

# FLASH ALERT

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## HOTMA GUIDANCE ON THE USE OF OPERATING SUBSIDY FOR CAPITAL FUND PURPOSES

Congress passed the Housing Opportunity Through Modernization Act (HOTMA) in 2016. Section 109(b) of HOTMA provides Public Housing Authorities (PHAs) flexibility to use up to 20 percent of its Operating Subsidy appropriated each year for Capital Fund Program (CFP) activities. [PIH Notice 2018-3](#) was issued on February 28 and provides the necessary guidance on the use of Operating Funds for Capital Fund purposes.

Beginning in CY 2018, all PHAs with a public housing program will have the option to use Operating Subsidy for Capital Fund activities except for Moving to Work (MTW) agencies and PHAs with fewer than 250 public housing units. Both the MTW agencies and PHAs with fewer than 250 public housing units already have flexibility with their operating funds.

PHAs that intend to use this flexibility are required to submit an Annual PHA Plan and must indicate they intend to use Operating Subsidy for CFP activities. PHAs must include this information in the statement of financial resources in the Annual Plan template. Small PHAs, for those years in which they are not also submitting a Five-Year Plan, must check the appropriate box on form HUD-50077-CRT-SM, indicating that there has been a change to the statement of financial resources since the last Annual Plan submission.

Qualified<sup>1</sup> PHAs that are not required to submit an Annual PHA Plan must make the information available regarding how they intend to use this flexibility and have this information readily available for the required annual hearing. PHAs that elect to use their Operating Subsidy for CFP activities must continue to follow statutory and regulatory requirements, including those related to the conduct of public hearings, Resident Advisory Board consultation, consideration of comments, board approval, and environmental reviews.

<sup>1</sup> The term "qualified PHA" means a public housing agency that meets the following requirements:

(1) The sum of the number of public housing dwelling units administered by the agency, and the number of vouchers under section 8(o) of the United States Housing Act of 1937 (42 U.S.C. 1437f(o)) administered by the agency, is 550 or fewer; and

(2) The agency is not designated under section 42 U.S.C. 1437d(j)(2) as a troubled public housing agency, and does not have a failing score under SEMAP during the prior 12 months.

Prior to HUD approval, the PHA will estimate the amount of Operating Subsidy to be used for CFP activities at the project level and the public housing level. Based on that estimate, PHAs should plan throughout the year for the amount of Operating Subsidy that they intend to use for CFP activities. The PHA may estimate any amount of Operating Subsidy for CFP activities at any project provided the following conditions are met:

1. The Operating Subsidy to be used for CFP activities at all projects does not exceed the maximum amount of 20 percent allowed at the PHA-wide level
2. The Operating Subsidy to be used for CFP activities at any one project does not exceed that project's total amount of Operating Subsidy

Operating Subsidy to be used for CFP activities must remain in e-LOCCS. If a PHA draws down too much of its Operating Subsidy from BLI 1000 each month, it may not have sufficient funds remaining in e-LOCCS when HUD calculates the maximum authority which will take place towards the end of the calendar year. PHAs should note that any Operating Subsidy drawn down from e-LOCCS prior to approval by HUD cannot be used for CFP activities.

**Table 1: Example - Allowable project-level budgets using operating subsidy for CFP activities**

	Project A	Project B	Project C	PHA Total
Op Sub for CY	\$200,000	\$150,000	\$50,000	\$400,000
Example 1	40,000	30,000	10,000	80,000
Example 2	80,000	0	0	80,000
Example 3	0	40,000	40,000	80,000
Example 4	30,000	10,000	20,000	60,000
Example 5	0	20,000	50,000	70,000

All the examples in Table 1 demonstrate allowable ways for a PHA to budget its projects' Operating Subsidy for CFP activities. In each example, at the PHA level (i.e., "PHA Total" column), the total amount of Operating Subsidy used across all projects for CFP activities is \$80,000 (which is 20 percent of the \$400,000 of total Operating Subsidy obligated to the PHA for all projects) or less. In addition, in each example, the amount budgeted at any one project for CFP activities is equal to or less than the amount of total Operating Subsidy obligated to the project, and at least that amount is assumed to be available in BLI 1000 in e-LOCCS.

At the end of each funding year (calendar year), HUD will publish the total amount of Operating Subsidy obligated to each PHA for the funding year and identify the maximum amount (20 percent) of Operating Subsidy that is allowed for CFP activities.

After HUD publishes the amount of Operating Subsidy that can be used for CFP activities, PHAs may need to update their original estimate of Operating Subsidy to be used for CFP activities and will be required to create a draft Annual Statement / Budget identifying the amount of Operating Subsidy the PHA will use for CFP activities for each project in the Activity Planning Module of HUD's Energy Performance and Information Center (EPIC) system. A PHA must create a separate draft Annual Statement / Budget for each Operating Subsidy grant where the PHA will be using Operating Subsidy for CFP activities.

Once the budget is created in EPIC, HUD will review the draft Annual Statement / Budget to ensure that it complies with the requirements outlined in PIH Notice 2018-3. If HUD concludes that the draft Annual Statement / Budget complies with the requirements, HUD will create a notional Operating Subsidy grant in the EPIC system using the grant number provided in the budget, as well as the amount specified (i.e. the amount of Operating Subsidy to be used for CFP activities specified in the draft budget).

HUD will complete the process of adding a new notional grant in the EPIC system within five business days after the end of the month in which the Annual Statement / Budget is created in the system and passes HUD's review. The PHA will then be able to link the draft Annual Statement / Budget to its corresponding grant and submit the budget. HUD will transfer Operating Subsidy in the amount listed in the submitted Annual Statement / Budget from BLI 1000 to BLI 1300.

Once funds are transferred to BLI 1300, PHAs must adhere to CFP requirements related to drawdowns and expenditures as detailed in 24 CFR 905.310, and other relevant HUD guidance for such funds. PHAs may not spend Operating Subsidy for CFP activities that are drawn from BLI 1000. PHAs that determine that they need to transfer all or a portion of the previously transferred Operating Subsidy from BLI 1300 back to BLI 1000 to be used for Operating Fund-eligible activities may do so after creating a revised Annual Statement / Budget in EPIC that contains a lower amount than the original budget. In these instances, HUD will work with PHAs to make the necessary adjustments to EPIC and ELOCCS.

When the transfer of Operating Subsidy to Capital Fund activities is completed, these dollars cannot be used for BLI 1406 or to increase the amount of the Capital Fund Management Fee (BLI 1410) that can be charged from the COCC. However, all other PHAs that do not use a fee-for-service approach will be allowed to provide funds for BLI 1408 and 1410 up to the percentage allowed per Capital Fund regulation. For example, if the total amount of a project's 2018 Operating Subsidy is \$500,000 and the project is dedicating \$75,000 in Operating Subsidy for CFP activities, the maximum amount of funds that could be allocated to BLI 1410 - which is currently limited to 10 percent - would be limited to \$7,500 [0.10 (10 percent regulatory limitation) X \$75,000 (amount of Operating Subsidy used for CFP activity)]. It would not be \$10,000 [\$500,000 (total Operating Subsidy) X 0.20 (20 percent allowed flexibility) X 0.10 (10 percent regulatory limitation)].

PHAs utilizing Operating subsidy for CFP activities must adhere to the same reporting standards that apply to a typical Capital Fund grant except an Actual Modernization Cost Certificate / Actual Development Cost Certificate does not have to be completed.

PIH Notice 2018-3 provides eight items to assist PHAs on financial management:

1. Operating Subsidy that has been identified for CFP activities by the PHA is not subject to the two-year obligation or four-year expenditure requirements normally associated with a PHA's CFP grant. These funds remain Operating Subsidy with "expanded uses." As Operating Subsidy, they must be expended within seven years of the funding year from which they came.
2. HUD is not creating any threshold requirements for the use of this flexibility, such as meeting minimum financial ratios or maintaining appropriate reserve levels, which may impact a PHA's Public Housing Assessment System (PHAS) score and designation. PHAs are advised to analyze the impact of using this flexibility on their PHAS score prior to use.
3. For a PHA operating under a COCC / fee-for-service model, using this flexibility could result in less excess cash at a property which could limit the PHA's ability to transfer funds from one project to another project or charge an asset management fee. PHAs are advised to analyze the impact of using this flexibility on their projects' excess cash calculations prior to use.

4. To be compliant with federal cash management rules, Operating Subsidy budgeted by the PHA for CFP activities may not be drawn down from e-LOCCS until the PHA has incurred an eligible cost and the PHA is ready to make payment. In accordance with federal cash management rules, once the PHA has drawn these Operating Subsidy funds for a CFP activity, the PHA has three business days to disburse the Operating Subsidy (i.e., make payment to the vendor / contractor).
5. The Annual Contribution Contract (ACC) requires all Operating Subsidy and other program income to be deposited into the PHA's General Fund. The use of Operating Subsidy for CFP activities does not change this requirement. However, a PHA must separately account for the use of this Operating Subsidy flexibility in such a manner as to be able to support compliance with the notice. A PHA's records need to show the following:
  - a. Only Operating Subsidy (not reserves / program income) was used for the allowed CFP activity
  - b. No more than 20 percent of that year's Operating Subsidy was used to fund CFP activities
  - c. Operating Subsidy was spent in accordance with the PHA's approved budget in EPIC

If a PHA uses this flexibility, it must ensure that its records support the CFP transaction(s) in all three ways described above.

A PHA may want to establish subsidiary accounts within its accounting system to account for the use of Operating Subsidy for CFP activities. The use of subsidiary accounts will help a PHA to track the amount, the funding year, the date when the Operating Subsidy was identified for CFP activities, and the date when the eligible CFP expense was paid. This recommended accounting is similar to that currently used for CFP accounting.

6. Operating subsidy identified for CFP activities remains Operating Subsidy with expanded uses, however, PHAs must follow the requirements of 24 CFR Part 905 when using these funds.
7. As with capital funds, budget revisions for Operating Subsidy to be used for CFP activities may be necessary from time to time.
8. Operating Subsidy that is to be used for CFP activities carries a further restriction from Operating Subsidy used for operations. From the time the PHA draws down these funds and before payment is made, the funds must be reported as restricted on the PHA's financial data schedule and financial statements.

Appendix A of PIH Notice 2018-3 provides guidance for Financial Data Schedule (FDS) reporting:

1. Operating Subsidy revenue regardless of its final use will be reported in the Low Rent column of the project under which HUD obligated such funds using FDS Line 70600 (HUD PHA Operating Grants).
2. Operating Subsidy that has been budgeted, approved for use to fund eligible CFP activities, and drawn down but not yet paid will be reported as restricted cash using FDS Line 112 (Cash - Restricted - Modernization and Development) or FDS Line 115 (Cash - Restricted for Payment of Current Liability) on the project Balance Sheet.
3. If the Operating Subsidy used for CFP activities was spent on items that are capitalized, PHAs must enter the respective amounts into the capital activity memo accounts located at the bottom of the project's Low Rent Income Statement on the FDS. These FDS line items are completed when the project incurred capital costs funded with non-Capital Fund related monies. The list of the capital activity memo accounts for the Low Rent column on the FDS are provided below:
  - ▶ FDS Line 11610 (Land Purchases)
  - ▶ FDS Line 11620 (Building Purchases)
  - ▶ FDS Line 11630 (Furniture and Equipment – Dwelling Purchases)
  - ▶ FDS Line 11640 (Furniture and Equipment – Administrative Purchases)
  - ▶ FDS Line 11650 (Leasehold Improvement Purchases)
  - ▶ FDS Line 11660 (Infrastructure Purchases)

As this new guidance is implemented, we will keep you informed regarding any changes to HUD's systems to administer this section of HOTMA.

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