



**National Association of Housing and Redevelopment Officials**

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November 6, 2006

Office of General Counsel  
Rules Docket Clerk  
Department of Housing and Urban Development  
Room 10276  
451 Seventh Street, SW  
Washington, D.C. 20410

Re: Comments on Notice, published September 6, 2006, 71 FR 52709, entitled "Public Housing Operating Fund Program: Guidance on Implementation of Asset Management [Docket Number FR-5099-N-01]"

Dear Sirs and Mmes:

Please find attached hereto comments concerning the above referenced Notice and related documents offered by the National Association of Housing and Redevelopment Officials (NAHRO).

Formed in 1933, with more than 22,000 agency and individual members, NAHRO is the nation's oldest and largest nonprofit organization representing local agencies and officials involved in the production and operation of affordable housing and in community development. Nearly every agency affected by the documents commented upon is a member of NAHRO.

Sincerely,

Saul N. Ramirez, Jr.  
Executive Director

Encl.

**Donald J Cameron**, SPHM, President; **Renée Rooker**, SPHM, Senior Vice President; **Bill Jacobs**, PHM, Vice President-Professional Development; **Montez C. Martin, Jr.**, Vice President-Community Revitalization & Development; **Maggie Lamont**, Vice President-Member Services; **Carlos A. Sanchez**, Vice President-Housing; **Richard S. Lujan**, Vice President-Commissioners; **Akinola Popoola**, PHM, Vice President-International; **Saul N. Ramirez, Jr.**, Executive Director

HUD Office of the General Counsel  
Rules Docket Clerk  
Docket No. FR-5099-N-01  
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To: Office of the General Counsel  
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U.S. Department of Housing and Urban Development  
Room 10276  
451 Seventh Street, SW  
Washington, DC 20410-0001

From: National Association of Housing and Redevelopment Officials (NAHRO)

**Re: Comments: Docket No. FR-5099-N-01  
Notice, Public Housing Operating Fund Program; Guidance on Implementation of  
Asset Management, 71 FR 52710, September 6, 2006**

These comments address the above referenced Federal Register Notice (The “Asset Management Notice”) and to a lesser extent related Notice PIH 2006-33 with attachment thereto, Supplement to Handbook 7475.1 REV., CHG-1, Financial Management Handbook (the Supplement), issued by HUD on the same day and pertaining to the same subject matter (the “Financial Management Notice”).

### **Background/Overview**

The Asset Management Notice states that it provides “interim guidance” for various aspects of public housing’s conversion to asset management, reciting as background the issuance of the Public Housing Operating Fund Program Final Rule, published September 19, 2005, 70 FR 54984 (the “Operating Fund Rule”). Similarly, the Financial Management Notice states that it transmits changes in financial management and reporting “requirements” for public housing agencies (PHAs) “pursuant to” the Operating Fund Rule. It is clear both from their text and context that these documents derive from Operating Fund Rule and are intended to implement its provisions. Unlike the Operating Fund Rule itself, they are not promulgated as regulations and since they do not have regulatory standing independent of the rule itself, they are subsidiary to the rule and must be consistent with its provisions in letter and spirit.

The Operating Fund Rule was created in a negotiated rulemaking process mandated by Congress to create a new distributional formula for public housing operating subsidy. At the insistence of the Department of Housing and Urban Development, rulemaking to bring about the conversion of public housing to asset-based management was added to the statutory mandate, which extended only to the development of distributional formula. NAHRO, along with other industry organizations and a number of PHAs, participated in that additional rulemaking.

The parties to the negotiated rulemaking committee contemplated a shift to asset-based management that would occur in stages, first with project based budgeting and accounting, then to actual asset-based management by the year 2011 (appropriately, the year 2012, inasmuch as

the Department published the rule more than a year later than anticipated by the committee). The participants envisioned a federal role that “supported” PHAs’ conversion to asset management (24 CFR 990.225(b)), and that, under the rule, PHAs would “manage their properties according to an asset management model, consistent with the management norms in the broader multi-family management industry.” (24 CFR 990.225(a)) They would also be required to implement project based management, project based budgeting and project based accounting, “which are essential components of asset management” (24 CFR 990.225(a)).

Each PHA subject to the rule is required to “develop and maintain a system of budgeting and accounting for each project in a manner that allows for analysis of actual revenues and expenses associated with each property.” (24 CFR 990.280(a)) They are do this “in accordance with Accounting Principles Generally Accepted in the United States of America (GAAP)...” (24 CFR 99.280 (b)(1)) Importantly, the rulemaking committee also agreed, and the Operating Fund Rule provides, that “... [p]rovided the PHA complies with GAAP...it shall have the maximum amount of flexibility in implementing project based accounting.” (24 CFR 990.280(b)(2)).

The Operating Fund Rule provides that project-specific operating costs will include “a property management fee charged to each project that is used to fund the operations of the central office. Amounts that can be charged to each project for the property management fee must be reasonable.” (24 CFR 990.280(b)(4)). It contemplates that central office cost centers will be created “to account for “non-project specific costs” and states that these costs shall be funded “from the property management fees received from each property and from asset management fees to the extent these fees are available.” (24 CFR 990.280(c)) Property management fees used to fund central office costs “must be reasonable.” The rule cites “human resources, Executive Director’s office, etc.” as examples of central office functions but does not state or imply that HUD will determine which functions will be centralized. It is noted that the negotiators did not agree, nor does the rule provide, that central office supervisory functions relating to project management could only be paid from HUD approved property management and asset management fees.

Although, federal law, including OMB Circular A-87, does not require it, the rule negotiators agreed that where a PHA chooses to centralize functions that “directly support a project,” it must charge each project “using a fee for service approach” and that each project must be charged only “for the actual services received and only to the extent that such amounts are reasonable.” (24 CFR 990.280(d)) The rule negotiators did *not* agree, and the rule does not provide, that the term “reasonable” – normally a term that in contemplation of law takes into account all relevant facts and circumstances - would be specified categorically in advance by anyone. Nor did they agree (and again the rule does *not* provide) that management fees would be limited to particular dollar amounts, uniformly applied, that do not reflect and support the true and actual cost of PHA central office functions.

Further indication that the drafters of the rule did not contemplate a “one-size-fits-all” approach to these matters can be found in the rule’s provisions governing HUD determinations of compliance with asset management requirements which require the assessment to be conducted

“by a professional familiar with property management practices and costs in the region or state in which the PHA is located.” (24 CFR 990.290(b)(1)).

Inasmuch as the “guidance” promulgated in the Asset Management Notice and the financial reporting “requirements” set forth in the Supplement attached to PIH Notice 2006-33 are derived from the rule and issued for the purpose of implementing it, the appropriateness of this guidance is dependent upon its consistency with the rule itself and the expectations of the rule negotiators reflected in the rule language.

### **General Comment**

As previously expressed to responsible HUD officials on numerous occasions by NAHRO and others, HUD’s highly prescriptive approach to asset management issues, beginning with its guidance on project designations and stop-loss guidance and continuing with this Asset Management Notice and Financial Management Notice contradicts the flexibility and discretion intended to be available to PHAs under the Operating Fund Rule.

Taken as a whole, this guidance - which in practical fact is mandatory - is designed to dictate in minute detail the manner in which PHAs must conduct their central office activities, deploy their staffs, spend their operating money and otherwise conduct their business. This was and is not the intent of the Operating Fund Rule. What began as a suggestion that PHAs operate their projects in a manner generally more consistent with the norms of the multi-family rental industry has morphed into yet another instance of HUD micromanagement and hyperregulation. As will be discussed in greater detail below, these notices also overreach in their attempts to draw within their scope programs and activities other than the Public Housing Operating Fund program.

Stated more specifically, NAHRO has the following concerns:

*1. HUD’s attempt to limit central office functions artificially by limiting the payment of central office costs to pre-prescribed amounts of management fees and asset management fees chargeable is arbitrary and outside the legitimate purpose of the Operating Fund Rule.*

As noted, the Operating Fund rule provides only that management fees will be “reasonable.” In the normal contemplation of law, the term “reasonable” takes into account context and relevant facts and circumstances. Creating a disconnect between legitimate central office functions and the money that may be made available to pay for them has little or nothing to do with any legitimate asset management concern. Rather it reflects an apparent underlying premise, without supporting data, that (i) central office costs of PHAs are excessive, and (ii) that this condition should be remedied by this rule. NAHRO objects on both counts. HUD could have answered this question by insisting that the Harvard Graduate School of Design determine the true costs of operating well run public housing by actually studying housing authorities rather than using the FHA database as a proxy for them (looking at a very small number of PHAs as a test group). It did not elect to do this.

The truth is that much of the central office cost of PHAs directly reflects the imposition of oversight requirements by HUD, a matter over which the PHAs have little or no control. And their status as governmental entities entails a complexity of operation that is not faced by private owners of subsidized properties. Despite many efforts on the part of NAHRO and other advocacy groups to point out that the regulatory environment of PHAs – as public agencies overseen by the Office of Public and Indian Housing – differs markedly from that of the typical FHA multifamily project, this guidance continues to reflect an implicit conclusion that FHA management fees are an appropriate benchmark for public housing. The truth is that HUD, having chosen not to study this, has no evidentiary basis on which either to draw such a conclusion or to reject the assertions to the contrary of PHA organizations.

The Notices reflect an implicit assumption that devolving virtually all management functions to the project level is necessarily more effective and efficient. Yet HUD has made no effort to test this assumption. “Efficiency” is not solely a matter of financial cost. Housing authorities have, for example, long been encouraged by HUD and the HUD Office of Inspector General to centralize their procurement functions. This has occurred for a reason, and HUD has demonstrated no basis to conclude that this reason no longer exists (notwithstanding that project level procurement may now be encouraged under a new procurement handbook). The same may be said for other management functions such as fair housing and equal opportunity compliance, to name but one. Do we seriously think, for example that medium sized and larger authorities will achieve meaningful compliance with Section 3 when such a function is devolved to the project level? The point is that guidance designed to implement a rule that calls for “maximum flexibility” to PHAs overreaches when it seeks to dictate through the imposition of financial rules what functions will and will not be conducted by PHAs within their central offices.

HUD’s apparent policy position is doubly ironic when considering that much of the central office function of PHAs has to do with satisfying the requirements of HUD itself and other legal requirements that arise by virtue of their status as public entities. Leaving aside regulatory oversight, in the realm of real estate management, HUD has no legitimate business creating guidance that effectively forces a PHA to devolve its maintenance functions or eliminate its warehouses if the housing authority in its discretion determines that centralizing these functions will attain greater operational efficiencies. Effective asset management may be accomplished in a variety of ways. The guidance has lost sight of this.

The Department has not explained why “excess” cash, after an adequate reserve has been established for each project, is not to be made available for central office use. As such the restriction is arbitrary. It also reflects policy judgments that go beyond the substance and scope of the Operating Fund Rule, such as efforts to discourage the use of operating subsidy for resident services.

*2. An interrelationship exists between the efficacy of the Asset Management Notice and Operating Fund appropriations. PHAs must be given adequate flexibility in the use of the resources provided to them.*

This guidance requires that central office costs be funded out of management fees and if funds are available by asset management fees. In practical effect, project direct costs must be paid first and central office costs will be paid with what is left. Central office functions will break down if the operating Fund financial resources made available to PHAs are inadequate. Yet HUD has made no effort to request adequate Operating Fund resources, even in the face of acknowledged shortfalls in utilities costs. Under current funding circumstances it is not hyperbole to say that the prospect of PHAs receiving asset management fees is mythological. Nor has HUD taken any substantial actions to reduce oversight burdens on PHA central offices. To the contrary, it has announced plans to conduct ‘comprehensive reviews’ of agency program compliance (in addition to Rental Integrity Monitoring Reviews (RIMS) and other existing reviews, as well as increased oversight activity by HUD’s Office of Fair Housing and Equal Opportunity.

The inadequacy of present and anticipated funding levels (with a predicted FY 2007 proration of 78% of need or less) makes it crucial that PHAs be actually provided the flexibility the Operating Fund Rule envisions to allocate their operating funds where they are needed.

In our interactions with HUD officials directly responsible for asset management implementation, the question of resources has repeatedly been raised. The reply has typically been that, whatever the merits, these officials do not control appropriations matters. This is no doubt true. However, it is, institutionally, an insufficient response. Adequacy of resources and the ability to administer central office functions are linked. The Department must recognize this and if funding is not to reflect need, it must make appropriate adjustments both in asset management guidance and oversight impositions.

*3. HUD should not establish standard fees based on available information at this time. The Asset Management Notice should not place the burden on PHAs to prove that HUD prescribed fees are inadequate.*

As noted above, the Operating Fund Rule provides only that property management and asset management fees and must be reasonable. It does not provide that they shall be fixed by HUD. While we appreciate that the Asset Management Notice permits a PHA to demonstrate that the HUD-prescribed fees are inadequate for its particular circumstances, we disagree with the premise that this burden rightly belongs with the PHA.

With regard to property management fees, it is unclear to us why public housing agencies should be limited to the 80<sup>th</sup> percentile of the fee level set by HUD field offices for all other practitioners of asset management in multifamily housing. Further, the condition of these fees schedules – some not updated for years, others apparently inaccurate – is unacceptable. A glance at the fee table in the Supplement (page 52) shows Pittsburgh’s fee several dollars higher than Philadelphia and Chicago, and Newark higher than New York City, while Honolulu lags them

all. Please provide the Department's detailed explanation of how it (and its field offices) arrived at these levels, including all assumptions, calculations and documentation as may be extant.

HUD set the asset management fee at \$10 per unit under an Annual Contributions Contract (ACC). We don't agree this is reasonable for every agency in every application, and request the Department's detailed explanation of how it arrived at this figure, including all assumptions, calculations and documentation as may be available.

NAHRO objects to the promulgation of standard fees by the Department without empirical justification that clearly takes into account the actual operating circumstances of PHAs. In this regard, the Public Housing Authorities Directors Association has made repeated requests to the Department concerning the data on which these fees are based. It is our understanding that these inquiries have never been satisfactorily answered. In the absence of sufficient empirical justification, we consider the promulgated fee amounts to be arbitrary.

HUD should permit PHAs to establish fee amounts flexibly during the entire phase-in to asset management (rather than the initial two year period as presently allowed for non stop-loss agencies) and should gather data concerning the adequacy of fees. PHA established fees should be presumed acceptable during this period unless HUD demonstrates to the contrary.

With respect to demonstrating that HUD prescribed fees are inadequate as provided in Section IX of the Asset Management Notice, NAHRO is concerned that the language is sufficiently vague that the Department could accept or reject any documentation or justification at will.

We recommend the following process: HAs will set fees that are in line with their market area and keep adequate documentation on file regarding how the fees were set. Should the Department disagree with those fee levels, it will demonstrate to the agency why they are inappropriate, and request the agency change the fees going forward in the next annual funding cycle. HAs would have the opportunity to rebut the Department's evidence. We feel a rebuttal provision is necessary for two reasons: first, the Department is not a local property manager and has no direct knowledge of an HA's local market; and the Department's own fee-setting protocols are unclear or inadequate.

The Department is reminded that PHAs are not able to spend more than their allocated funds, regardless of how they may allocate them internally. Flexibility in this regard will presumably not cost the federal government money, so rigidity in the Department's approach to fee-setting is unnecessary.

*4. The asset management scheme being implemented by the Department will not succeed without meaningful regulatory reform.*

NAHRO and others have also urged HUD that any policy to limit central office functions must also involve comprehensive regulatory reform for public housing. Rhetorically, HUD supports this. Yet, aside from a marginal proposal to streamline certain agency plan submissions, serious

regulatory reform has not materialized. If the Department wants to treat PHAs as if they are FHA projects, its approach to regulatory reform must be fundamental, dramatic, and contemporaneous with implementing asset management. NAHRO stands ready to work with the Department to achieve regulatory reform. The department has hinted that PHAS must be reconsidered. Yet no indication has been given that the department seeks to involve industry groups and PHA stakeholders in that effort.

*5. Placing limitations on the assignment of its assets by a PHA is inconsistent with the Operating Fund Rule and the U.S. Housing Act.*

NAHRO objects to the limitation in the Asset Management Notice requiring that PHAs allocate no more than 6 months operating reserve to its central office.

The Operating Fund Rule states that at the time of conversion to project based accounting “a PHA shall apportion its assets, liabilities and equity to its respective projects, and HUD-accepted central office cost centers.” (24 CFR 990.280(b)(1)) The rule places this authority and responsibility upon the agency not upon HUD. Moreover, the U.S Housing Act as amended by the Quality Housing and Work Responsibility Act (QHWRA) vests in housing authorities flexibility to make management and financial decisions about their operations, communities and finances. Limiting the PHA’s assignment of its own assets in this way contradicts the provision of the operating Fund Rule at 24 CFR 990.280(b)(2) which states that PHAs are to have the “maximum amount of responsibility and flexibility in implementing Project-based accounting.” These are not mere words on a page.

Presuming that reasonable reserves are established at, or otherwise made available to, the properties, the amount of assets allocated to the central office should not be a federal concern. The Department’s apparent preoccupation with squeezing PHAs’ central office cost centers seems to belie an intent unrelated to asset based accounting and management.

*6. Treatment of fee income as de-federalized, non-program income is a positive development that should be expanded.*

Recognition of the earned fee/de-federalization concept is positive and long overdue step in the right direction. It is consistent with the status of PHAs as independent local government entities whose relationship with the federal government is founded upon contract.

NAHRO urges the Department to adopt a more comprehensive policy favoring the de-federalization of earned income by PHAs. This should be undertaken together with a re-examination of the Annual Contributions Contract (ACC), which should be revised to reflect more accurately a genuine contractual relationship. The lack of mutuality and adhesiveness of the present public housing ACC have led some to suggest that this document is an “illusory contract” or a regulation rather than a contract. If PHAs, as asset managers, are to more closely resemble the multifamily industry they must have a contract that also more closely resembles contracts in use in that industry.

*7. In attempting to regulate aspects of the Capital Fund Program, the Voucher Program and Mixed Finance developments, Section VIII of the Asset Management Notice overreaches the Operating Fund Rule and may contravene statute.*

The Operating Fund Rule states that PHAs must develop and maintain a system of accounting that allows for analysis of actual revenues and expenses associated with each property, and that project based budgeting and accounting will be applied to all programs supporting projects under an ACC (e.g., Operating Fund, the Capital Fund, etc.). (24 CFR 990.280(a)).

While the logic of this provision is obvious from an accounting standpoint, it does not follow that funding from programs other than the Public Housing Operating Fund Program become characterized as operating funds by virtue of their use in an ACC project. The clear intent of this provision is to require a complete accounting of revenues and costs affecting each project – no more, no less. Additional attempts to restrict use of the Capital Fund with respect to central office costs is not supportable based upon the Operating Fund Rule language.

The Asset Management Notice states in section XII that “[w]hen a PHA transfers funds from the Capital Fund to the Operating Fund, these funds lose their Capital Fund Program identity and are governed by all Operating Fund rules.” However, Section 9 (g) of the U.S. Housing Act states that PHAs (with more than 250 units) may use up to 20% of their Capital Funds for “activities” that are eligible under the operating Fund. The Department has reached a legal conclusion not supported by the statutory language, which makes no mention of the conversion of funds to a different program.

Similarly, the Operating Fund rule contains no support for the Department’s position, stated in the Asset Management Notice, that present Capital Fund regulations allowing PHAs to charge up to 10% of the Capital Fund for administration, and allowing the use of Capital Funds for management improvements may be superseded by this guidance.

Inasmuch as many PHAs rely upon Capital Funds to supplement their inadequate Operating Fund distributions, these provisions have considerable practical significance. NAHRO questions the policy basis for the Department’s seeming obsession with choking the central office operations of PHAs. Actually, PHAs, lacking transition funding that the Department has declined to seek, may well lack adequate central office resources to convert successfully to asset- based accounting and management.

NAHRO objects to the inclusion of these Capital Fund restrictions in this guidance. These provisions appear to contravene existing statutory and regulatory law, which may not be validly accomplished in sub-regulatory guidance, and have no articulated policy basis.

*8. Provisions relating to the voucher program contained in the Asset Management Notice may involve complexity that is not apparent.*

The Asset Management Notice encourages importation of voucher program administration into the asset management scheme by adopting a fee for service methodology. The Notice would permit use of 20% or \$12 per unit month of the section 8 administrative fee to be used for central office costs, without allocation to the section 8 program. Section 8 program guidelines applicable to administrative fees contain certain incentives relating to program performance. In reviewing the ACC and governing regulations on voucher lease-ups and budget utilization, HUD has the authority to “freeze” an HA’s administrative fee reserves (not fees) if an HA’s annual average voucher lease-up drops below 90 percent of their ACC level. The purpose of “freezing” administrative fee reserves, is to ensure that HAs are using a reasonable portion of their Section 8 administrative fee reserves to support a minimal voucher leasing level (i.e. 90 percent) before investing their fee reserves in other programs.

The Asset Management Notice fails to mention voucher leasing threshold below which an HA can drop below before they are limited to using a lower percentage of Section 8 administrative fees or dollars per PUM, than HUD proposes. These provisions should be harmonized. Additionally, recent appropriations acts have required that the use of section 8 admin fees be limited to the section 8 program. Without statutory clarification we are unsure that provision defederalizing these moneys under the Asset Management Notice would be effective.

An informal survey of NAHRO agency members indicated that that the vast majority of agencies are currently charging less to the Section 8 administrative fees for indirect management expenses than the amounts allowed under the Asset Management Notice. Thus, HUD’s proposal incentivizes these agencies to submit management fees that exceed amounts currently charged under OMB Circular A-22. Contrast this with provisions purporting to limit charges under the Capital Fund Program. The reason for this apparent policy difference is not apparent. NAHRO suggests that Section 8 should not under any circumstances be posited as a cure for inadequate operating Fund subsidy.

*9. PHAs with fewer than 250 public housing units should not be required to convert to asset based management in order to stop their losses in subsidy.*

NAHRO agrees with the temporary relief afforded small agencies from the central office cost center requirement and urge that such relief be unlimited in duration. In addition, we suggest that the Department undertake to alter the Operating Fund Rule to allow small agencies to cap their losses at a fixed percentage, rather than converting to asset management, which is not sensible for these agencies. NAHRO believes that the financial impact of this change would be minimal and allowing these agencies to remain exempt from asset management conversion would avoid unnecessary expense and administrative disruption.

It is noted that in this regard that the Harvard Cost Study formula has been shown to involve very significant error as a predictor of cost at the single development/small agency level. The Operating Fund rule requirement (added unilaterally after completion of the negotiated rulemaking process) that appeals based on local conditions be brought annually, all but excludes small agencies from a meaningful appeals process.

*10. NAHRO urges the department to consider testing asset management protocols before final implementation. The present ability of the department to achieve an orderly transition is questionable.*

The changes brought about by the Operating Fund Rule represent a fundamental reordering of the way in which public housing is managed. Unfortunately, much remains unknown about the basis assumptions of FHA multifamily – PHA comparability that underlies much of the Department’s asset management guidance.

Further we believe that the Department is not prepared to properly address the influx of information that this program will generate – first from stop-loss submissions, then to 3,200 financial statements (possibly 14,000, should the Department exercise its option to require financials at the property level). As late as October 25 2006, HUD demonstrated that it had yet to finalize changes to the Financial Data System (FDS) which is used by all PHAs to submit financial data on their agencies. This system is not fully adapted to the Department’s own asset management program requirements because critical decisions have yet to be made, again affecting stop-loss agencies before all others. PHA’s Public & Indian Housing Information Center (PIC) submissions directly affect an agency’s subsidy eligibility, yet that system is not capable even now of accepting submissions accurately or timely despite the Department’s best intentions otherwise.

NAHRO continues strongly to urge that the asset management protocols be tested before full implementation by considering stop-loss agencies’ submittals as the much-needed beta-test for this program, and hold them harmless in subsidy reductions until all program requirements, including questions about fees and conforming other programs and provisions under the 1937 Act, are finalized. Implementation of the new formula would remain on schedule, as would the schedule for all other agencies’ compliance with project-based budgeting and accounting, unless HUD is unable to make final decisions on critical program attributes including financial reporting and data system functionality, and incorporate lessons learned from the stop-loss demonstration, in a manner timely for the remaining agencies to adopt and implement the program requirements.

*10. This guidance purports to impose binding requirements without a formal rulemaking process as required under the Administrative Procedure Act and HUD’s “Rule on Rules.”*

While NAHRO appreciates the opportunity to comment on these notices, we are troubled that they seek to impose binding requirements in a non-regulatory form. We are cognizant that this subject matter is complex and may involve a certain amount of adjustment as the conversion of

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public housing to asset management unfolds. Accordingly, we continue to urge as we have on previous occasions that this “guidance” be re-crafted so that it genuinely meets that definition. Such an action would be both sensible and would avoid serious questions concerning rulemaking compliance.