data reflected within HUD’s systems and adjusted for anticipated changes in the inventory expected to become effective in 2015.

The increase in estimated eligibility is due primarily to inflation factors, but is mitigated by increased rent contributions and a projected net reduction of units through demolitions and dispositions out of the inventory and conversions under the Rental Assistance Demonstration.
Public Housing Operating Fund

anticipated savings in fiscal year 2016 from changes to the flat rent policy (enacted in fiscal year 2014, resulting in $40 million in savings) and a proposed increase in the medical expense exclusion threshold from 3 to 10 percent ($23 million in savings).

Key outcomes of the Operating Fund program are:

- Increasing occupancy in public housing;
- Decreasing energy costs; and
- Leveraging Federal resources.

Proposals in the Budget

- Revise the Threshold for Deduction of Medical and Related Care Expenses (associated savings estimated at $23 million)
- Provide Additional Operating/Capital Fund Flexibility
- Expand the Moving-to-Work (MTW) Program
- Authorize Triennial Re-Certifications of Fixed-Income Families
- Launch a Utilities Conservation Pilot

2. What is this program?

Authorized by Section 9 of the United States Housing Act of 1937, the Public Housing Operating Fund program supports the operation of 1.1 million units of public housing, contributing to the long-term viability and preservation of the portfolio. Of the families served by the program, approximately 60 percent are elderly and/or disabled households on a fixed income. The program also allows communities to consider their local priorities for serving housing needs, by establishing preferences for the elderly, disabled, homeless veterans, homeless persons generally, as well as the working poor. In addition, Public Housing remains a key component of the overall effort to eliminate homelessness, including veteran’s homelessness.

Operating Fund eligibility for PHAs is determined based on a formula. That formula was established through negotiated rulemaking in 2007 and is codified at 24 CFR 990. A 2003 study by the Harvard University Graduate School of Design (the “Harvard Cost Study”) provided the basis for negotiations. The Harvard Cost Study examined Public Housing operating expenses at a well-run public housing authority relative to Federal Housing Administration (FHA) insured affordable rental housing.

Operating Fund subsidy eligibility has four primary cost drivers:

1. Allowable Project Expense Levels (PEL), which were baselined against comparable FHA properties;
Public Housing Operating Fund

2. Reimbursement cost of utilities, or the Utilities Expense Level (UEL);
3. Tenant incomes and their corresponding rent contributions; and, finally
4. Number of months a unit is eligible for funding, or the Eligible Unit Months (EUMs).

The Public Housing program provides deeply affordable, publicly owned housing units. It is an essential piece of the housing market that provides support for some of the nation’s most vulnerable renters as well as local economies. Wage-earners residing in public housing earn too little to afford market-rate housing, yet they are contributing members of the local communities in which they reside. The program conveys direct and indirect benefits on those communities in the form of employment opportunities, either at the PHA or associated with the provision of services to residents, and in terms of the goods and services purchased by PHAs.

Public Housing serves vulnerable, low- and extremely low-income families. Currently, the program serves families with an average household income of approximately $13,724. In comparison, the median household income in the United States is $63,900. Extremely low-income families (families earning less than 30 percent of an area’s median income) make up approximately 70 percent of public housing households. More than 40 percent of all households served include children. The average household contributes more than $270 a month toward rent and utilities.

PHAs must undertake a significant level of administrative and program implementation requirements that go well beyond the activities that other real estate owners and operators, including those in other HUD supported multifamily programs, perform. These requirements are codified within both the 1937 Housing Act as well as program regulations. The Department is focused on identifying meaningful ways to reduce the level of administrative burden and streamline program requirements in ways that would not undermine accountability or program outcomes.

Some areas of PHA responsibility are:

- Annual recertifications
- Timely rent collection
- Submission of annual audited and unaudited financial statements to HUD
- Asset management over the physical and financial integrity of the program
- Validation of community service requirement completion
- Annual unit inspections
- Prioritization and planning for the long-term capital needs and viability of their properties

Public Housing Operating Funds are used to support such costs and activities as:

http://www.huduser.org/portal/datasets/il/il14/Medians2014_v2.pdf
Public Housing Operating Fund

- Day-to-day management and operations for public housing including intake and maintenance staffs;
- Routine and preventative maintenance;
- Energy costs associated with public housing units;
- Anti-crime and anti-drug activities, including the costs of security;
- Operating costs for public housing units within mixed-finance projects that are owned and operated by private owners;
- Supportive services to residents, including service coordinators;
- Resident participation activities, including resident councils so that residents can have a voice in management and policy setting at the PHA;
- Insurance; and
- Debt service incurred to finance the rehabilitation and development of public housing units.

HUD is engaged in several priority initiatives to ensure the long-term preservation and sustainability of the public housing portfolio and that grantees are good stewards of federal resources. Several key initiatives are described below.

Homelessness Initiative

As a pivotal United States Interagency Council on Homelessness (USICH) partner in the effort to prevent and end homelessness, the Department is looking beyond its traditional programs that directly address homelessness, in order to expand on the opportunities within the rental assistance programs, both Public Housing and Housing Choice Voucher programs, to serve those who are homeless, near homeless, or at risk of becoming homeless, including homeless veterans. The proposed budget enables HUD to continue the strategies that support the four major goals to prevent and end homelessness outlined below:

1. Build on past progress to prevent and end chronic homelessness;
2. Prevent and end homelessness for veterans;
3. Prevent and end family and youth homelessness; and
4. Set a path to ending all types of homelessness.

Across the Public Housing and Housing Choice Voucher program offices, HUD has committed staff on an ongoing basis to support this initiative. These staff supported the initial scoping of work related to the USICH and the Department’s Annual Performance Goal.
Public Housing Operating Fund

(APG) to reduce homelessness. The Department continues to conduct regional meetings with PHAs and their Continuum of Care partners to highlight best practices and successful local initiatives. Staff also collect and interpret data and develop guidebooks and notices.

Through our engagement of PHAs and Continuums of Care, HUD has seen an increase in the numbers of homeless families served by the Public Housing program. In fiscal year 2014, PHAs reported housing 2,215 families experiencing homelessness. At the same time, public housing reduces the number of vulnerable families that would otherwise fall into homelessness. In recent years, public housing admissions dropped by 5.5 percent overall, indicating that families experiencing homelessness are benefiting from greater program access even as overall new admissions are decreasing as a result of fewer families leaving public housing.

Energy and Sustainability Initiatives

The President has set an ambitious goal of cutting energy waste in half over the next 20 years. The President’s plan calls on federal agencies to rapidly increase investments in energy productivity, increase the use of renewable energy technology within the Public Housing portfolio, ramp up energy-efficiency standards, and deploy the tools and technology needed to engage consumers, the private sector, and government leaders. Building upon the work of the Energy Performance Contracting (EPC) program, the Budget includes a proposal for a Utilities Conservation Pilot (see below) that would expand opportunities for PHAs of all sizes to undertake needed energy conservation measures.

The Department’s strategy to achieve its targets includes conducting regional communications to increase PHA awareness of the program’s flexibility and current guidance, providing technical assistance tools to facilitate EPC project planning and implementation among small agencies, as well as examining opportunities for the Department to grant increased flexibility within our current statutory framework.

One of the Department’s Agency Performance Goals (APG) is to complete cost-effective energy, green, and healthy retrofits (APG 4). From 2010 to 2011, the EPC program contributed nearly half of the 119,965 Public and Indian Housing (PIH) energy-efficient units over a 2-year period, which helped the Department exceed its APG 4 goal and resulted in 201,444 energy, green, and healthy retrofit units overall. The program has continued to contribute large numbers to APG 4.

Moving-to-Work

MTW is a demonstration program that provides PHAs the opportunity to design and test innovative, locally designed strategies that use federal dollars more efficiently, help residents find employment and become self-sufficient, and increase housing choices for low-income families. MTW gives PHAs exemptions from many existing public housing and voucher rules and more flexibility with how they use their federal funds. MTW PHAs are expected to use the opportunities presented by MTW to inform HUD about ways to better address local community needs.
Public Housing Operating Fund

Rental Assistance Demonstration

The Department continues its Rental Assistance Demonstration (RAD) to test new preservation tools for the HUD-assisted housing stock. It will use its statutory authority under the Consolidated and Further Continuing Appropriations Act of 2012 (Public Law 112-55) to transfer amounts from the fiscal year 2016 Operating Fund and Capital Fund appropriations to the Tenant-Based Rental Assistance (TBRA) or Project-Based Rental Assistance (PBRA) accounts to fund renewal costs for public housing units converting under RAD in calendar year 2015. For additional information, refer to the Rental Assistance Demonstration justification.

3. Why is this program necessary and what will we get for the funds?

Despite a national shortage of affordable rental housing, only one in four families eligible for federal rental assistance programs receives such assistance. HUD’s forthcoming report to Congress, Worst Case Housing Needs 2013, reveals that among very low-income renter households that lacked assistance in 2013, 7.7 million had worst case housing needs resulting from severe rent burden (paying more than one-half of their monthly income for rent) or living in severely inadequate housing units. From 2003-2013, worst case needs have increased by 48.9 percent as public-sector housing assistance and private-sector housing development have substantially failed to keep up with the growing demand for affordable rental housing.

As of the end of fiscal year 2013 through increased efforts between HUD’s Office of Field Operations and PHAs, the Department increased public housing occupancy to more than 1.091 million units. The program’s increased occupancy highlights the Department’s focus on making the most efficient use of program resources. Working with HUD, PHAs have become even more successful at ensuring that all affordable housing resources are available to meet surging demands within their community. As a consequence of the recent recession and foreclosure crisis, increasing numbers of families face shrinking household incomes, altered employment opportunities, and are more likely to rent rather than own their home.

The Department has been working toward several goals identified in its Strategic Plan. While achievement of these goals depends on strong performance across several programs, adequate funding of the public housing program is critical to success in several key areas:

- “Meet the Need for Quality Affordable Rental Homes” (Goal 2);
- “Utilize Housing as a Platform of Improving Quality of Life” (Goal 3); and
- “Build Inclusive and Sustainable Communities Free From Discrimination” (Goal 4).

Not only would funding at a lower level potentially reduce the number of families served, it will also lead to the following negative consequences:
Public Housing Operating Fund

- Diminished quality of life for residents;
- Increased capital needs;
- Longer periods of vacancy;
- Increased worst-case housing needs and homelessness;
- Diminished community security; and
- Job losses.

Further, funding at a lower level may also undermine the capacity of PHAs to address their properties’ capital needs through conversion under HUD’s Rental Assistance Demonstration (RAD). While PHAs can voluntarily convert to project-based Section 8 funding under RAD, Congress provided no additional, incremental subsidy to facilitate such conversions. Properties convert at their existing subsidy levels, which — in the interest of preservation — must be demonstrably adequate to address capital needs without undermining long-term operating sustainability. To the extent existing subsidy levels are reduced, it will reduce the pool of public housing properties that are eligible for conversion through RAD.
HUD’s income limits are adjusted based on actual median incomes for the state and locality (metropolitan area). *30 percent of AMI is approximately $19,170 per year for a 4-person household, (national estimate - adjusted based on actual state and local incomes) and $13,420 for a single person. Note, that the US national poverty guideline for 2014 was set at $23,850 for a 4-person household (the guidelines are not adjusted locally, but provide a single limit for the 48 contiguous states and DC).
4. How do we know this program works?

As part of the Department’s goal in fiscal years 2011 and 2012, the Department increased occupancy within the Public Housing program by over 21,000 additional families. The program has achieved a sustained 96 percent occupancy rate, which is beyond the level commonly attained within the rental housing market. Our goal is to maintain this higher occupancy rate and not lose ground as we continue to maximize the availability of this important affordable housing resource.

The Department intends to take measures to meet this goal that will not only serve more families, but will also improve the overall management and oversight of the program. While working toward identifying goal targets, the Department completed a thorough analysis of its policies, a comprehensive review of data, and other steps needed to increase capacity building. Moving forward, this new information will enable the Department to be more confident in linking performance standards to the budget request.

Additionally, HUD will continue its work to increase the supply of energy-efficient affordable housing units and promote green and sustainable housing practices. HUD exceeded its most recent two-year Annual Performance Goal of 159,000 energy efficient and healthy units, by completing 161,400 units of which almost half (78,000) were public housing units.

Metrics used to measure the performance of Public Housing include the Enterprise Income Verification (EIV) System and the Public Housing Assessment System (PHAS), which collectively measure the level of improper payments, physical state of units, and the financial condition of the organizations. HUD will continue to take aggressive steps to address the causes of improper rental housing assistance payments and ensure that the right benefits go to the right people. To ensure attainment of the aforementioned goals, HUD is focusing on the PHAs, owners, management agents, and contract administrators’ compliance with the mandated EIV system use to further reduce income reporting errors.

HUD Oversight, Monitoring, and Risk Assessment of PHAs

PIH has recognized that a more proactive risk analysis and identification model is necessary in order to facilitate earlier detection of problems, target interventions and improve oversight at PHAs. Accordingly, PIH is continuing to move forward with the Comprehensive National Risk Assessment and the Public Housing Agency Recovery and Sustainability initiative (PHARS). Other proposed improvement initiatives include the Compliance Monitoring pilot and revisions to Section 6(j) in fiscal year 2015. Collectively, PIH believes these efforts will improve its ability to oversee and monitor the more than 4,000 PHAs that administer these programs.
Public Housing Operating Fund

This strategy prioritizes PHAs nationally based on risk with an emphasis on recent data and historic trends. Using quantitative and qualitative analysis to determine financial, physical, governance, and management risk PIH will develop mitigation strategies to address the risk based on the severity and available resources. The mitigation strategy, built from the PHARS model, a place-based approach to turning around troubled and substandard PHAs, which focused on identifying the root cause and executing a recovery strategy focused on outcomes.

Field Offices will focus on individual PHAs with the greatest risk at both the entity and project level using both on-site and remote monitoring tools. For the Public Housing program, and specific to the Operating Fund, this will include looking at occupancy rates, as well as metrics like tenant account receivables and physical inspection scores.

The primary source of data for the Public Housing program is the PIH Information Center (PIC) system. The Department has been working toward clarifying definitional boundaries in the PIC system through the development of stricter protocols, particularly for analyzing vacancy data. Program monitoring directives such as this provide the greatest potential for success in optimizing Public Housing funds. The Department will continue to work to validate data entered into the PIC system on a routine basis, to guarantee the quality, accuracy and reliability of the data, which drives policy and program decisions at the national level.

5. Proposals in the Budget

- **Revise the Threshold for Deduction of Medical and Related Care Expenses (associated savings estimated at $23 million).**
  
  This provision would generate estimated savings of $23 million in fiscal year 2016. The change would increase the threshold for the deduction of medical and related care expenses from 3 to 10 percent of family income. This provision was included in the Department’s fiscal year 2015 budget request, and is repeated for 2016. (SEC. 229)

- **Provide Additional Operating/Capital Fund Flexibility.** The 2016 Budget proposes to allow PHAs with more than 250 public housing units greater flexibility to use their public housing Operating and Capital funds interchangeably. In addition, HUD is proposing to allow PHAs the flexibility to use their Operating Reserve funds not only for operating purposes, but also for capital improvements.

  Larger PHAs are restricted to using funds from Capital Fund and Operating Fund grants for the prescribed eligible uses of §§ 9(d) and (e), respectively, of the 1937 Act irrespective of the nature of an individual PHA’s needs, except that they may use up to 20 percent of their annual capital grants for eligible Operating Fund expenses.
Public Housing Operating Fund

Specifically, the 1937 Act limits the use of Operating Funds for capital improvements to only paying debt service rather than for direct expenditure on the capital improvements, even when available Operating Funds are sufficient to meet the need. As a result, PHAs must pay financing charges to use existing funds for rehabilitation and development of the housing stock. Typically, these transactions are fully collateralized with on-hand operating reserves, meaning the PHA is effectively paying the financing fees and incurring a liability to access their funds HUD. With a $26 billion backlog in capital needs, PHAs need greater flexibility to address as much need as possible with the limited resources available.

HUD proposes to allow PHAs with more than 250 public housing units to transfer up to 30 percent of their Capital Funds to their Operating Fund. PHAs would be allowed to use these funds for operating expenses. In addition, such PHAs would be allowed to use their operating reserves for capital expenditures.

This proposal would not increase HUD or PHA expenditures, but shift funding. Based on the fiscal year 2014 allocation of funds, this would impact 791 PHAs. Using the fiscal year 2016 request for funding, approximately $162 million could be transferred from the Capital Funds of these PHAs to their Operating Funds and Operating Fund reserves.(SEC. 223)

- **Expand the MTW Program to High-Capacity PHAs.** In partnership with HUD, participating PHAs will design and implement innovative policies related to housing preservation, family self-sufficiency, mobility, cost-effectiveness and other priority areas. Key tenant protections will continue to apply and PHAs will be subject to rigorous reporting and evaluation requirements. Up to fifteen PHAs, managing no more than 150,000 combined Housing Choice Voucher and Public Housing units, would be selected competitively.(SEC. 242)

- **Allow for triennial recertification of fixed income households.** This proposal would apply to HCV, Project-Based Rental Assistance, and public housing. Similar to proposals found in earlier comprehensive voucher program reform bills, it would authorize PHAs and owners to recertify fixed-income families every 3 years. Eligible families would be defined as those families for whom at least 90 percent of income is from sources such as Social Security; federal, state, local, and private pension plans; and the supplemental security income program. If implemented, this policy change would significantly reduce administrative burden on PHAs and owners. It is estimated that more than half of all public housing households can be classified as elderly or disabled households, and are likely to be fixed income families.(SEC. 243)

- **Utility Conservation Pilot.** HUD proposes to implement a pilot program modeled on the Operating Fund’s Frozen Rolling Base with a portion of the savings accruing to the federal government. The objectives are to:
  
  - Extend energy incentives to a broader range of PHAs,
Public Housing Operating Fund

- Reduce the amount of financing that would be required to implement repairs, and
- Significantly streamline the application process.

The Department believes more PHAs will be able to undertake energy conservation measures (ECMs) and reduce their energy consumption while also addressing a portion of public housing’s $26 billion backlog of capital needs. HUD is committed to helping PHAs find solutions to substantially reduce their utility and water consumption, thereby reducing program costs, as well as decrease their environmental impact. The Energy Performance Contracting (EPC) Program has been very successful at helping large and medium sized agencies leverage energy savings to finance ECMs. However, current budgets make the requirement to take on debt to finance repairs difficult. Further, many small agencies have been unable to secure financing based on the size of their transaction. This pilot could reduce the need to take on debt in many cases, and, potentially, eliminate the need entirely in others.

The Utility Conservation Pilot would allow PHAs to freeze their rolling base at current consumption levels if they commit to achieving a reduction in their energy consumption. The time period for freezing the base would be based on the percentage of reduction the PHA estimates it will achieve. The frozen rolling based would be reduced by 1 percent a year until it is equal to a PHA’s actual consumption, for up to a maximum of 20 years.

For example, if a PHA commits to achieve a 5 percent reduction in consumption, their utility reimbursement under the Operating Fund would gradually roll down over a period of 5 years. In year one, the PHA would receive 100 percent of the subsidy calculated using the frozen rolling base. In year 2, the PHA would receive 99 percent until finally, in year 6 the PHA’s operating subsidy would reflect the PHA’s actual energy consumption at 95 percent of their original consumption level.

Models for this pilot show estimated cost savings over 10 years from 2016 - 2025 of potentially $265 million. Of these savings, HUD would retain 92 million over the 10 year period. This includes “avoided cost” savings of $26.9 million due to replacing aging or failing equipment and facilities. PHAs will reduce their carbon emissions by 586,000 tons of CO\textsuperscript{2} and the pilot stands to create 2,227 jobs over the 10 year period. These estimates are based on the following conservative assumptions:

- 2.5 percent or 28,436 public housing units will join the pilot annually starting in 2016 with 284,000 units over 10 years;

- PHAs achieve a reduction of energy consumption equivalent to 11 percent of total amount they spend on energy costs based on a multifamily archetype. 11 percent savings are achieved by year 12 which is the typical project term for current PHA ECM contracts;

- PHAs invest $800 in capital costs per unit annually with a $227 million investment over 10 years.(SEC. 244)
Energy Utility Cost Savings from PIH’s Utility Conservation Pilot ($M)

Including energy utility cost savings and avoided cost savings

Total Cumulative Savings (2016-25): $265M
HUD Share: $92M

- HUD Share (energy utility costs): $65M
- HUD Share (avoided costs): $27M
## OPERATING FUND FORMULA ELIGIBILITY

<table>
<thead>
<tr>
<th>#</th>
<th>Description</th>
<th>Actual FY 2014</th>
<th>Estimate FY 2015</th>
<th>Estimate FY 2016</th>
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<tr>
<td>1</td>
<td>Non-Utility Expense Level (PEL)</td>
<td>$5,309,075,417</td>
<td>$5,489,252,759</td>
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<td>Utilities</td>
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<td>3</td>
<td>Less: Tenant Income</td>
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<td>4</td>
<td>Public Housing Operating Fund Base (line 1-3)</td>
<td>3,954,348,636</td>
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<td>4,203,953,659</td>
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<td>5</td>
<td>MTW Alternative Formula Grant, PHAs not in Base</td>
<td>$535,094,450</td>
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<td>6</td>
<td>Public Housing Add-ons</td>
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<td>7</td>
<td>Elderly/Disabled Coordinators</td>
<td>$16,442,843</td>
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<td>8</td>
<td>Resident Participation</td>
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<td>9</td>
<td>Energy-Add On for Loan Amortization</td>
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<td>Payments in Lieu of Taxes</td>
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<td>Cost of Independent Audit</td>
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<td>Asset Management Fee</td>
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<td>Mutual Help and Turnkey Units</td>
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<td>Stop Loss</td>
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## Public Housing Operating Fund

### PUBLIC AND INDIAN HOUSING

#### PUBLIC HOUSING OPERATING FUND

**Summary of Resources by Program**

(Dollars in Thousands)

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<tr>
<th></th>
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<td>PHA Financial Hardship Assistance</td>
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<td>Rental Assistance Demonstration</td>
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<td>Transformation Initiative (transfer)</td>
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<td><strong>Total</strong></td>
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**NOTES:**

The Rental Assistance Demonstration transfers reflected are the estimated amounts needed in 2015 and 2016 to support public housing properties converting to the Section 8 platform in either the Tenant-Based or Project-Based Rental Assistance accounts in the first full year following conversion. In the second full year following conversion, those properties’ units will be picked up as part of the Tenant-Based or Project-Based renewal formulas (e.g., units converting in 2014 are reflected in the PBRA and TBRA accounts in 2016).
The fiscal year 2016 President’s Budget includes proposed changes in the appropriation language listed and explained below. New language is italicized and underlined, and language proposed for deletion is bracketed.

For [2015] 2016 payments to public housing agencies for the operation and management of public housing, as authorized by section 9(e) of the United States Housing Act of 1937 (42 U.S.C. 1437g(e)), [4,440,000,000] $4,600,000,000.

(Department of Housing and Urban Development Appropriations Act, 2015.)