

**DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT****24 CFR Part 905**

[Docket No. FR-4843-F-02]

RIN 2577-AC49

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

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

**ACTION:** Final rule.

**SUMMARY:** This final rule implements a program to allow public housing agencies (PHAs) to use proceeds of their Capital Fund program for financing activities, including payment of debt service and housing development and modernization activities. A PHA may grant a security interest in future Capital Fund grants, subject to the appropriation of those funds by Congress. This final rule follows a July 18, 2007, proposed rule that addressed the use of public housing Capital Funds and Operating Funds for financing activities, and takes into consideration the public comments received on that rule.

This final rule addresses only the use of public housing Capital Funds for financing activities. Given the public comment received on the proposed rule, HUD determined that further consideration must be given to HUD's proposal for use of operating funds for financing activities. The final rule makes changes to the proposed rule in response to public comments, including a streamlined approval process for standard and high-performing PHAs that have borrowings against their Capital Funds within certain limits, or that propose to use their Capital Fund financing proceeds in a mixed-finance development. The final rule, also in response to comment, provides greater specificity than the proposed rule with respect to submission requirements for requests for Capital Fund financing transactions.

**DATES:** *Effective date:* December 20, 2010.

**FOR FURTHER INFORMATION CONTACT:** Jeffrey Riddel, Director, Office of Capital Improvements, Office of Public and Indian Housing, Department of Housing and Urban Development, 451 7th 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. Background**

Section 9 of the U.S. Housing Act of 1937 (1937 Act) (42 U.S.C. 1437g) states that Capital Funds can be used for activities including "development, financing, and modernization" (see 42 U.S.C. 1437g(d)(1)(A)). Section 30 of the 1937 Act provides that HUD may authorize a PHA to mortgage or otherwise grant a security interest in any public housing project or other property of the PHA upon such terms and conditions as the Secretary may prescribe. (See 42 U.S.C. 1437g(g), which sets limitations on the use of Capital Funds.)

Under section 9(g)(3)(A) of the 1937 Act (42 U.S.C. 1437g(g)(3)(A)), Capital Funds may not be used for new construction of housing 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. There are two exceptions to this statutory requirement. First, section 9(g)(3)(B) of the 1937 Act (42 U.S.C. 1437g(g)(3)(B)) provides an exception for units that are affordable for low-income families in excess of this limitation, but the Capital Fund formula shall not provide additional funding for the specific purpose of construction and operation of housing in excess of this limitation. Second, section 9(g)(3)(C) of the 1937 Act (42 U.S.C. 1437g(g)(3)(C)) provides an exception to the Capital Fund formula limitation for the operation and modernization of mixed-finance housing, or housing that otherwise leverages significant other investment, if the estimated cost of the useful life of the project is less than the estimated cost of providing tenant-based section 8 assistance for the same period of time.

In any financing transaction that involves pledges of future appropriations of Capital Funds, the Antideficiency Act (31 U.S.C. 1431) applies. The Antideficiency Act states, in relevant part, as follows: "An officer or employee of the United States Government or of the District of Columbia government may not make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation; involve either government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law. \* \* \*

Because funds cannot be obligated in advance of an appropriation being

made, any financing commitments based on Capital Fund expenditures over a period of years must explicitly be made subject to the availability of appropriated funds.

More detailed information regarding the background of this rulemaking, including HUD's initial proposal, can be found in the preamble of the proposed rule published on July 18, 2007, at 72 FR 39546-39547.

**II. This Final Rule**

As noted in the "Summary" of this final rule, the proposed rule published on July 18, 2007, addressed the use of both public housing Capital Funds and Operating Funds for financing activities; this final rule proceeds to promulgate regulations for the Capital Fund Financing Program (CFFP) only. Public comments raised issues on the Operating Fund Financing Program (OFFP) component of the July 18, 2007, proposed rule, such that HUD determined further consideration must be given to those comments before promulgating final regulations on the OFFP component. HUD, however, is ready to proceed with issuing final regulations for the Capital Fund component of the July 18, 2007, proposed rule.

Some of the key changes made to the CFFP component at this final rule stage include the following:

- The entire section is recodified as subpart E of part 905, and section numbers redesignated accordingly, so that, for example, proposed § 905.700 is in this final rule § 905.500.
- This final rule permits PHAs to pledge up to 100 percent of their replacement housing factor (RHF) funds for debt service, provided that such pledge constitutes no more than 50 percent of the PHA's combined future Capital Funds (*i.e.*, formula funds and RHF funds). Acceleration of Capital Fund-financed debt is allowed, but only with HUD approval. HUD will allow PHAs to pledge 100 percent of their RHF due, in part, to the fact that the maximum term that PHAs can underwrite RHF for is 10 years, which is the maximum period of time a PHA can receive a tier of RHF. This is half the maximum term of 20 years permitted where PHAs pledge Capital Fund formula funds for the payment of debt service, and therefore considerably more conservative. The 50 percent cap is being established to limit the amount of RHF funds that PHAs can pledge. This limitation will be triggered for those PHAs where RHF makes up such a significant portion of their overall Capital Fund that the pledge will cause the total amount pledged to exceed 50

percent of the PHA's combined future Capital Funds and RHF funds. The table below provides examples of the potential impact of the 50 percent cap.

	Capital fund formula grant	RHF grants	Total capital fund grants	Max debt service from capital fund grants (50% of total)	Debt service from RHF grants	Debt service from formula grant	Total debt service
Scenario 1 .....	\$5,000	\$500	\$5,500	\$2,750	\$500	\$1,667	\$2,167
Scenario 2 .....	1,000	500	1,500	750	500	250	750
Scenario 3 .....	500	500	1,000	500	500	0	500
Scenario 4 .....	200	500	700	350	350	0	350

(1) In Scenario 1, because the RHF is much less than the Capital Fund formula grant, the PHA can leverage 100 percent (\$500) of its projected RHF and 33 percent (\$1,667) of its projected Capital Fund formula grants.

(2) In Scenario 2, the 50 percent cap is triggered. The PHA will leverage 100 percent (\$500) of its projected RHF, but may leverage no more than 25 percent (\$250) of its projected Capital Fund formula grants because borrowing more would exceed the 50 percent cap.

(3) In Scenario 3, the 50 percent cap is triggered. The PHA will be able to leverage 100 percent (\$500) of its RHF, but will not be able to leverage any Capital Fund formula grants because borrowing more would exceed the 50 percent cap.

(4) In Scenario 4, the 50 percent cap is triggered. The cap results in the PHA being able to use only a portion of its RHF and none of its Capital Funds formula grants for debt service because borrowing more would exceed the 50 percent cap. This is due to the fact that the Capital Fund formula grants represent only a small portion of the PHA's overall funding.

- Where the proposed rule would have permitted PHAs to pledge "more than" 33 percent of its projected future annual Capital Fund grants for debt service upon a showing to HUD that the PHA has sufficient Capital Fund grants to meet its needs, it was silent on the issue of existing grants. The final rule makes explicit that PHAs may pledge up to 33 percent of its future Capital Fund grants, and may pledge 100 percent of its RHF grants, provided that such pledge constitutes no more than 50 percent of the PHA's combined future Capital Funds (*i.e.*, formula grant funds and RHF funds). Subject to a reasonableness test, PHAs may pledge more than 33 percent of their existing Capital Fund grants.

- A streamlined procedure is provided for mixed-finance proposals and Capital Fund Financing Proposals from PHAs: (1) That are standard or high performers under the Public Housing Assessment System (PHAS) and have cumulative CFFP transactions of less than \$2 million, or (2) that are high PHAS performers and have cumulative CFFP transactions of less than \$20 million. For standard or high performing PHAs, management assessments under the following regulations—24 CFR 905.505(e), fairness opinions under 24 CFR 905.505(k), and demonstration of construction management and financial controls under 24 CFR 905.505(l)—may not be required as part of the Capital Fund Financing Proposal. HUD retains the discretion to require assessments, opinions, or controls in certain cases. In addition, physical needs assessments and quarterly reporting have been removed as requirements for PHAs that use the CFFP in mixed-finance transactions, and for PHAs that size

their CFFP based only upon the projected receipt of RHF. Finally, as part of its processing of Capital Fund Financing Proposals on a case-by-case basis, HUD had been requiring PHAs to include in their cover letter the status of other HUD approvals needed to utilize CFFP proceeds, such as the approval of development proposals where the proceeds are proposed to be used for development. This final rule removes that information as a required part of the Capital Fund Financing Proposal. In the future, HUD will make the determination of required approvals based upon the PHA's description of the proposed use of proceeds. HUD will condition any CFFP Financing approvals upon the receipt of any other HUD approvals needed to use the proceeds.

- In response to comments to clarify the requirements of a Capital Fund Financing Proposal in the rule, and limit the number of requirements for PHAs to make submittals in accordance with terms and conditions as determined by HUD, § 905.510(b) is revised to list the submittal requirements for a Capital Fund Financing Proposal. The Capital Fund Financing Proposal requirements as presented in this final rule are based upon the proposal requirements for the program as it is currently being implemented on a case-by-case basis. In addition to the streamlining for certain transactions referenced above, changes in this final rule from what HUD has required on a case-by-case basis for all proposals include: (1) The cover letter is no longer required to include a narrative on the status of ancillary approvals required to use the CFFP proceeds; and (2) an effective cost of financing schedule is no longer required to be

submitted as part of the CFFP Financing Proposal.

- The 40-year use restriction in section 9(d)(3) of the 1937 Act (42 U.S.C. 1437g(d)(3)) is stated at § 905.505(c). This section follows the statutory language and provides for exceptions as "provided in" the 1937 Act. Such exceptions would include, for example, demolition of obsolete units under section 18 of the 1937 Act (42 U.S.C. 1437p) and required conversion under section 33 of the 1937 Act (42 U.S.C. 1437z-5).

- The required contents of the transmittal letter under 24 CFR 905.510(b)(1) are specified. The letter must contain a description of the proposed financing and use of proceeds, the percentage of Capital Funds being dedicated to debt service, the percentage of the PHA's public housing units benefiting from the financing the impact of the financing on the public housing portfolio, and any additional information that may be required.

- Financing schedules, including debt service and sources and uses, are required by § 905.510(b)(3) of this final rule.

- A Capital Fund Plan currently consisting of a CFP Annual Statement/Performance and Evaluation Report (form HUD-50075.1, and CFP 5-Year Action Plan (form HUD-50075.2) are described in § 905.505(h) and (n). The PHA must provide evidence that the PHA has conformed to the requirements related to the Declaration of Trust (DOT) as described in § 905.505(c)(4) and mentioned in § 905.510(b)(6).

- The PHA must provide a board resolution authorizing the PHA to finance a loan up to a specified amount, to provide all the security interests required by the loan, and authorizing the Executive Director of the PHA to

negotiate and execute required legal documents as required by § 905.510(b)(7).

- The PHA must provide an opinion of counsel stating that the PHA has authority to enter into the transaction and that the transaction complies with the 1937 Act, Federal regulations, and the applicable Annual Contributions Contract (ACC) as described in § 905.510(b)(7).

- If a PHA is proposing direct debt service payments through HUD's Line of Credit Control System (LOCCS), the PHA must execute a Capital Fund Financing Amendment to the ACC as required by § 905.510(b)(8).

### III. Summary of Public Comments

The public comment period closed on September 17, 2007, and HUD received 21 public comments. HUD received public comments from a variety of sources, including private citizens, six PHAs, three trade associations, four law firms, and several housing development consultants. A summary of the issues raised and HUD's responses to these issues are as follows.

*Comment:* The proposed rule will not succeed as long as the Operating Fund and Capital Fund are so severely underfunded.

*Response:* These comments concern appropriation levels, and are therefore outside of the scope of this rule. Furthermore, there exists a multiplicity of sources that PHAs can combine with Capital Funds to help meet the needs of their public housing portfolio. These include public housing sources, such as energy performance contracts, as well as nonpublic housing sources such as low income housing tax credits (LIHTCs), funds from the Federal Home Loan Banks' Affordable Housing Program, and local funds. Creative, proactive housing authorities can utilize Capital Funds and Capital Fund financing in conjunction with other sources to meet the needs of their public housing portfolios.

In regard to the Operating Fund, HUD received many comments from respondents that, at current levels of pro-ration, the OFFP is not feasible. These comments warrant careful consideration. In order to provide the level of rigor necessary to meaningfully respond to the comments received on the OFFP, and yet not encumber the processing of the CFFP rule, HUD has decided to decouple the processing of the CFFP rule from the OFFP rule.

*Comment:* Private lenders must accept the risk of continued and sufficient congressional appropriations to pay off the debt. Given the uncertain level of congressional funding for the Capital

Fund and Operating Fund programs, lenders will likely charge higher fees and impose additional credit enhancements or performance standards, resulting in higher costs to finance capital improvements.

*Response:* While it is true that the Antideficiency Act (31 U.S.C. 1431) requires all future-year financing to be subject to the availability of appropriations, investors have developed a level of comfort with the CFFP. Certainly, the CFFP has been more stable than other similar investments in the recent past. Since HUD began implementing the CFFP in 2000, rates have remained remarkably stable. The CFFP has been structured in a way so that most transactions receive unenhanced, underlying AA<sup>1</sup> ratings from Standard & Poor's. Other costs for CFFP transactions have been comparable to similar financing mechanisms in the marketplace. While investor perception may change if appropriations decrease below current levels, to date the CFFP has provided a financing tool with pricing similar to financing options available to HUD's multifamily portfolio.

*Comment:* The process for approving Capital Fund financing arrangements is too extensive and cumbersome and may require an entire year or more from planning through closing. Commenters made recommendations to simplify the approval process by making it similar to that of mixed-finance housing programs; to eliminate the requirement for a fairness opinion for transactions borrowing less than \$2 million; to eliminate the requirement for third-party management reviews as duplicative and costly; and to eliminate management assessments for any transaction where the Capital Funding being financed is less than \$20 million, and the PHA is not classified as a poor-performing PHA.

Similarly, several commenters stated that PHAs have experienced delays in getting HUD approvals and that these delays add costs or may negatively impact the deals. These commenters recommended that HUD establish clear time frames for the review and approval process, recommending a range of dates such as 30, 45, or 60 days. The commenters all noted that clear timelines will improve the willingness

of private partners to enter into these transactions.

*Response:* HUD initially implemented the CFFP on a case-by-case basis, to allow maximum flexibility in initial implementation of the program, and provide PHAs and HUD an opportunity to learn from collective experience at the inception of the program. However, one of the consequences of this approach was that the process of reviewing and approving transactions took longer than HUD believes would have otherwise been the case if HUD had initiated implementation of the program through rulemaking. HUD believes that rulemaking will make implementation more standardized and consistent, but, if done earlier, might have hampered the ability to more expeditiously implement changes during the early evolution of the program. HUD now has sufficient experience both to implement rulemaking, and to ensure a more streamlined review process. Reviews now take approximately 2 to 3 months on average, the same length of time as in the Mixed-Finance Development Program, for which HUD's regulations are found in 24 CFR part 941, subpart F. However, there continue to exist opportunities to further streamline the process and make it more efficient.

This final rule therefore makes the following streamlining changes:

(1) The rule removes the effective cost of financing schedule as a program requirement. HUD will continue to make this tool available to PHAs as a mechanism whereby they can complete an "apples-to-apples" comparison of different financial structures. Nonetheless, PHAs remain obligated pursuant to 2 CFR part 225 (cost principals for state, local, and Tribal governments, OMB Circular A-87) to assure the cost reasonableness of their financial transactions, and the reasonableness of the proposal remains a requirement for approval.

(2) Management assessments (proposed § 905.705(e)), fairness opinions (proposed § 905.705(k)), and information about financial and construction management controls (proposed § 905.705(l)) are no longer required where Capital Fund Financing Proposals being pursued as part of mixed-finance transactions, the PHA is a standard or high performer under PHAS and is undertaking a CFFP transaction of less than \$2 million cumulatively, or the PHA is a high performer under PHAS and is undertaking less than \$20 million in cumulative CFFP transactions. HUD retains the discretion to require assessments, opinions, or controls in

<sup>1</sup> In the Standard & Poor's rating system, an AA rating is the second-highest rating (AAA being the highest), and indicates that the obligor's capacity to meet its financial commitment on the obligation is very strong. Unenhanced, underlying ratings refer to debt obligations not supported by financial guarantees, structuring techniques, multiple-party features, or other external credit support. See <http://www.standardandpoors.com>.

certain cases. The removal of submittal requirements for financial and construction management controls applies only to the demonstration of such controls within the Capital Fund Financing Proposal itself. PHAs still must adhere to public housing requirements in regard to the use of CFFP proceeds.

(3) Proposed § 905.705(c)(5) (final § 905.505(c)(4)) has been modified for CFFP use with a mixed-finance project such that the evidence of Declarations of Trust (DOTs) will be part of the mixed-finance evidentiary approval process.

(4) Proposed § 905.705(h)(2) (final § 905.505(h)(2)) has been modified to remove the requirement for the submission of a budget detailing the use of CFFP proceeds for certain PHAs. This requirement has been eliminated for PHAs that size their loans based only upon RHF funds, as well as those that use the CFFP proceeds as part of a mixed-finance transaction. CFFP approval letters for these transactions will be conditioned upon the approval of the related development proposal.

(5) Proposed § 905.705(p) (final § 905.505(p)) has been revised to eliminate quarterly reporting requirements under this program where the CFFP proceeds are being used as part of a mixed-finance transaction, and for PHAs that size their transactions based only upon RHF funds.

(6) This final rule removes proposed § 905.710(b)(4). Proposed § 905.710(b)(4) would have requested redundant information.

*Comment:* HUD's submission and reporting requirements for this program are excessive. Commenters stated that HUD is bringing fewer resources to the project but is imposing requirements as though funding the entire project. They recommended that HUD reporting requirements be proportional to its financial stake in the project and that they reflect a more business-like approach to partnering with the private sector.

*Response:* This final rule reduces reporting requirements for PHAs that combine CFFP with mixed-finance projects. PHAs that pursue mixed-finance projects have both HUD and investor reporting requirements associated with the mixed-finance transaction, and HUD agrees that the CFFP reporting requirements could be reduced. In fact, this final rule streamlines those requirements, as described above in the preamble.

However, for non-mixed-finance projects, quarterly reporting is still necessary. Unlike Capital Funds, CFFP proceeds do not appear in the Line of Credit Control System (LOCCS).

Therefore, quarterly reports are the only mechanism at HUD's disposal by which it can monitor the project.

*Comment:* Several items in the rule provide that requirements must be accomplished by the PHA "in a form and manner to be determined by HUD" or that additional "terms and conditions" may be determined by HUD. HUD should work with PHAs and other outside parties to clarify these points before the rule is published as a final rule.

*Response:* HUD agrees with the comment that a clearly defined set of rules will result in a more efficient process for assembling Capital Fund Financing Proposals, and for HUD's review of those proposals. Since the Capital Fund Financing Proposal process which HUD has implemented on a case-by-case basis is a defined process with known submittal requirements, this final rule revises § 905.710 (now § 905.510 in the final rule) to state the general submittal requirements, while retaining HUD's administrative discretion in approving Capital Fund Financing Proposals that may present unique or complex financing for modernization and development.

This final rule revises § 905.510(b)(1) to describe in more detail the requirements for the transmittal letter and § 905.510(b)(2) to provide the requirement for incorporating a table of contents and contact information in the proposal. This final rule also revises § 905.510(b)(3) to reflect the required financing schedules that must be submitted. These include the debt service schedule, sources and uses schedule, and portfolio schedule. The effective-cost-of-financing schedule was dropped as a submittal requirement, although HUD will continue to make it available on its Web site to assist PHAs in assessing the overall financial costs of different financial structures.

This final rule revises § 905.510(b)(4) to summarize other submittal items required pursuant to proposed § 905.705 that were not delineated elsewhere in proposed § 905.710. New § 905.510(b)(6) incorporates the requirement for evidence regarding DOTs. New § 905.510(b)(7) incorporates the requirement for a board resolution and a counsel's opinion. New § 905.510(b)(8) states the requirement for a Capital Fund Financing Amendment to the ACC be executed as part of the CFFP transaction. This final rule revises proposed § 905.705(j) to specify requirements associated with variable rate transactions. This final rule also revises proposed § 905.705(n) (final § 905.505(n)) to state specific additional

requirements that are also included in the Capital Fund Financing Amendment to the ACC.

*Comment:* HUD should establish safe harbors for financing transactions with Capital Funds. Such safe harbors could include: The PHA has not been designated as troubled, the PHA has not defaulted on loan or obligations secured by Capital Funds, the PHA has described the proposed transaction in its PHA plan, the PHA pledges no more than one-third of its annual allocation of Capital Funds under section 9(d) of the 1937 Act, the PHA is in compliance with obligation and expenditure requirements under section 9(j) of the 1937 Act, and the PHA submits a fairness opinion of an independent qualified third party.

*Response:* Cost controls and safe harbor standards work well for transactions where industry norms are established and readily identifiable and few variations are expected, such as with development or management fees. Financing does not lend itself to such standards being established. Interest rates change daily. As recent events in the area of mortgage financing have demonstrated, the financial markets, including the home financing market, can be turbulent, if not volatile. Safe harbor standards are simply not workable in this environment.

Instead of safe harbor standards, the CFFP establishes a requirement for an independent third-party fairness opinion, with certain exceptions where there are other indications of reduced risk. The requirement for a fairness opinion, as opposed to cost control and safe harbor standards, permits HUD to maintain flexibility in implementing the program. This approach allows PHAs to structure financial transactions that best meet their needs, provided that the fairness opinion establishes that the transaction is fair and reasonable given current market conditions.

HUD believes that the streamlining process introduced in this rule (and described elsewhere in this preamble) will also assist with the issue. HUD's review process for complete Capital Fund Financing Proposals now averages approximately 2 to 3 months, and this shorter process time should allow PHAs to lower costs and respond to market conditions, which HUD believes is a better solution than safe harbor standards for this purpose.

*Comment:* The rule will provide little assistance to small PHAs. HUD should consider other forms of incentive to assist those PHAs.

*Response:* HUD recognizes and appreciates that the relative cost of financing is more expensive for smaller

PHAs. As a result, HUD has revised the rule to streamline procedures for smaller PHAs based on the size of their financings.

For those PHAs that are standard or high performers with cumulative borrowings of less than \$2 million, the requirement for the submission of management assessments and fairness opinions, and a demonstration of construction management and financial controls is limited. HUD reserves the right to require a fairness opinion or return the proposal if financing costs are outside of what HUD considers anticipated norms. This streamlining should assist small PHAs in reducing the costs of financing.

*Comment:* The proposed rule refers to mortgaging public housing properties under section 30 of the 1937 Act (42 U.S.C. 1437z-2), but does not establish regulations for mortgaging public housing property. HUD should implement provisions related to mortgaging public housing property. Also, in implementing section 30 of the 1937 Act, HUD should allow PHAs to subordinate the DOT. Otherwise, the rule risks devaluing PHA real estate and destroying the potential utility of section 30 of the 1937 Act. Other comments stated that HUD should remove this authority. One commenter states that the authority is not needed and lenders might unnecessarily require pledges of real estate collateral; another states that the granting of security interests in public housing property other than Capital Funds is already addressed in 24 CFR part 941, subpart F (mixed-finance development).

*Response:* HUD may provide more detailed guidance to PHAs regarding mortgaging their properties in the future. In the meantime, this final rule does not remove the basic authority to mortgage real property. While it is true that in entering into financing transactions PHAs should aggressively represent their interest with financing providers, the overall success of the CFFP program is demonstrated by the fact that HUD has approved more than \$3 billion in CFFP transactions to date. These transactions have been structured on an appropriations-based financing model; that is, where future appropriations, not real estate, represents the security interest provided to lenders. Since the appropriations-based financing approach has been accepted by the housing finance market, lenders will have no basis to unnecessarily demand pledges of real estate collateral.

*Comment:* The proposed rule missed the opportunity to encourage innovative financing for public housing that is

more in line with financing for other rental housing. The rule should allow PHAs to pledge public housing Operating Funds, Capital Funds, rents, and the underlying property. Another commenter remarked that banks evaluate market-rate apartments on their ability to generate sufficient rents to cover expenses and have sufficient funds remaining to cover the debt, and if not, on the ability of the property to generate sufficient sales proceeds to pay off the loan and cover expenses in the event of a foreclosure. That commenter further stated that, given the nature of public housing, lenders cannot view PHAs or their stand-alone projects as market-rate financing, but rather that private and public housing are at opposite ends of the financing spectrum. Other commenters noted that, at current proration levels, PHAs will not have the cash flow necessary to support financing.

*Response:* HUD recognizes that public housing financing is quite different from financing in the private sector. Since, in operating pro-formas (standard financial projections), changes in revenue have disproportionate impacts on net operating income (NOI), changes in the current appropriations level could cause the NOI to be volatile. The potential for volatility in the NOI, and thus, by extension, the debt coverage ratio, should PHAs undertake conventional NOI-based financing, present additional constraints on adopting a private sector model.

Moreover, the unique regulatory environment in which public housing operates essentially precludes the adoption of a private sector model. While, pursuant to asset management, PHAs must now undertake project-based accounting, except for mixed-finance projects, the public housing property in any PHA's portfolio is all owned by a single legal entity, namely the PHA. This is entirely different than the private sector model, where separate properties are normally owned by distinct legal entities, even if ultimately controlled by an individual or other overarching entity.

Furthermore, HUD has approved more than \$3 billion in Capital Fund Financing Proposals involving almost 200 PHAs, many of these amongst the largest PHAs in the country. The CFFP model is based upon a PHA-wide pledge, and is not property specific. Given the nature of the covenants involved in CFFP transactions, it would not be possible for PHAs that have undertaken those transactions to provide mortgages in underlying properties without first refinancing their CFFP debt. Thus, a property-based

approach would be further precluded for any PHA that has already undertaken a CFFP.

*Comment:* Proposed § 905.705(c)(5), which would require that an effective DOT be recorded in the first position, will severely hamper the amount of private funds that can be leveraged, because the lender would discount the value of any land and improvements pledged as security, due to the lender's security interest being subordinate to the DOT.

*Response:* HUD's experience shows that there is limited value in allowing PHAs to provide security interests in real estate as part of the CFFP. As noted elsewhere, the appropriations-based CFFP program has demonstrated broad market acceptance, as well as strong ratings and attractive pricing from the investment community. The CFFP regularly achieves ratings of AA, which is a similar or better rating than that provided to strong multifamily housing projects, and has been used to leverage substantial funding.

*Comment:* The rule fundamentally errs in treating borrowings secured by RHF funds as identical to borrowings secured by Capital Funds. There is no reason why the leveraging of RHF funds should be subject to any greater HUD review than the direct expenditure of them. Another commenter stated that HUD should allow for 80 percent pledging of the RHF funds, and allow the market to determine if 80 percent is an acceptable risk.

*Response:* In general, HUD agrees that CFFP transactions that are sized assuming that only RHF funds will be used for the payment of debt service could be treated differently than CFFP transactions that are underwritten to include formula funds for the payment of debt service. However, generally, transactions that size loans based upon the receipt of RHF funds have always also included formula funds for the payment of debt service. Moreover, transactions that pledge RHF funds have always also included a pledge of formula funds. To date, there has not been a financing transaction involving RHF funds that isolates the remainder of the Capital Fund (*i.e.*, formula funds) from the transaction, for debt service payments or for security purposes. Thus, there is not a clear distinction between the two types of transactions.

Nonetheless, HUD agrees that the rule should allow for different treatment of proposals where the sizing of the loan is based only upon the use of RHF funds for the payment of debt service, if such a transaction occurs. This final rule revises proposed § 905.705(g) (final § 905.505(g)) to provide that

transactions structured in the above-noted manner shall not be required to complete or submit a physical needs assessment as part of their CFFP Financing Proposal.

In addition to the above, while RHF funds and loan proceeds for such transaction must still be identified in schedules in the PHA's CFP Annual Statement/Performance and Evaluation Report and CFP Five-Year Action Plan, those schedules are not required to be submitted as part of the Capital Fund Financing Proposal. This final rule revises proposed § 905.705(h) to remove the requirement for PHAs that size their loans based only upon the future receipt of RHF to submit a budget as part of their Capital Fund Financing Proposal (final § 905.505(h)(2)).

Finally, HUD agrees that RHF funds should be treated differently than formula funds, for underwriting purposes. Therefore, this final rule revises § 905.505(i)(2) (redesignated from proposed § 905.705(i)(2)) to permit PHAs to pledge up to 100 percent of their RHF funds for debt service, provided that this constitutes no more than 50 percent of the PHA's combined Capital Funds (*i.e.*, formula funds and RHF funds). HUD will allow PHAs to pledge 100 percent of their RHF due, in part, to the fact that the maximum term PHAs can underwrite RHF for is 10 years, which is the maximum period of time a PHA can receive a tier of RHF. This is half the maximum term of 20 years permitted where PHAs pledge Capital Fund formula funds for the payment of debt service, and, therefore, considerably more conservative. The 50 percent cap is being established to limit the amount of RHF funds PHAs can pledge in addition to formula Capital Funds. This limitation will be triggered for those PHAs where RHF funds make up a significant portion of their overall Capital Fund such that pledging RHF funds could exceed the 50 percent overall cap.

*Comment:* One commenter questioned the practical value of proposed § 905.705(i)(1), given that proposed § 905.705(i)(2) permits a PHA to pledge more than 33 percent of its annual Capital Fund grant upon a showing that is essentially duplicative of the physical needs assessment required by proposed § 905.705(g).

*Response:* HUD agrees that some further explanation of these related sections is necessary. Accordingly, this final rule removes proposed § 905.705(i)(2) and adds § 905.505(i)(3), to make explicit HUD's policy that, as long as it is reasonable to do so, a PHA may exceed 33 percent when pledging its existing Capital Fund grant. The PHA

is necessarily more limited as to pledges of future Capital Fund grants because of the possibility of other capital needs arising. This final rule also revises proposed §§ 905.705(i)(1) and 905.705(i)(3) as final §§ 905.505(i)(1) and 905.505(i)(2), to clarify that PHAs may exceed the 33 percent of future projected Capital Funds threshold only if they are utilizing RHF grants to size their financing. These revised sections allow PHAs utilizing RHF funds to exceed 33 percent leverage in their overall future Capital Funds (PHAs are permitted to pledge up to 50 percent of their overall future Capital Fund, including formula funds and RHF funds), in order to leverage up to 100 percent of their RHF funds.

*Comment:* In the context of a project using an LIHTC, operating agreements and CFP Annual Statement/Performance and Evaluation Reports should allow the use of these funds to pay the annual LIHTC fund investment management fee specified in the respective operating agreement governing the investment of these LIHTC funds in a development or modernization activity. The investment management fee should be specified in the initial operating agreement, should not escalate faster than the consumer price index, and should initially not exceed \$8,000 annually.

*Response:* As a cost of financing, the fee would be a permissible Capital Fund expenditure, provided it is proportional to the ratio of public housing units to non-public housing units in the project.

*Comment:* The time deadlines for HUD review of documentation should be waived in a mixed-finance development transaction. The rule should permit PHAs to submit executed copies of the required legal documents to HUD when they become available.

*Response:* Submission of executed closing documents to HUD is required so that HUD may upload the debt service schedule into LOCCS. However, as a business practice for Capital Fund Financing Proposals that are part of mixed-finance transactions, HUD regularly conditions its CFFP approval on the receipt of approval of the mixed-finance program. This final rule revises § 905.715(b)(2) to reflect this business practice. Section 905.515(b)(2), as revised by this final rule, requires closing documents to be submitted within 60 days of the date of HUD's approval letter; that letter sets conditions that must be met prior to closing (rather than using the closing date). HUD continues to make efforts to reduce paper submittal requirements, and now requires that only one hard copy of the Capital Fund Financing Proposal be submitted. The remaining

copies can be submitted as electronic copies.

*Comment:* Given the condition of HUD's information management and program systems, PHAs may be prevented from participating in the CFFP due to erroneous or missing information in HUD's PHAS.

*Response:* HUD disagrees. The PHAS has consistently provided data in a time frame sufficient to permit the timely conclusion of financing transactions.

*Comment:* Given the \$18 billion backlog of capital needs, it is unreasonable to require PHAs to complete a physical needs assessment at the project level that covers the PHA's entire public housing portfolio before seeking approval of a CFFP or OFFP transaction. No PHA can legitimately demonstrate an ability to address all the capital needs of its stock.

The requirement of a physical needs assessment should be removed and HUD should rely on information in the CFP Annual Statement/Performance and Evaluation Report and CFP Five-Year Action Plan. Rather than conducting a physical needs assessment, PHAs should be required to consider alternative sources of financing. The physical needs assessment should be permissive rather than mandatory.

Proposed § 905.705(g) should be clarified to indicate how current the physical needs assessment must be.

*Response:* This final rule revises proposed § 905.705(g) to remove the requirement that PHAs demonstrate, based on the physical needs assessment, that they can maintain their public housing portfolio over the term of the financing. Instead, this final rule, responsive to public comments, requires that the PHA demonstrate that the financing will not negatively impact the ability of the PHA to meet the ongoing needs of its public housing portfolio over the term of the financing. In order to make this analysis, PHAs will need to project their future funding, and the demand for that funding from both capital and non-capital activities. PHAs that borrow more than \$2 million cumulatively and are not leveraging non-public housing funds must demonstrate that they have considered leveraging. As noted previously, PHAs that size their loans based only upon the receipt of future RHF, or that use their CFFP as part of mixed-finance transactions, are not required to meet the requirements of proposed § 905.705(g) (final § 905.505(g)).

In response to comments that HUD should not require a physical needs assessment at all, but rather require PHAs to seek alternative means of financing, or make the physical needs

assessment permissive, HUD notes that CFFP loans result in PHAs obligating a significant portion of long-term future funding streams to pay off the loans. For this reason, long-term capital planning is an essential part of undertaking the obligations and commitments associated with CFFP financing. However, the underlying point, that PHAs should consider alternative financing sources when structuring their CFFP transactions, is valid, as it maximizes funding for the PHA. Therefore, this final rule revises final § 905.505(g) such that PHAs that borrow in excess of \$2 million and do not leverage non-public housing funds must state why the proposed borrowing is appropriate in light of other alternatives available.

In response to the comment that the rule should clarify the timing of the physical needs assessment, at present, the requirements stated in 24 CFR 968.315 apply. PHAs must conduct a new physical needs assessment at least once every 5 years.

*Comment:* One commenter noted that the rule's prohibition on the use of financing proceeds for central office cost center costs raises numerous questions, including whether the application is a central office or project cost, whether HUD is suggesting that property managers set up affiliates to perform developer duties, and how the project-based requirements would be met if the proceeds were used for predevelopment or new development purposes. Several commenters recommended that proposed § 905.705(h)(4) be eliminated. Another commenter stated that the provisions should be changed to permit PHAs to use CFFP financing proceeds to pay for costs directly incurred by the central office cost center.

*Response:* The limitation concerning the use of CFFP proceeds for administrative and central office cost center costs effectively precludes PHAs from doubling the amount of Capital Funds that PHAs can use for administrative costs. Currently, and under the revised rules issued pursuant to asset management, administrative and central office cost center costs are eligible costs under the CFFP. Administrative and cost center costs are generally among the first costs set aside by PHAs each year as they budget their use of Capital Funds. Therefore, any Capital Funds used by PHAs to pay debt service will already be the net of administrative or central office cost center costs. Since CFFP debt is repaid from Capital Funds, if the rule permitted PHAs to use CFFP proceeds for these costs as well, the rule would in effect be doubling the ceiling on such use of Capital Funds, by allowing the

PHA to take the fee once from the CFFP proceeds, and then a second time from the Capital Funds used to repay the CFFP financing.

PHAs should use their Capital Funds to cover any eligible administrative costs associated with CFFP transactions, within the allowable limits. The rule proposed in § 905.705(h)(4) an exception to the use of CFFP proceeds for administrative costs for mixed-finance projects.

In response to public comments, the final rule revises proposed § 905.705(h)(4) (final § 905.505(h)(5)) to add a clarification that CFFP proceeds may be used, in addition to for the modernization and construction of public housing dwelling units, for the development or modernization of non-dwelling space. However, PHAs that have significant physical needs in their public housing dwellings should take measures to ensure that they meet the test in § 905.505(g) if they propose to use CFFP proceeds for non-dwelling facilities.

This final rule also revises proposed § 905.705(h)(4) (final § 905.505(h)(5)) to clarify that CFFP proceeds may be used to reimburse predevelopment costs only to the extent that those costs were incurred in accordance with regulatory requirements. Section 941.302 limits predevelopment costs for traditional public housing to 3 percent of total development costs. Section 941.612 specifies the process for drawing down funds for predevelopment costs for mixed-finance transactions.

*Comment:* Individual projects may not be able to fund the debt service, and the asset management project level may change with ongoing demolition, redevelopment, and realignment. As a result, the regulations should be expanded to include a method to use Capital Funds for debt service at the agency level.

*Response:* This CFFP final rule permits PHAs to size their financing either on the project level, or on an agency level. The pledge of CFFP, however, is at an agency level. Further, this final rule allows PHAs to size their loans based on a pledge of up to 100 percent of their RHF funds (final § 905.505(i)(2)). This revision should provide considerable resources to PHAs that wish to utilize the CFFP to realign their public housing portfolio.

*Comment:* One commenter recommended that HUD define the term "costs already incurred" in proposed § 905.705(h)(4).

*Response:* This final rule removes the phrase "cost already incurred" from proposed § 905.705(h)(4) (final § 905.505(h)(5)), and clarifies the

language in § 905.505(h)(5) of this final rule to specify that CFFP proceeds may reimburse only predevelopment costs incurred in accordance with regulatory requirements.

*Comment:* Proposed § 905.705(j)(1) should permit CFFP financing terms anywhere from 30 to 40 years.

*Response:* Given the nature of appropriations-based financing, terms in excess of 20 years are difficult to support. By way of reference, the restrictive covenant associated with the use of Capital Funds for modernization is limited to 20 years. This final rule revises the language in § 905.505(j)(1) to clarify the limitation of the term to 20 years.

*Comment:* One commenter recommended that § 905.705(j)(2) be clarified to provide that "any loan with mandatory debt service payments shall have a cap on such payments and shall be self-amortizing." Another commenter recommended that the prohibition on acceleration be removed. The commenter stated that such a restriction could negatively impact the marketability of the program.

*Response:* All CFFP transactions have mandatory debt service payments, and pursuant to § 905.705(j)(1) they are fully amortizing. HUD's policy in implementing the CFFP has been not to permit acceleration provisions. Given that HUD has approved more than \$3 billion in Capital Fund Financing Proposals, there is broad market acceptance of the program, including HUD's policy on acceleration. Nonetheless, there may be circumstances in which a PHA proposes and can justify the inclusion of an acceleration provision in a CFFP transaction. This final rule revises § 905.505(j)(2) to allow for that possibility.

*Comment:* The requirement for a fairness opinion will add significant expense to a PHA's financing of a new development. Financial markets are competitive and if a PHA has thoroughly "shopped" its financing needs, the PHA will receive a fair and competitive rate. Therefore, this requirement should be removed.

One commenter recommended that HUD require a fairness opinion only if the opinion has a conclusive effect and if redundant determinations regarding commercial fairness will not be made by HUD. Another commenter recommended that the fairness opinion be limited to a determination that the "interest rate, points and costs are reasonable given market conditions."

*Response:* The requirement for a fairness opinion permits HUD to maintain flexibility in implementing the



program. This approach allows PHAs to structure financial transactions that best meet their needs, provided that the fairness opinion establishes that the transaction is fair and reasonable given current market conditions.

HUD will continue its general requirement to have independent third-party fairness opinions completed. However, this final rule eliminates that requirement for several types of transactions that present a reduced risk. For example, fairness opinions are eliminated for borrowings of less than \$2 million, because of the relatively small amount of funds at risk; for high performers up to \$20 million, because high performers have a demonstrated ability to effectively implement their public housing program; and in mixed-finance transactions, because PHAs in mixed-finance transactions are generally represented by a strong development team and have increased regulatory oversight under the mixed-finance program. In any of these cases, HUD can require a fairness opinion if the transaction does not meet industry norms. This final rule adds § 905.507(a)(2) to eliminate the requirement for a fairness opinion for standard or high-performing PHAs that have cumulative CFFP transactions of less than \$2 million, PHAs that were high performers under PHAS and have cumulative CFFP borrowings of less than \$20 million, and PHAs that propose to use their CFFP proceeds as part of a mixed-finance transaction. Notwithstanding these changes, if HUD determines that the interest or other costs are not in line with industry norms, HUD may require a fairness opinion or return the application.

Regarding the request to limit fairness opinions, fairness opinions are already limited to the business terms of financing transactions. As such, they are a low-cost and efficient mechanism for ensuring the reasonableness of the financing terms given current market conditions. HUD does not currently contemplate further reducing the scope of fairness opinions.

*Comment:* For pooled bond transactions or a single bond transaction, the fairness opinion should be required only for transactions above \$10 million.

*Response:* This final rule relaxes requirements for fairness opinions. PHAs that have cumulative CFFP borrowings under \$2 million, high-performing PHAs with cumulative CFFP borrowings of less than \$20 million, and all PHAs using the proceeds to undertake mixed-finance transactions generally are not required to submit fairness opinions.

HUD does not anticipate establishing separate criteria for bond pools. PHAs participating in bond pools are treated in the same manner as PHAs that submit stand-alone Capital Fund Financing Proposals. As such, the standards for requiring or waiving the submission of a fairness opinion will be the same for all PHAs, whether or not they participate in a pooled bond transaction.

*Comment:* The requirements for construction management and financial controls at proposed § 905.705(l) are duplicative of the requirement that PHAs obtain approval for changes for work items at proposed § 905.705(m) and add unnecessary layers of administrative requirements.

*Response:* Proposed § 905.705(l) (final § 905.505(l)) is aimed at obtaining representations from PHAs that they have sufficient construction management and financial controls in place to offer protections from fraud, waste, or abuse. Proposed § 905.705(m) (final § 905.505(m)) is a mechanism whereby PHAs may obtain approval from HUD for modifications to their approved budgets. Obtaining such approvals from HUD does not substitute for the value of effective internal controls on the part of the PHA.

Nonetheless, toward the underlying goal of streamlining the regulations where possible, this final rule at § 905.507 removes this requirement for assurances regarding construction management and financial controls for PHAs that meet the following criteria: PHAs that have cumulatively less than \$2 million in CFFP financing and are standard or high performers, as well as high-performing PHAs that have cumulatively less than \$20 million in CFFP financing, and all PHAs using the proceeds to undertake mixed-finance transactions.

*Comment:* Proposed § 905.705(p) would establish burdensome and costly requirements on PHAs and should be changed. One commenter suggested that such information should be submitted semi-annually rather than quarterly. Another suggested that HUD limit its requirements to the PHA's annual reports and copies of reports submitted to the financing institution. Other commenters questioned the need for these reports altogether, since HUD should be able to get this information from other reports submitted as part of the PHA's CFP Annual Statement/Performance and Evaluation Report or PHA Annual Plan.

*Response:* Section 905.505(h)(1) now clarifies that the use of CFFP proceeds shall be included in the CFP Annual Statement/Performance and Evaluation Report and CFP Five-Year Action Plan

in the same manner as other uses of a PHA's Capital Funds. In addition, the use of Capital Funds for the payment of debt service needs to be included in the CFP Annual Statement/Performance and Evaluation Report and CFP Five-Year Action Plan in the same manner as other uses of Capital Funds.

HUD requires that PHAs report quarterly in regard to CFFP transactions, because data on the use of CFFP proceeds are not included in automated HUD systems in the same manner as Capital Funds, for which current data on obligation and expenditure can be accessed.

*Comment:* Proposed § 905.710(b)(3) would require parties to dedicate time and resources to negotiating an agreement without the confidence that they would ultimately obtain HUD approval. The rule should strike a better balance between protecting HUD's limited resources and requiring private parties to commit extensive resources to a transaction that may not be approved.

*Response:* HUD's review of the documents associated with CFFP transactions is for conformance with program requirements only. As such, any negotiations should already be complete and the documents should be in their final form before the Capital Fund Financing Proposal is submitted to HUD.

HUD nevertheless does recognize and appreciate that clarity and transparency in policy and programmatic requirements increases the efficiency of the overall process, both in structuring the Capital Fund Financing Proposal, and in HUD's review after the proposal is submitted. Toward this end, HUD has been developed legal guidance for bond documents. The legal guidance will provide sample provisions that the PHA could adopt at its discretion. Although the legal provisions would be optional, such provisions could provide a reference point for structuring Capital Fund Financing Proposals, removing some of the uncertainty that PHAs may now experience in structuring their transactions.

*Comment:* While the proposed rule required PHA to submit a complete set of financing documents (§ 905.705(b)(3)), the proposed rule did not specify the documents that are to be submitted. More importantly, the proposed rule did not indicate how the documents are to be evaluated.

One commenter recommended that § 905.710(b)(3) be removed and made more like the streamlined requirements for mixed-finance projects. Another commenter recommended that HUD establish a process to approve LIHTC LLC (Limited Liability Company)



operating agreements and critical third-party financing documents before these documents are made final.

*Response:* Financing documents vary significantly from one transaction to the next, even for similar transactions, such as direct loans or private placements. There is no definitive way that HUD can identify in a regulation the entire list of financing documents that each PHA will enter into as part of a CFFP.

In regard to eliminating the requirement for financing documents as part of a streamlined process similar to the mixed-finance program, HUD has had much greater experience with mixed-finance public housing than with the CFFP. Although HUD has been implementing the CFFP on a case-by-case basis since 2000, it was not until 2005 that the program began to be more widely used. As such, the CFFP is not deemed to be ripe for the same streamlining efforts as are currently being promulgated for HUD's mixed-finance program. Nonetheless, HUD appreciates the need to continually increase the efficiency of HUD programs, and this final rule does introduce some streamlining of procedure as have already been discussed in this preamble.

In regard to HUD establishing a process to approve LIHTC LLC Operating Agreements before the documents are finalized, it is important to note that LIHTC documents, and HUD's review thereof, are subject to the mixed-finance program regulations at 24 CFR part 941. On December 27, 2006, HUD published a proposed rule entitled "Streamlined Application Process in Public/Private Partnerships for the Mixed-Finance Development of Public Housing Units." The streamlined process would substantially reduce the legal documents that must be submitted to HUD for review as part of the mixed-finance process.

*Comment:* Proposed § 905.710(b)(3) (final § 905.510(b)(5)), which provides that HUD will not review preliminary financing documents that are still under negotiation, is problematic. The rule should make this requirement an option at HUD's discretion. PHAs may need assurance that HUD will approve the security interests prior to concluding negotiations.

*Response:* The CFFP is an appropriations-based financing program. As an appropriations-based form of financing involving the CFFP, the security interest provided by PHAs to lenders or bondholders is a pledge of future Capital Funds, subject to the availability of appropriations. As HUD has approved more than \$3 billion in Capital Fund Financing Proposals, the

security interest provided pursuant to this program has been well established, accepted by the marketplace, and should be familiar to all program participants.

In terms of reviewing financing documents that are still under negotiation or making the requirement for financing documents optional, HUD is not a party to the agreements between PHAs and their lenders or bondholders, although these negotiations concern substantial Federal funding. HUD's review of the documents associated with CFFP transactions is necessary for conformance with program requirements and to determine that the proposed use of Capital Funds is sound and consistent with use requirements. As such, HUD review can be useful only if negotiations are complete and the financing documents are in their final form and provided to HUD.

*Comment:* HUD's proposed amendments to part 905 do not address whether Capital Fund financing proceeds may be used for short-term loans or bridge loans. The final rule should expressly provide for these uses. HUD's current informal position appears to be that proceeds from CFFP financings cannot be used to generate program income, and recommended that this type of structure be permitted.

*Response:* This final rule revises proposed § 905.705(j)(1) (final § 905.505(j)(1)) to explicitly allow for short-term or bridge loans, provided they are fully amortizing. However, the commenter is correct that it has been HUD's position, while implementing the program on a case-by-case basis, that the transactions may not be structured in such a way so as to allow for the generation of program income. The rationale for this approach is related to the differences in financial controls for grant and non-grant programs. HUD permits Capital Funds and HOPE VI funds to be used in a manner that generates program income. These are both grant programs, where the focus is on the initial use of the grant. Part 85 of HUD's regulations (24 CFR part 85) explicitly addresses the generation of program income in grant programs. The CFFP, however, is a financing program. Given the long-term implications of CFFP financings, one of HUD's objectives in reviewing such applications is to ensure, to the extent feasible, that the proposed financing, including the use of the proceeds, will not have a negative effect on the viability of the PHA's public housing over the term of the financing. In order to make this analysis, the permanent use of the proceeds must be known. In the case of program income, however, the

eventual re-use of the income cannot be known with any certainty given the fact that the re-use is in the future. This final rule modifies § 905.705(j)(1) to formalize the existing policy that CFFP transactions may not be structured in a manner that generates program income, unless otherwise approved by HUD.

#### IV. Findings and Certifications

##### *Paperwork Reduction Act*

The information collection requirements contained in this rule have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) and given OMB control numbers 2577–0157 and 2577–0226. 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.

##### *Regulatory Planning and Review*

OMB reviewed this rule under Executive Order 12866 (entitled "Regulatory Planning and Review"). OMB determined that this rule is significant as meant by the order, although it is not an economically significant regulatory action as defined in 3(f)(1) of the order. This rule creates transfers in that it permits Capital Funds that would be expended in future years to be expended earlier on eligible activities such as large capital improvements; however, this does not result in economically significant differences in expenditures or transfers to and among stakeholders. Rather, it merely time-shifts funding in a way that enables PHAs to obtain the benefits of future funding at an earlier time. In the course of time, however, PHAs would use the same future streams of Capital Funds absent this rule. While the expenses of financing must be considered, these do not rise to the level of economic significance. This rule will have no direct budgetary impact.

The rule in itself does not add any new cost to the financing program and does not create any significant transfers. The only new costs to the program participant are transaction fees and interest cost associated with borrowing under the CFFP rule. These fees and cost would constitute transfers under this rule. For example a municipal bond would cost on average 2 percent in fees, in addition to the coupon interest rate, which is also 5 percent on average. To date, HUD's office overseeing the CFFP report that to date, about \$183.4 million has been allocated to debt service

(interest and principal). Applying this rule of thumb, the \$183.4 million annual payment would have generated transfers of about \$3.7 million initially in fees (2 percent), and about \$9.2 million annual in interest costs. HUD's argument on these transfers is that a well-managed PHA would not undertake an investment if the net present value were less than zero. Thus, the option would be exercised only by those PHAs for whom there is an expected benefit. The CFFP final rule would permit PHAs to borrow for uses such as issuing bond debt to be repaid out of future CFP subsidy allocations. The financing costs associated with bond transactions are as follows. A municipal bond would cost on average 2 percent in fees, in addition to the coupon interest rate, which is also 5 percent on average. To date, according to HUD's office overseeing the CFFP, about \$183.4 million has been allocated to debt service (interest and principal). That is about 7 percent of annual appropriation for the CFFP program. In addition, this final rule also permits PHAs to pledge up to 100 percent of their Replacement Housing Factor (RHF) funds for debt service, provided that such pledge constitutes no more than 50 percent of the PHA's combined future Capital Funds (i.e., formula funds and RHF funds). In 2008, a total of 294 PHAs received RHF funds: 251 PHAs received \$97,936,944 RHF in first increment, and 123 PHAs received \$112,825,095 RHF in second increment funding. Five years after the implementation of the RHF phasedown, the \$113 million second increment funding would be eliminated and redistributed by formula to all eligible 3,138 PHAs. This means that in time, debt supported by about \$98 million in RHF (or as much as \$500 million, if one assumes level payments and a 5-year term) could be added to the \$10.2 billion "debt ceiling." Data from HUD's office of CFFP also show that the cost of insurance for CFFP transactions approved in 2008 and 2009 were, on average, 1.2 percent of the amount approved.

This final rule provides the regulatory framework for compliance with the statute and establishes an approval process for PHAs to request authorization from HUD to pledge Capital Funds for debt service payments, including payments of debt service and customary financial costs for the modernization and development of public housing—including public housing in mixed-finance development. Key benefits of the use of Capital Funds for financial activities include:

- There exist economies of scale in making large-scale housing

improvements. If the average cost for improving a unit fell as the number of units improved increases, then it would make economic sense to increase the number of units improved. These benefits may warrant undertaking the costs of debt.

- The lump sum of loan proceeds will make possible large-scale improvements at the PHA's biggest sites that could not be undertaken on the basis of annual CFP allocations. This is corroborated using the findings of a study by Abt Associates and funded by HUD (Abt Associates, *Capital Needs of the Public Housing Stock in 1998: Formula Capital Study*, January 2000; hereafter, "the study"). The study estimated the total inspection-based existing modernization needs for the 1,194,370 units of public housing to be \$22.5 billion in 1998—an average of \$18,847 per unit, and another \$2 billion to address ongoing accrual needs or, on average, \$1,679 per unit, assuming that the inspection-based existing modernization needs were completely met.

- Large-scale repair work will diminish the backlog of deterioration at key sites now, saving future CFP dollars and better securing the portfolio for the future.

- Making repairs now using loan proceeds should also result in lower operating costs, linking the capital investment with the need for properties to stand on their own financially under HUD's new subsidy and asset management rules.

- Allowing more flexibility in planning will allow PHAs to take advantage of economic trends. The optimal investment decision depends upon expectations concerning the direction of critical variables. For example, if the manager of a PHA observes that construction costs are rising faster than the costs of debt, there would be a reason to invest sooner and at a higher intensity than if construction costs were declining. This rule allows the flexibility to invest at varying levels of intensity. Indeed, the Department believes that a well-managed PHA would not undertake an investment if it did not view the transaction as having a positive impact on its Capital Fund program. Thus, the option would be exercised only by those PHAs for whom there is an expected benefit.

- There are also costs of the use of Capital Funds for financial activities. The CFFP final rule would permit PHAs to borrow and issue bond debt to be repaid out of future Capital Fund program subsidy allocations. However, there are financing costs associated with such transactions that are discussed

elsewhere in this economic impact statement.

In conclusion and notwithstanding the financing costs under the CFFP, the implementation of the final rule would not have any budgetary impact on the Federal budget, and would not create any significant transfers, but rather would advantageously time-shift the use of Capital Funds. The rule would also comply with the statutory requirement that requires the Secretary of HUD to establish guidelines for the use of public housing Capital Funds for financial activities.

HUD also considered alternatives to this rulemaking. As an alternative to publishing a rule on the CFFP, HUD could continue to implement the CFFP on a case-by-case basis without publishing a rule, as we have been doing since 2000. This is not an optimal approach, as the rulemaking process enables HUD to solicit comment from the public on the proposed rule, and to incorporate changes into the program based on those comments to the extent HUD determines it to be feasible. Furthermore, a final rule published in the **Federal Register** and then the CFR will serve to establish rules of general applicability and make those rules accessible to the public.

Another possible alternative would involve changing the terms we deem approvable in a CFFP transaction. For example, we could allow a PHA to pledge more than 33 percent of its Capital Funds, or borrow for a period in excess of 20 years. Since HUD has been implementing the CFFP on a case-by-case basis since 2000, 33 percent appears to be an appropriate debt coverage ratio. At that ratio, PHAs can borrow a sufficient sum to enable them to address a substantial scope of work, but at the same time leave a sufficient amount of Capital Funds after the payment of debt service to mitigate for changes in appropriations, and to enable PHAs to address ongoing modernization needs. With regard to changing the period of years for which a PHA could borrow funds for, while extending the period would increase borrowing capacity, it would greatly increase the amount of Capital Funds used to pay interest costs. Furthermore, synchronizing the term of the CFFP with the term of the Capital Fund ACC amendment that PHAs signed each year when they receive Capital Fund grants would provide consistency between the financing program and its intended funding source.

HUD's economic impact analysis is contained in the docket file, which 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 7th 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 final 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 was made, at the proposed rule stage, 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)). That Finding of No Significant Impact remains applicable to this final rule and 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 7th 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.

#### *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 regulatory changes made by this final rule will allow PHAs additional flexibility in

using their Capital Funds. However, the decision whether to use this capability will be left 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 small PHAs. This final rule also grants some procedural exemptions to small PHAs, as measured by their total financings. 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.

#### *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.

#### *Congressional Review of Final Rules*

This rule constitutes a "major rule" as defined in the Congressional Review Act (5 U.S.C. Chapter 8). This rule has a 60-day delayed effective date and will be submitted to the Congress in accordance with the requirements of the Congressional Review Act.

#### *Catalog of Federal Domestic Assistance Number*

The Catalog of Federal Domestic Assistance number for 24 CFR part 905 is 14.850.

#### **List of Subjects in 24 CFR Part 905**

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

■ For the reasons stated in the preamble, HUD amends 24 CFR part 905 as follows:

#### **PART 905—THE PUBLIC HOUSING CAPITAL FUND PROGRAM**

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

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

■ 2. Designate §§ 905.10 and 905.120 as subpart A, and add a heading for subpart A before current § 905.10 to read as follows:

#### **Subpart A—Capital Fund**

■ 3. Revise the heading of § 905.120 to read as follows:

#### **§ 905.120 Penalties for slow obligation or expenditure of Capital Fund program assistance.**

\* \* \* \* \*

■ 4. Add and reserve subparts B through D, and add subpart E, consisting of §§ 905.500 through 905.515, to read as follows:

#### **Subpart E—Use of Capital Funds for Financing**

Sec.

905.500 Purpose and description.

905.505 Program requirements.

905.507 Streamlined application requirements for standard and high-performing PHAs.

905.510 Submission requirements.

905.515 HUD review and approval.

#### **§ 905.500 Purpose and description.**

(a) This subpart provides the requirements necessary for a PHA to participate in the Capital Fund Financing Program (CFFP), under which the PHA may 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 public housing agency as security.

(b) Under the CFFP, 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). A PHA that undertakes 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.

#### **§ 905.505 Program requirements.**

(a) *Written approval.* 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;

(2) The reasonableness of the provisions in the Capital Fund Financing Proposal considering the other pledges or commitments of public housing assets, the PHA's capital needs, and the pledge being proposed; and

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

(b) *Antideficiency.* Any pledge of future year Capital Fund grants under this section is subject to the availability of appropriations by Congress for that year. All financing documents related to future year Capital Fund amounts must include a statement that the pledging of funds is subject to the availability of appropriations.

(c) *Conditions on use—(1) Development.* Any public housing that is 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 of public housing 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) *Applicability of latest expiration date.* Public housing subject to the use conditions described in paragraph (c) of this section, 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.

(4) *Declaration of Trust.* All public housing rental projects must show evidence satisfactory to HUD of an effective Declaration of Trust being recorded in first position, meeting the requirements of paragraph (c) of this section and covering the term of the financing. If part of a mixed-finance project, this evidence will be with the mixed-finance evidentiary documents.

(d) *Public Housing Assessment System (PHAS) designation.* Generally, a PHA shall be designated a standard performer or high performer under PHAS (24 CFR part 902), and must be a standard performer or higher on the management and financial condition indicators. HUD will consider requests from a PHA 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. The PHA must comply with all applicable fair housing and civil rights requirements in 24 CFR 5.105(a). If a PHA has received a letter of findings, charge, or lawsuit involving ongoing systemic noncompliance under Title VI of the Civil Rights Act of 1964, Section 504 of the Rehabilitation Act of 1973, the Fair Housing Act, or Section 109 of the Housing and Community Development Act of 1974, and the letter of findings, charge, or lawsuit has not been resolved to HUD's satisfaction, then unless the Capital Fund Financing Proposal is part of a plan to address such findings, charge, or lawsuit, the PHA will not be eligible for financing pursuant to the CFFP. HUD will determine if actions to resolve the charge, lawsuit, or letter of findings taken are sufficient to resolve the matter.

(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.* (1) 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 that takes into consideration existing needs and the lifecycle repair and replacement of major building components. The activity to be financed must be identified as a need in the physical needs assessment.

(2) Based on the assessment under paragraph (g)(1) of this section, the PHA must demonstrate that the financing will not negatively impact the ability of the PHA to meet the ongoing needs of

its public housing portfolio over the term of the financing. In making this demonstration, PHAs must reduce any projected future Capital Fund grants to account for planned or anticipated activities that would have the effect of reducing or otherwise limiting the availability of future Capital Fund grants. PHA projections must be detailed on the portfolio schedule form prescribed by HUD, and shall project a stabilized number of units (Stabilized Base Unit Count) to be reached in no more than 5 years after all planned or anticipated activities have been completed that would reduce future Capital Fund grants. PHAs must also take into consideration projected use of Capital Funds for other eligible activities under part 905, and may take into consideration alternative sources of financing that are available to help meet its needs.

(3) For PHAs that are proposing to borrow more than \$2 million on a cumulative basis, to the extent that:

(i) Capital and other eligible Capital Fund needs exceed projected Capital Fund program funding amounts, and the PHA is not leveraging non-public housing funds as part of its Capital Fund Financing Proposal transaction, then

(ii) The PHA must demonstrate that it has considered leveraging non-public housing funds, and state why the proposed financing is appropriate in light of alternative sources available.

(iii) Notwithstanding paragraphs (g)(3)(i) and (ii) of this section, PHAs that size their financing by utilizing only replacement housing factor (RHF) funds, or PHAs that propose to use their Capital Fund Financing Proposal proceeds as part of a mixed-finance modernization transaction, are not required to comply with § 905.505(g).

(h) *CFP Plan.* (1) The use of the CFFP proceeds shall be included in a form and manner as required by HUD for CFP planning and budgeting and in a same manner as a Capital Fund grant. The CFFP proceeds shall be included as a separate Capital Fund grant to the same extent that PHAs are required to plan and budget Capital Fund grants. The use of Capital Funds for the payment of debt service and related costs shall be planned and budgeted as would other eligible uses of Capital Funds.

(2) As part of its Capital Fund Financing Proposal, the PHA shall submit a Capital Fund financing budget, in the form and manner required by HUD, detailing the proposed use of the Capital Fund Financing Proposal proceeds. There shall be no requirement for PHAs to submit a Capital Fund financing budget as part of their Capital

Fund financing proceeds where the sizing of the financing is based upon the use of RHF funds for debt service, or where the Capital Fund Financing Proposal proceeds are being used as part of a mixed-finance transaction.

Approval letters for mixed-finance and RHF-related Capital Fund financing transactions shall be conditioned upon the approval of the mixed-finance proposal, or, in the case of conventional development, upon the approval of the development proposal and the execution of an associated construction contract with which the Capital Fund financing proceeds would be used.

(3) The work financed with Capital Funds and described in the Capital Fund financing budget will be based on the physical needs assessment. The Capital Fund financing budget shall list the work items (e.g., roof replacement, window replacement, accessibility modifications) 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 the development") is not sufficient.

(4) The CFP Plan (submission (as described in paragraph (h) of this section) shall include a copy of the physical needs assessment described in § 905.505(g).

(5) Financing proceeds under this part may be used only for the modernization or development of public housing and related costs including the modernization or development of non-dwelling space. Financing proceeds 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. Financing proceeds may be used to reimburse predevelopment costs, but only to the extent they were incurred in conformance with applicable regulatory requirements.

(i) *Debt Coverage Percentage.* (1) Except as stated in § 905.505(i)(2), a PHA shall not pledge more than 33 percent of its annual future Capital Fund grants for debt service payments, assuming level Capital Fund 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 Funds, including a voluntary compliance agreement. This percentage of Capital Funds dedicated for debt

service, taking into account adjustments for activities that would reduce the receipt of Capital Funds, is called the "Debt Coverage Percentage."

(2) A PHA may pledge up to 100 percent of any projected replacement housing factor (RHF) grants for debt service payments, provided that the pledge extends to the formula fund portion of its Capital Fund grants also, but that not more than 50 percent of its overall projected Capital Fund grants (including formula funds and RHF funds) are pledged. RHF projections shall account for any projected reductions in RHF over the term of the financing. Unless otherwise approved by HUD, PHAs shall be limited to sizing their loans based upon increments of RHF currently being received by the PHA. CFFP transactions pledging RHF funds shall include accelerated amortization provisions, requiring all RHF funds received by the PHA to pay debt service as those RHF funds are received. A RHF grant shall be used only to develop or pay financing costs for the development of replacement public housing units in accordance with § 905.10.

(3) Subject to the reasonableness test in § 905.505(a)(2), PHAs may exceed 33 percent when pledging existing Capital Fund grants and RHF grants for the payment of debt service. Existing grants are grants that have been received by the PHA at the time of HUD's approval of the Capital Fund Financing Proposal.

(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. All Capital Fund financing transactions shall be fully amortizing. Bridge loans and other short-term loans are permitted; however, unless otherwise approved by HUD, the CFFP Financing transaction may not be structured in a manner that generates program income.

(2) *Acceleration.* Unless otherwise approved by HUD, the financing documents shall provide that HUD approval is required before a lender may accelerate a PHA's debt obligation, for default or otherwise.

(3) *Public housing assets.* A PHA may not pledge any public housing assets unless specifically approved in writing 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.* All variable-rate transactions shall include an interest-rate cap. The financing documents must specify that the PHA shall not be liable to pay debt service with public housing funds, and that there shall be no recourse to public housing assets, beyond the interest-rate cap. The limitation on the pledge of Capital Funds specified in § 905.505(i) shall be calculated based on the interest-rate cap.

(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) *Terms and conditions.* 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) *Financial controls and construction management.* (1) The PHA shall have a financial control and construction management plan describing how the PHA will ensure that:

(i) Adequate controls are in place regarding the use of the 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 that 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 budget from HUD:

(1) A change in the type of activity being financed (for example, if the approved Capital Fund financing budget 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 in 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 non-dwelling space.

(n) *Applicability of other Federal requirements.* The proceeds of the 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. PHAs undertaking CFFP transactions shall be subject to the following requirements, which shall be further enumerated in a Capital Fund Financing Amendment to the Annual Contributions Contract (CFF ACC Amendment):

(1) Amounts payable to the PHA by HUD pursuant to the CFFP and pledged to the payment of debt service by the PHA shall be used exclusively for debt service in accordance with the debt service schedule approved by HUD and shall not be available for any other purpose;

(2) The financing does not constitute a debt or liability of HUD or the United States, the full faith and credit of the United States are not pledged to the payment of debt service, and debt service is not guaranteed by HUD or the United States;

(3) Nothing in this CFF ACC Amendment or 24 CFR part 905 is intended to diminish HUD's authority to administer, monitor, and regulate the public housing program, including HUD's authority to exercise any administrative sanction or remedy provided by law; provided, however, that except as required by law, HUD will not assert any claim or right under the ACC, including the exercise of administrative sanctions and remedies, if and to the extent that the effect of such claim or right would be to reduce the payment of Capital Fund moneys to the PHA below the level necessary to pay debt service or delay the time for payment of such moneys such that required amounts would not be available to pay debt service when due;

(4) The financing is subject to mandatory prepayment prior to the obligation end date and expenditure end date of the Capital Fund financing proceeds to the extent necessary for the

Capital Fund Financing Proposal proceeds to comply with section 9(j) of the 1937 Act (42 U.S.C. 1437g(j)). Bond and loan documents shall include appropriate provisions such that prepayment shall be made by the lender, trustee, or appropriate third-party servicer approved by HUD, without any action by HUD post-approval;

(5) HUD agrees, subject to the availability of appropriations, to approve immediately upon receipt from the PHA (subject to any legal requirements or constraints applicable at the time), a CFP Plan document (as described in 24 CFR 905.505(h)) and/or an annual CFF ACC Amendment, to the extent and in an amount sufficient to make the applicable debt service payment;

(6) Prior to cumulatively reducing its inventory of public housing units by more than 5 percent of the Stabilized Base Unit Count, if, after the removal of units from inventory, the Debt Coverage Percentage under § 905.505(i)(1) would constitute more than 33 percent of future Capital Funds, the PHA shall prepay the financing such that the reduction in inventory shall not cause the Debt Coverage Percentage to increase. If the reduction in inventory is required by law or public housing requirements, the prepayment is not required to be made prior to the reduction in inventory, but instead shall be made as soon as possible after the PHA becomes aware of the requirement of law or public housing requirements, but only to the extent that Capital Funds are not otherwise needed by the PHA to address the health and safety issues or other requirements of law in the PHA's public housing portfolio, all as determined by HUD. For PHAs that size their loans based upon the projected receipt of RHF funds, prior to undertaking an activity that will reduce its RHF units below the number of units projected in the Capital Fund Financing Proposal as required by § 905.505(i)(3), the PHA shall prepay its loan such that debt service does not exceed 100 percent of projected RHF after accounting for the reduction in RHF units, all as determined by HUD.

(o) *Performance measures.* Pursuant to 24 CFR 905.505(h) a PHA is required to identify in its CFP Plan documents specific items of work that will be accomplished using the proceeds of the proposed financing. The identified items, which shall be quantifiable, shall be the basis on which HUD evaluates a PHA's performance. HUD may also utilize the Capital Fund financing budget, and Capital Fund Financing Proposal approval documents as the

basis to evaluate a PHA's performance. Failure to meet 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 use of the CFFP proceeds shall be reported in the same manner as a Capital Fund grant. The PHA shall submit a performance and evaluation report on a quarterly basis. PHAs that utilize their Capital Fund financing proceeds as part of a mixed-finance transaction, and PHAs that size their financing based upon RHF in their Capital Fund financing transactions, are not required to submit quarterly reports.

(2) Each CFFP transaction and/or development project is subject to fiscal closeout in the same manner of a Capital Fund grant. Fiscal closeout includes the submission of an Actual Modernization Cost Certificate (AMCC) or Actual Development Cost Certificate (ADCC), an audit, if applicable, a final quarterly report, and a final Performance and Evaluation report.

#### **§ 905.507 Streamlined application requirements for standard and high-performing PHAs.**

(a) PHAs with cumulative CFFP borrowings of less than \$2 million and that are standard or high performers under PHAS; PHAs that are high performers under PHAS with cumulative CFFP borrowings of less than \$20 million; PHAs that propose to use their CFFP proceeds in a mixed-finance transaction, or proposals where the sizing of the financing is based only upon the use of RHF funds for debt service, shall not be required to submit:

(1) A third-party management assessment under § 905.505(e);

(2) A third-party fairness opinion under § 905.505(k);

(3) An assurance of financial controls and construction management under § 905.505(l).

(b) Notwithstanding § 905.507(a), if HUD determines that interest or other costs do not appear to meet industry norms, or other aspects of the proposal present atypical risks, HUD retains the discretion to require assessments, opinions, or controls, or to return the proposal.

#### **§ 905.510 Submission requirements.**

(a) All requests for HUD approval of CFFP transactions shall be submitted to the Office of Public and Indian Housing (PIH), Attention: Office of Capital

Improvements, in such form and in such number of copies as designated by PIH through direct notice.

(b) Each Capital Fund Financing Proposal shall be tabbed and presented with the following information in the order listed:

(1) *PHA transmittal letter.* The PHA must submit a letter signed by the PHA Executive Director (or Chief Executive Officer, if applicable) briefly describing the proposed financing and use of proceeds, the percentage of Capital Funds being dedicated to debt service, the percent of the PHA's public housing units benefiting from the financing, and the impact of the financing upon the public housing portfolio, and transmit to HUD a request for approval of the CFFP transaction. The transmittal letter shall provide any additional information required pursuant to this subpart including, but not limited to:

(i) Describing the transaction being proposed;

(ii) Describing in detail any existing financing or similar commitments of public housing funds;

(iii) Describing and providing justification for significant financial or legal provisions, such as variable interest or acceleration provisions;

(iv) Describing construction management and financial controls.

(2) *Term sheet, table of contents, and contact information.* The PHA must submit the HUD-prescribed term sheet that describes the basic terms of the transaction and financing structure, including the proposed amount of the financing, the term, interest rates, security, and reserve requirements. A table of contents must identify the materials submitted, as well as list the materials the PHA is not required to submit pursuant to this rule. Contact information for all of the participating parties is also required.

(3) *Financing schedules.* The PHA must submit financing schedules that include a debt service schedule, sources and uses schedule, and a portfolio schedule (including projections for RHF, as appropriate), and an adequacy-of-Capital Funds schedule, all in a format prescribed by HUD.

(4) *Other required submissions.* The following submissions must be incorporated in the proposal to the extent required to be submitted by this part: Capital fund financing budget, management assessment, fairness opinion, and physical needs assessment.

(5) *Financing documents.* The PHA must submit a complete set of the legal documents that the PHA will execute in connection with the CFFP transaction. The legal documents must identify the nature and extent of any security being provided, as well as the position of any security interest (e.g., first lien position, second lien position). The legal documents are to be submitted to HUD only after they have been negotiated and agreed upon by the parties to the transaction. HUD will not review preliminary documents that are still under negotiation.

(6) *Declaration of Trust requirements.* The PHA must submit evidence that the PHA has conformed to the Declaration of Trust requirements in accordance with this subpart.

(7) *Board resolution and counsel's opinion.* The PHA must submit evidence of a PHA Board resolution that authorizes the PHA to: Undertake the loan up to a specified amount, provide all security interests required by the loan, and repay the loan with Capital Funds (including RHF funds, when applicable) as required by the financing documents. The Board resolution must also provide authorization for the Executive Director or other executive staff to negotiate and enter into all legal documents required as part of the transaction. The PHA must submit PHA counsel's opinion, which opines that the PHA has the authority to enter into the transaction, and affirms that the transaction complies with the requirements of the 1937 Act, as amended; Federal regulations; and the ACC, as amended.

(8) *Depository Agreement and ACC.* The PHA must submit a Depository Agreement (form HUD-51999) and a CFF ACC Amendment.

(9) Other documents as required by HUD.

#### **§ 905.515 HUD review and approval.**

(a) After receipt of a Capital Fund Financing Proposal, HUD shall review the proposal for completeness. HUD will return to the PHA 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 under this subpart. HUD may require the PHA to make modifications to any of the CFFP documents submitted and may require the PHA to resubmit all or any portion of the proposal. After HUD determines that a proposal complies with all applicable requirements, HUD shall notify the PHA in writing of its approval and any condition(s) of the approval.

(b) (1) A copy or copies of the CFF ACC Amendment shall accompany the approval letter.

(2) Within 60 days of the date of HUD's approval of the transaction or, if HUD sets conditions on its approval, within 60 days of the date that the PHA satisfies such conditions (as evidenced by documentation retained in the PHA's file and available to HUD upon request), but in no event longer than 120 days after the HUD approval, 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 required by HUD to take certain actions such as initiating debt service payments through HUD's automated systems.

(3) Failure to provide the required documents to HUD within the time frame required under § 905.515(b)(2) may result in HUD rescinding its approval.

Dated: October 8, 2010.

**Sandra B. Henriquez,**

*Assistant Secretary for Public and Indian Housing.*

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