Development Costs in the LIHTC Program

NCHMA Annual Meeting

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United States Government Accountability Office

Report to the Chairman, Committee on the Judiciary, U.S. Senate

September 2018

LOW-INCOME HOUSING TAX CREDIT

Improved Data and Oversight Would Strengthen Cost Assessment and Fraud Risk Management

GAO-18-637

GAO Highlights

ights of GAO-18-637, a report to the man. Committee on the Judiciary, U.S.

AO Did This Study

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What GAO Found

GAO identified wide variation in development costs and several cost drivers for Low-Income Housing Tax Credit (LIHTC) projects completed in 2011–2015. Across 12 selected allocating agencies, median per-unit costs for new construction projects ranged from about $126,000 (Texas) to about $326,000 (California). Within individual allocating agencies, the variation in per-unit cost between the least and most expensive project ranged from as little as $104,000 per unit (Georgia) to as much as $606,000 per unit (California). After controlling for other characteristics, GAO estimates that

- larger projects (more than 100 units) cost about $85,000 less per unit than smaller projects (fewer than 37 units), consistent with economies of scale.
- projects in urban areas cost about $13,000 more per unit than projects in nonurban areas.
- projects for senior tenants—nearly one-third of all projects—cost about $7,000 less per unit than those for other tenants, potentially due to smaller unit sizes.

Allocating agencies use measures such as cost and fee limits to oversee LIHTC development costs, but few agencies have requirements to help guard against misrepresentation of contractor costs (a known fraud risk). LIHTC program policies, while requiring high-level cost certifications from developers, do not directly address this risk because the certifications aggregate costs from multiple contractors. Some allocating agencies require detailed cost certifications from contractors, but many do not. Because the Internal Revenue Service (IRS) does not require such certifications for LIHTC projects, the vulnerability of the LIHTC program to this fraud risk is heightened.

Weaknesses in data quality and federal oversight constrain assessment of LIHTC development costs and the efficiency and effectiveness of the program. GAO found

- inconsistencies in the types, definitions, and formats of cost-related variables 12 selected agencies collected.
- allocating agencies did not capture the full extent of a key indirect cost—a fee paid to syndicators acting as intermediaries between project developers and investors that IRS requires be collected.
- IRS does not require allocating agencies to collect and report cost-related data that would facilitate programwide assessment of development costs. Further, Congress has not designated any federal entity to maintain and analyze LIHTC cost data.

en without a designated federal entity, opportunities exist to advance oversight evelopment costs. In particular, greater standardization of cost data would foundation for allocating agencies to enhance evaluation of cost drivers and management practices.

United States Government Accountability Office

Objectives

- Assess development costs for LIHTC projects completed in 2011-2015 in selected locations and factors affecting these costs,
- Analyze steps allocating agencies have taken to oversee LIHTC development costs, and
- Identify factors limiting assessment of LIHTC development costs.

Selected Allocating Agencies

Arizona	New York
California	New York City
Chicago	Ohio
Florida	Pennsylvania
Georgia	Texas
Illinois	Washington

The 12 selected allocating agencies accounted for 50% of the total 2015 credit ceiling amount and spanned five major geographic regions.

Project Sample

Project sample included 1,849 projects that received 9% credits from and submitted final cost certifications to the 12 allocating agencies from 2011-2015.

Our sample included nearly all projects completed by the 12 allocating agencies over the period 2011-2015 and are generalizable for our agencies.

However, our results are not generalizable to all allocating agencies.

Data Collection

Development cost and project characteristics data primarily from cost certifications and applications

Total development cost	Project address	Income limits
Line-item costs	Construction type	Tenant type
Eligible basis	Developer name	Square footage
Tax credit allocation	Number of buildings	Structural features
Net tax credit price	Number of units	Syndicator
Funding sources	Number of bedrooms	Year of completion

Augmented Project Data

- **Neighborhood characteristics**: The American Community Survey
- **Geographic characteristics data**: Department of Agriculture
- **Transit data**: Department of Transportation

Description of Analyses

To describe costs and characteristics of LIHTC projects, we

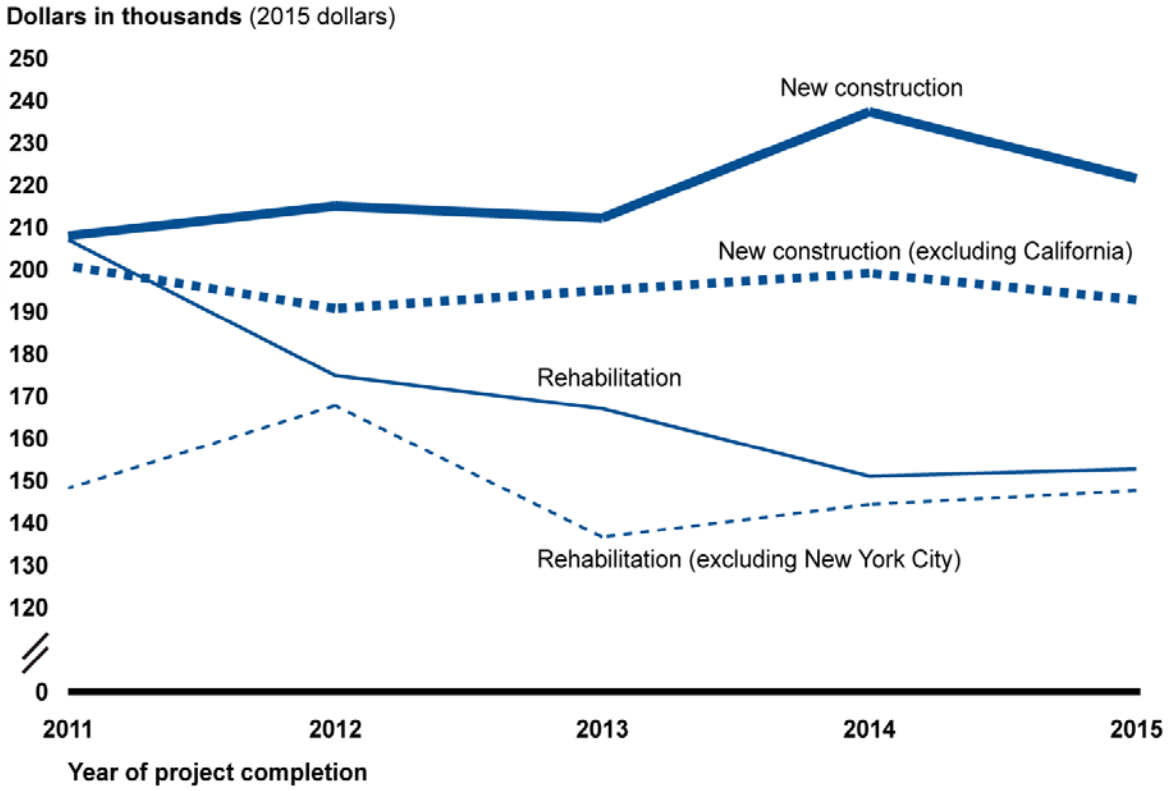
- Calculated summary statistics (distributions and medians) for key elements in our database and
- Developed a regression model to estimate relationships between development costs and relevant project and location characteristics.

We also assessed the reliability of the project data we collected by testing for missing values, outliers, and obvious errors, and interviewing allocating agencies about interpretations of variables.

Results – Summary

- New construction costs generally increased (7%) and rehabilitation costs generally decreased (26%) from 2011-2015
  - Cost trends were sensitive to—and varied by—the allocating agencies in our sample
- Median per-unit cost for new construction projects was $218,000 but varied by about $200,000 ($126,000 in Texas vs. $326,000 in California)
  - Median per-unit costs for rehabilitation projects was $169,000
- Hard costs were about 70% of total development costs, soft costs about 30%, a consistent observation across the 12 allocating agencies

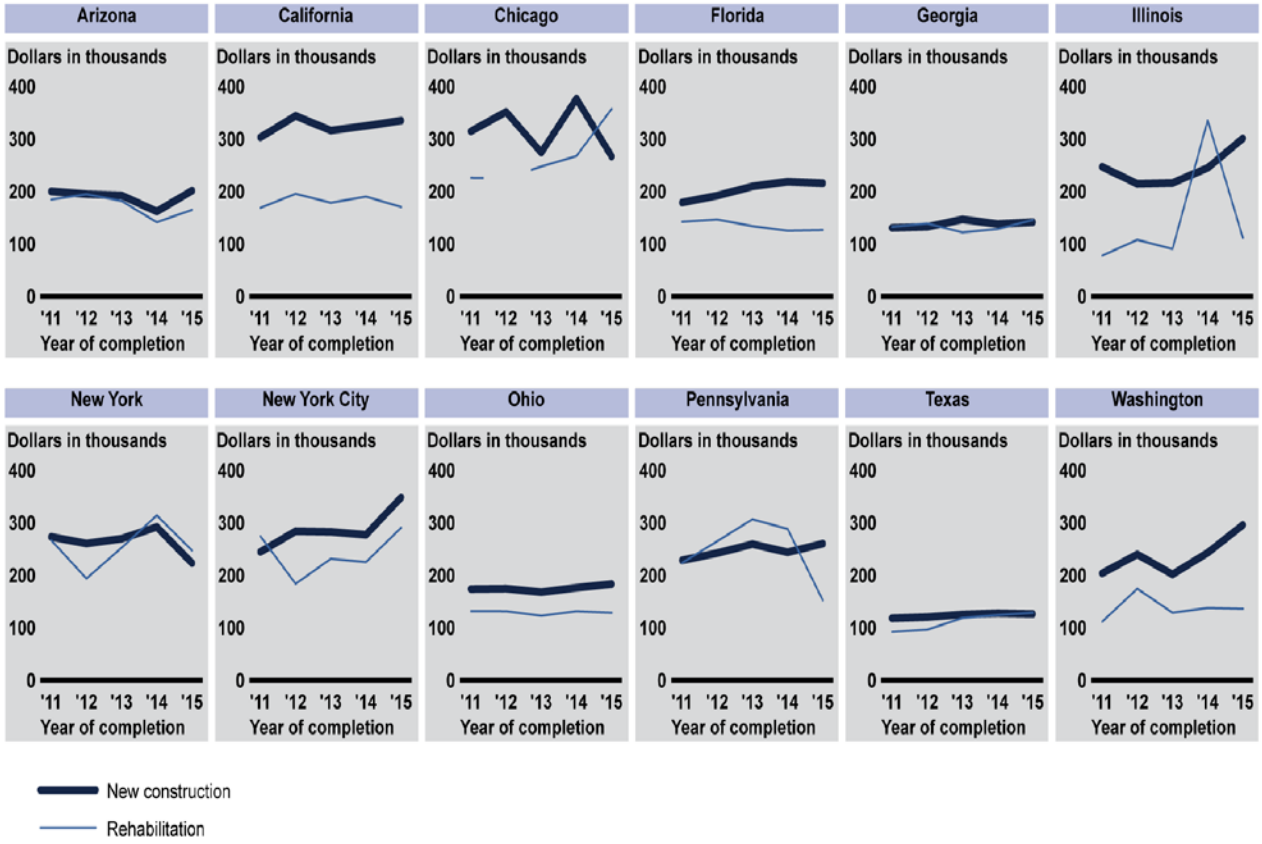
Median Per-Unit Development Cost in Constant Dollars for Selected Allocating Agencies, by Construction Type, 2011–2015



Source: GAO analysis of allocating agency data. | GAO-18-637

Note: The data in the figure are for projects completed in 2011–2015 that received 9 percent Low-Income Housing Tax Credits from the 12 selected allocating agencies (10 states and 2 cities): Projects were considered completed when their final cost certifications were signed. We excluded California and New York City from the alternative trend lines because their costs were among the highest, changed sharply in some years, and represented roughly one-fifth of all new construction and rehabilitation projects, respectively.

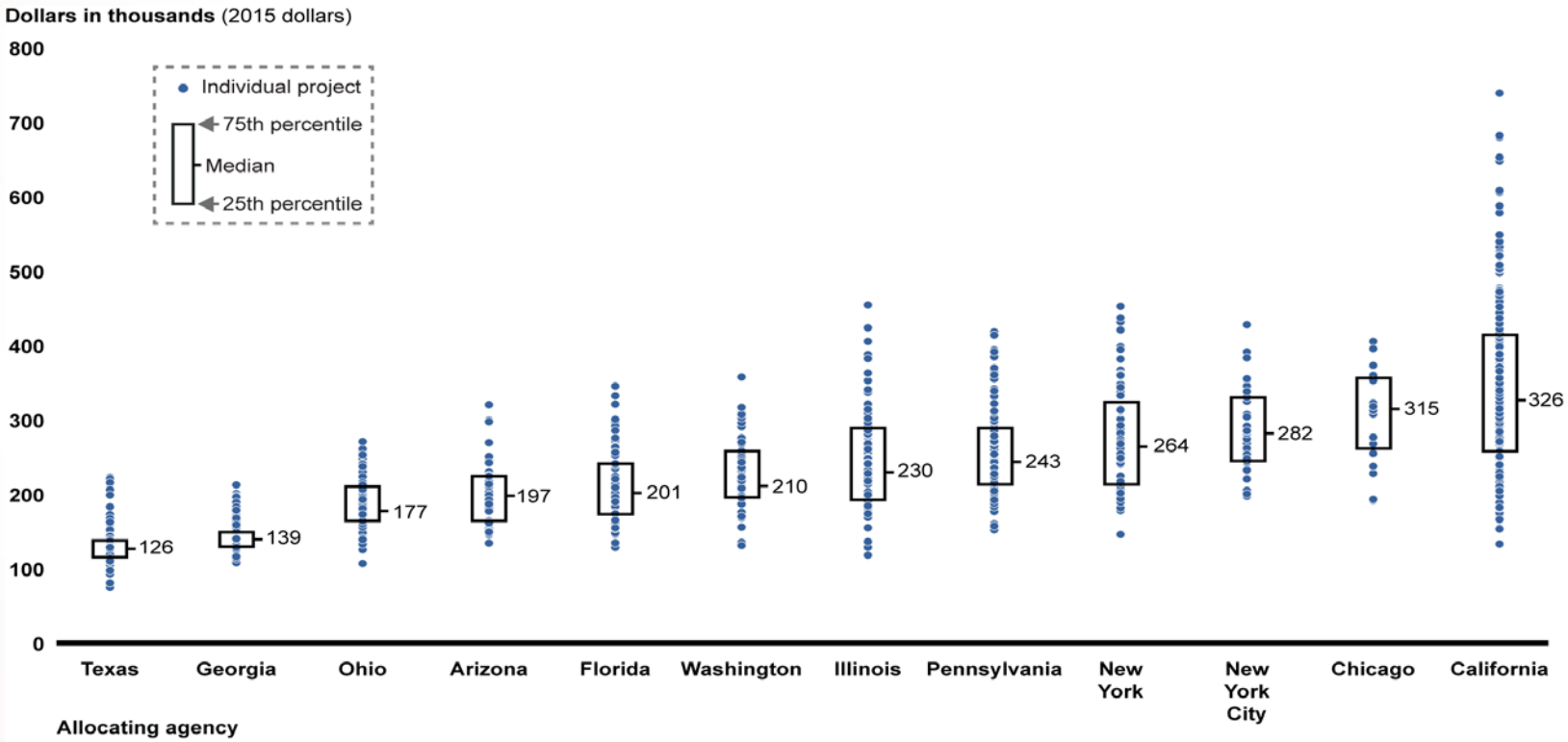
Median Per-Unit Development Costs (2015 dollars) of LIHTC New Construction and Rehabilitation Projects Completed in 2011–2015, by Selected Allocating Agency



Source: GAO analysis of allocating agency data. | GAO-18-637

Notes: The data in the figure are for projects that were completed in 2011–2015 and received 9 percent Low-Income Housing Tax Credits (LIHTC) from the 12 selected allocating agencies. Chicago did not allocate LIHTCs to any rehabilitation projects that were completed in 2012.

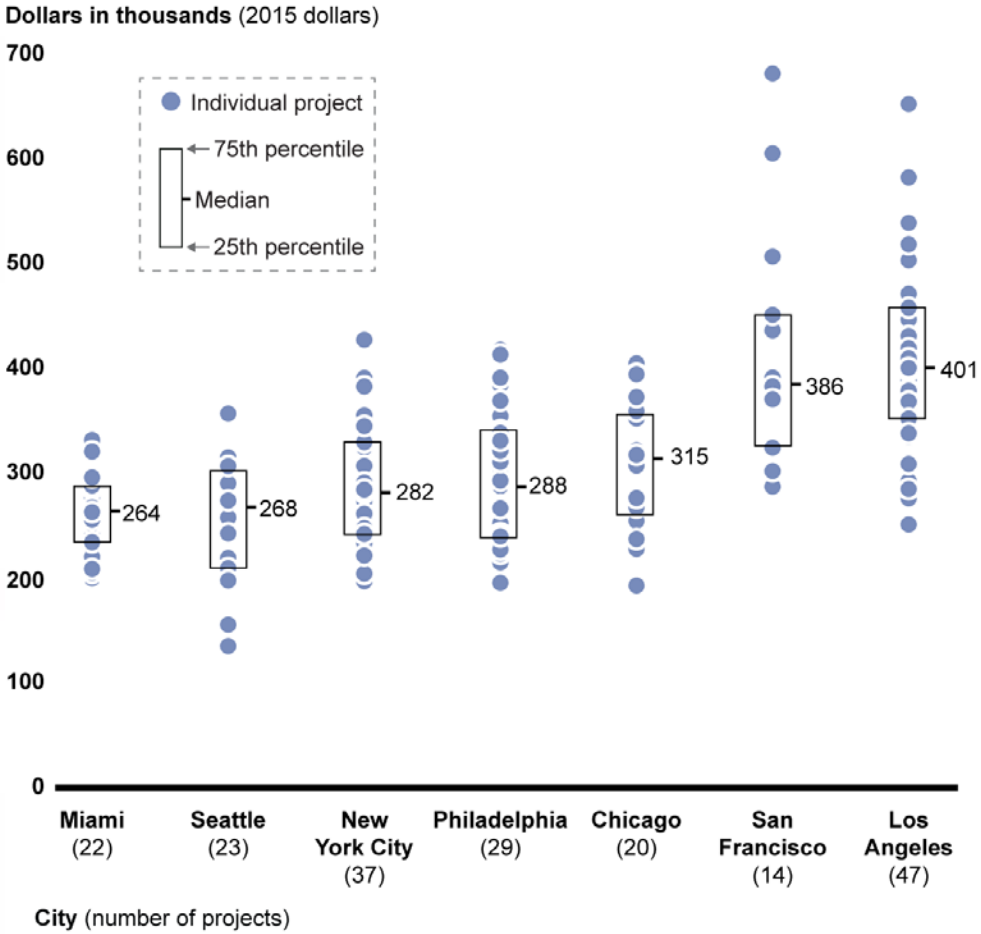
Per-Unit Development Costs for New Construction Projects, by Selected Allocating Agency, 2011–2015



Source: GAO analysis of allocating agency data. | GAO-18-637

Note: The data in the figure are for projects completed in 2011–2015 that received 9 percent Low-Income Housing Tax Credits from 12 selected allocating agencies (10 states and 2 cities).

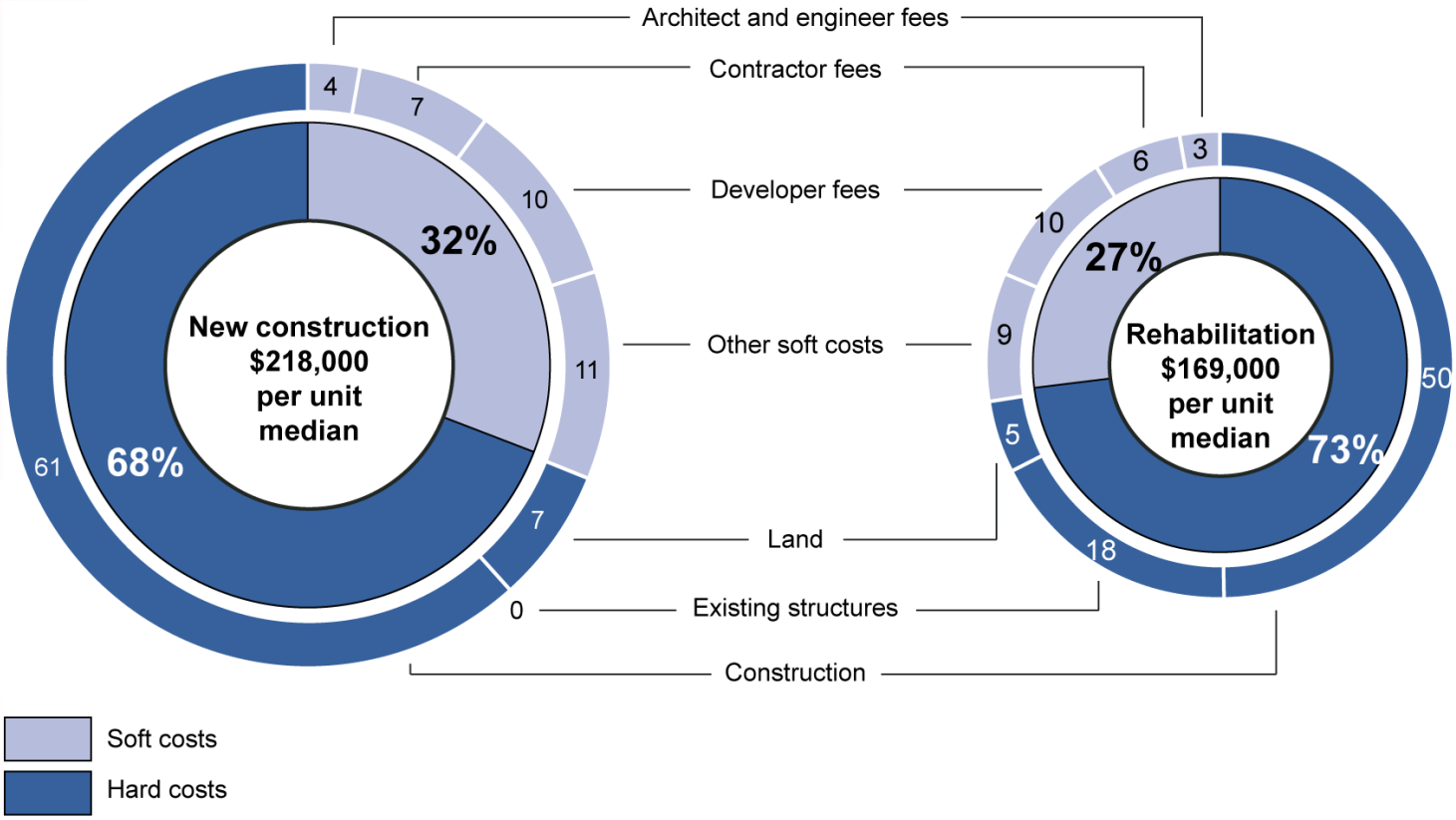
Per-Unit Development Costs for New Construction Projects, by Selected Cities, 2011–2015



Source: GAO analysis of allocating agency data. | GAO-18-637

Note: The data in the figure are for projects completed in 2011–2015 that received 9 percent Low-Income Housing Tax Credits from six selected allocating agencies (four states and two cities). Projects in Chicago and New York City only include projects funded by the municipal allocating agency.

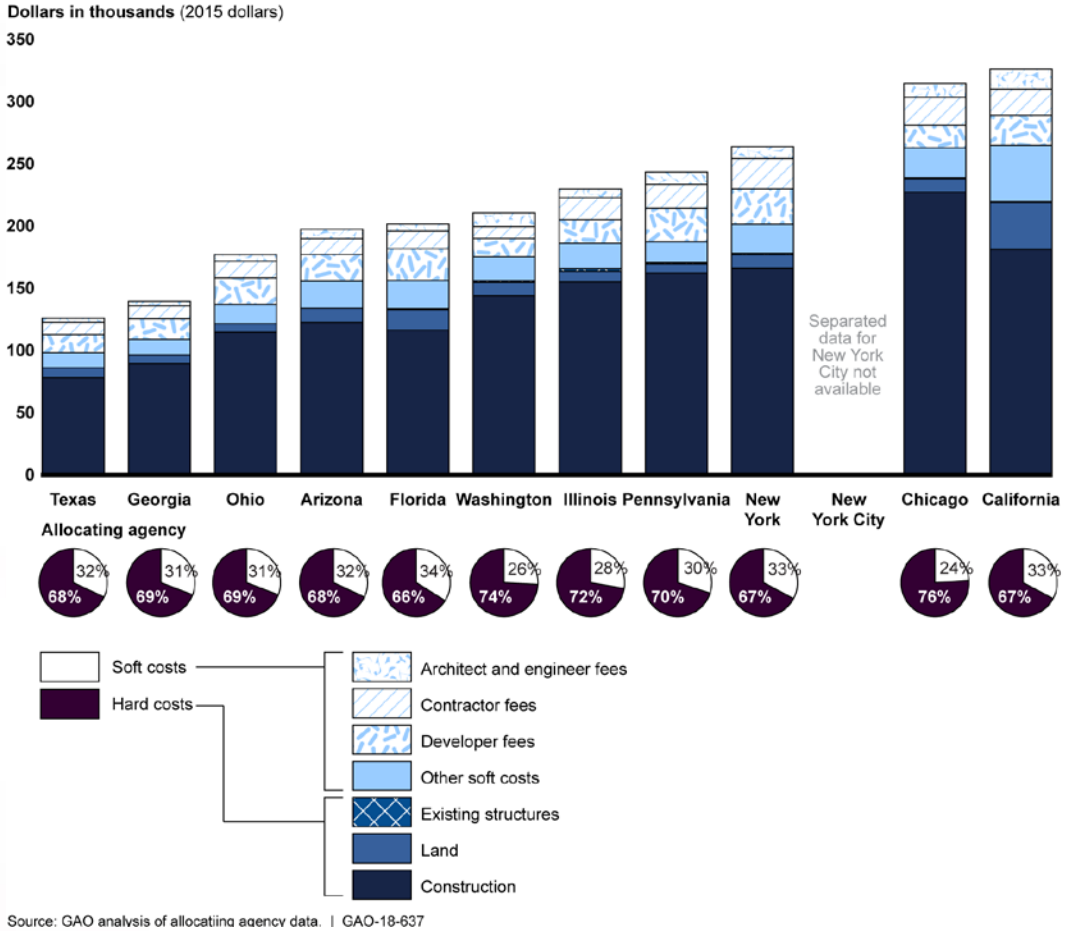
Cost Categories as a Percentage of Development Costs for Selected Allocating Agencies, by Construction Type, 2011–2015



Source: GAO analysis of allocating agency data. | GAO-18-637

Note: The data in the figure are for projects completed in 2011–2015 that received 9 percent Low-Income Housing Tax Credits from 12 selected allocating agencies (10 states and 2 cities). We included costs for lower-tier (or project-level) tax credit partnership and syndication costs under other soft costs. These costs primarily included accounting, consulting, legal, partnership activities, and syndicator fees and were less than 1 percent (about 0.41 percent) of total cost.

Hard and Soft Costs as a Proportion of New Construction Development Cost, by Selected Allocating Agency, 2011–2015



Source: GAO analysis of allocatiing agency data. | GAO-18-637

Note: The data in the figure are for projects completed in 2011–2015 that received 9 percent Low-Income Housing Tax Credits from 12 selected allocating agencies (10 states and 2 cities). We did not include projects from New York City because we could not separate contractor fees from construction costs.

Regression Analysis

Purpose:

- To **estimate the relationship** (correlation) between the cost of developing LIHTC projects and key characteristics (project location, financing and other characteristics),
- **identify potential cost drivers**, and
- **explain the large variation** in costs we identified across the selected allocating agencies

Identification strategy:

- GAO used variables highlighted in the LIHTC literature and interviews with experts, to the extent they were available in project documentation

Regression Analysis: Variables

Project characteristics

- Number of units
- Building configuration
- Bedroom sizes
- Construction type
- Senior vs. nonsenior tenants
- Income mix

Project financing

- ARRA
- CDBG
- HOME
- HOPE VI
- USDA Rural Development

Geographic characteristics

- Location (rural, suburban, urban)
- DDAs/QCTs
- Poverty rate
- Property values
- Rental prices
- Age of housing stock

Other characteristics

- LEED certification
- Nonprofit involvement
- Parking structures
- Distance to transit
- Allocating agency
- Project year

Regression Analysis: General Findings

- A number of the characteristics we collected were associated with **significant increases or decreases in per-unit costs**

- The specific effect of each of these characteristics **varied by allocating agency**, suggesting that our estimates are sensitive to the agencies' particular local conditions

- Differences in the prevalence of these characteristics in completed LIHTC projects **help explain cost outliers and the variations in development costs** among agencies

Regression Analysis: Project Characteristics

- Characteristics associated with cost increases:
  - Larger buildings (60 or more units) and more buildings
  - Larger units (3 or more bedrooms)
  - New construction projects
  - Predominantly low-income projects

- Characteristics associated with cost decreases:
  - Number of units (economies of scale)
  - Smaller units (1 or fewer bedrooms)
  - Senior projects

Regression Analysis: Location Characteristics

- Characteristics associated with cost increases:
  - Urban areas
  - DDAs/QCTS *(when not controlling for local economic factors)*
  - Higher poverty rates
  - Higher property values
  - Areas with older homes (before 1945)

- Characteristics associated with cost decreases:
  - Rural areas *(soft costs only)*
  - Lower poverty rates
  - Lower property values and rental prices
  - Areas with newer homes (after 1994)

Regression Analysis: Project Financing

- Characteristics associated with cost increases:
  - CDBG *(construction costs only)*
  - HOME *(construction and soft costs only…)*
  - HOPE VI

- Characteristics associated with cost decreases:
  - ARRA *(2011-2012 projects only)*
  - USDA Rural Development loans and grants

Regression Analysis: Other Characteristics

- Characteristics associated with cost increases:
  - Distance to transit stations (0.5 miles or less)
  - Parking structures (subterranean or podium)
  - LEED certification (any level)
  - Nonprofit involvement (i.e., nonprofit set-aside)

Note: These characteristics were not available for all of the selected allocating agencies.

Regression Analysis: Cost Outliers

Projects with outlier costs more often included characteristics associated with cost increases or decreases:

High-cost projects (above 75th)

- Fewer units
- Larger units
- More nonprofit involvement
- Fewer senior projects
- More urban
- Higher home values
- Higher rental prices
- More QCTs/DDAs

Low-cost projects (below 25th)

- More units
- Smaller units
- Less nonprofit involvement
- More senior projects
- Fewer urban, more rural
- Lower home values
- Lower rental prices
- More reliance on ARRA and USDA Rural Development

Abt's Recent Cost Study

- Prepared for NCSHA
- High-level cost and characteristics data for about 2,500 projects completed from 2011-2016
- At least 2 projects from every state, at least 25 projects in each of 35 states from 2011-2016 (not representative or generalizable)
- Includes projects developed with both 9% and 4% credits
- Data provided by 14 LIHTC syndicators

General Consistency in Per-Unit Costs

Abt study

- Median per-unit cost: **$164,757**; Interquartile range: **$121,254 - $224,903**

GAO study

- Median per-unit cost new construction: **$218,000**; Interquartile rage: **$158,800 - $295,200**
- Median per-unit cost rehabilitation: **$169,000**; Interquartile range: **$124,000 - $249,900**

Possible explanations for differences:

- GAO included all projects from 10 states; Abt included some projects from every state
- Abt included projects with 4% credits
- Abt results aggregate new construction and rehabilitation projects

Costs Over Time

- The Abt report concluded that construction costs for LIHTC projects **grew in line with** the average growth of all construction costs nationwide (about 8.4% from 2011-2016)

- GAO found the median per-unit construction cost of LIHTC projects (unadjusted) and a BLS construction cost index **both increased** by 11% and 10%, respectively from 2011-2015
  - However, the index increased consistently by about 2% annually
  - **But the magnitude and direction of changes for LIHTC projects varied** (+8% in 2013-2014; -5% 2014-2015)

GAO's results suggest that factors other than construction inputs drove changes in the median cost of LIHTC projects

LIHTC Costs vs Market Costs

Several factors may help explain differences between LIHTC and market development costs:

- Durability
- Agency and local requirements
- Profit motive
- Other soft costs

Data limitations limited GAO's ability to meaningfully compare LIHTC costs to market costs

Consistent Regression Results

Consistent with our analysis, the Abt report found that:

- **Location matters**: "Costs were higher for projects developed in principal cities of metropolitan areas, DDAs, and QCTs."
- **Project and unit size matter**: "Smaller projects were more expensive per unit to build than larger projects, likely due to economies of scale…" "Projects where the unit size averaged more than 2.5 bedrooms were also more expensive…"
- **Project type matters**: "New construction projects were substantially more expensive than [rehabilitation projects]."

Cost Containment Approaches – All Agencies

Types of cost containment approaches, as of 2017

Most of the 57 allocating agencies used two or more of the following strategies to manage LIHTC development costs:

- Cost limits (total development costs or eligible basis)
- Credit allocation limits
- Fee limits (e.g., developer fee limits)
- Cost-based scoring criteria

Other Cost Containment Practices at 12 Selected Agencies

- **Identifying and eliminating from consideration projects with outlier costs** (Ohio)
- Requiring a **bid process** for selecting contractors and subcontractors (Chicago, Florida, New York City)
- Requiring **third-party cost reviews** (Illinois, Georgia)
- Requiring developers or general contractors to **pay for cost increases** using contingency funds, profits, or other sources of funding (10 selected agencies)

Cost-Certification Controls to Manage Fraud Risk

- About 9 allocating agencies require additional cost-certification controls to help address the risk of fraud involving misrepresentation of contractor costs
  - **General contractor cost certifications for all projects**: Delaware, Florida, Kentucky, Michigan, Missouri, and Ohio
  - **General contractor cost certifications for projects with related parties**: Arizona, Georgia
  - California requires auditors performing developer cost certifications to **audit to the level of the subcontractor**

- NCSHA's most recent recommended practices advise allocating agencies to require additional cost certification due diligence

Recommendations

- Congress – designate a federal agency to collect and report on LIHTC development cost data

- IRS –
  - Encourage allocating agencies and other LIHTC stakeholders to collaborate on the development of more standardized cost data
  - Require general contractor cost certifications for all LIHTC projects
  - Clarify how allocating agencies should collect and review information on syndication expenses (including investor-level expenses)

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