August 17, 2018

Mr. Daniel Garcia-Diaz  
Director, Financial Markets and Community Investment  
United States Government Accountability Office  
441 G Street, N.W.  
Washington, DC 20001  

Dear Mr. Garcia-Diaz:

Thank you for giving the National Council of State Housing Agencies (NCSHA) the opportunity to comment on the U.S. Government Accountability Office’s (GAO) draft of its report on Low Income Housing Tax Credit (Housing Credit) development costs. As you know, NCSHA represents the Housing Finance Agencies (HFAs) of every state and the agencies that administer the Housing Credit in the few states where the HFA does not.

This report is the third major study in a series of reports GAO has completed on the Housing Credit in recent years. Throughout this process, GAO has consulted with NCSHA to gain our perspectives on various aspects of Housing Credit administration. We have appreciated the opportunity to contribute to GAO’s work on the program and, in particular, are grateful for the chance to respond directly to the drafts of this and the other reports GAO has conducted in this series.

State Housing Credit allocating agencies take very seriously their responsibilities as administrators of this program. In devolving the Housing Credit program to states for direct administration, Congress recognized the states’ strong track record in running affordable housing programs and their commitment to mission. We believe states have risen to that challenge, as is evidenced by GAO’s review of state policies in this report on development costs and its 2016 report on state administration of the program.

This report outlines in great detail the many policies and practices states have adopted to oversee and contain Housing Credit development costs. These policies go well above and beyond the statutory and regulatory requirements of the program. Though different states may take different approaches to this task, the commitment to maximizing Housing Credit resources is unanimous across states.
While states actively seek to maintain cost reasonableness, many of the forces that impact costs are outside their control. The costs of materials, land, and labor—the major drivers of development cost for all multifamily construction, not just Housing Credit construction—are subject to market forces. Other cost drivers, such as local regulatory requirements, permitting and impact fees, and construction delays, which may result from neighborhood opposition, are also beyond the scope of control of state agencies.

Still, states do their best to ensure that they make the most of the finite federal resources provided through the Housing Credit to serve as many households as they can, while addressing to the best of their abilities federal and state policy priorities such as serving the lowest income households for the longest time possible, helping those with special needs, advancing community revitalization, encouraging energy efficiency, and building in areas where tenants will have access to quality schools, transportation, and employment opportunities.

**NCSHA and Its HFA Members**

NCSHA represents the HFAs of the 50 states, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands. HFAs are governmental and quasi-governmental, nonprofit agencies created by their jurisdictions to address the full spectrum of housing need, from homelessness to homeownership. HFAs are dedicated to their common affordable housing mission, reinvest their earnings in the furtherance of that mission, and are publicly accountable.

HFAs have established over many decades a track record of outstanding performance in affordable housing finance. In addition to administering the Housing Credit, HFAs issue tax-exempt private activity Housing Bonds, and many administer other federal housing programs, such as Section 8, the HOME Investment Partnerships program, and the Housing Trust Fund.

**Housing Credit Development Costs**

Most of GAO’s findings regarding development costs and cost drivers are consistent with independent research NCSHA recently commissioned on Housing Credit development costs. Over the last year, on behalf of NCSHA, Abt Associates (Abt)—a research and consulting firm with strong expertise in affordable housing and other social policy areas—has collected and analyzed Housing Credit development cost data from properties across the country using information provided by 14 syndicators, including eight of the largest national syndicators and six regional equity funds. Abt’s data set includes cost data for more than 2,500 projects containing more than 160,000 housing units.

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1 NCSHA is a nonprofit, nonpartisan organization. None of NCSHA’s activities related to federal legislation or regulation are funded by organizations that are prohibited by law from engaging in lobbying or related activities.
The data Abt collected differs from GAO’s data set in two major ways:

- Whereas GAO received cost certifications for all properties placed in service in 10 states between 2011 and 2015, Abt’s analysis uses data from properties across the nation, including at least two projects in every state and nearly every territory, and more than 25 projects in each of 35 states placed in service between 2011 to 2016 (though it does not have complete data for any individual state).

- The Abt data also includes some tax-exempt bond-financed 4 percent Housing Credit properties along with 9 percent Housing Credit properties, whereas GAO’s data set includes 9 percent Housing Credit properties only. (Abt estimates that the data it uses in its analysis represents 47 percent of the 9 percent Housing Credit properties and 20 percent of the 4 percent Housing Credit properties placed in service during the time period studied.)

Despite these differences, Abt’s analysis generally supports the GAO’s conclusions regarding certain cost drivers and the impact of property characteristics on development costs.

The median per unit total development cost (TDC) of properties in the Abt data set was $164,757, which is less than the $204,000 TDC per unit GAO observed. We surmise that the difference is in part due to the national scope of the Abt research, while several of the 10 states participating in GAO’s research happen to include some of the highest cost cities in the nation, such as San Francisco, Los Angeles, New York City, Seattle, Chicago, and Miami. In addition, unlike the GAO data, the Abt data included 4 percent Housing Credit properties, which Abt found to be less expensive on average than 9 percent properties (a statistically significant finding).

However, despite this difference, the Abt analysis suggests many of the same findings as GAO’s work related to property characteristics. Specifically, larger projects with more units cost less per unit than smaller projects with fewer units due to economies of scale, projects in urban areas are more expensive than projects in other areas, and projects serving seniors are less expensive than other projects on average.

The Abt study finds the following about Housing Credit total development costs:

- The median TDC per unit, inclusive of “soft costs” (e.g., fees for contractors, architects, and other professionals) and land costs, between 2011 and 2016 was $164,757, adjusted for construction cost inflation.

- The mean TDC per unit, inclusive of soft costs and land costs, between 2011 and 2016 was $182,498, adjusted for construction cost inflation.

These figures reflect TDCs for newly constructed buildings as well as rehabilitations of existing properties.
Answers to two questions put these figures in context:

- How do Housing Credit development costs compare to the costs of multifamily apartment development overall?

- How does the recent growth in Housing Credit development costs compare to that of multifamily apartment development overall?

With respect to comparing Housing Credit development costs to overall apartment development costs, the Abt analysis does not attempt to answer this question, but other research helps to do so. According to data provided to NCSHA by Dodge Data and Analytics, construction costs — not including soft costs and land — for all newly constructed apartments averaged approximately $151,000 per unit between 2011 and 2016.2

According to Fannie Mae, soft costs account for an average of 25 percent of overall apartment development costs.3 While land prices vary widely and national data is difficult to obtain, anecdotal evidence suggests they may account for 5 to 10 percent, on average, of TDC (much more in high-cost areas).

Adjusting the $151,000 per unit in construction costs by 30 to 35 percent to account for soft costs and land yields an average TDC per unit for multifamily apartments overall of roughly $196,000 to $204,000 between 2011 and 2016. Abt found that the average Housing Credit cost per unit for new construction, including soft costs and land, was approximately $209,000 during that period.

The slightly higher costs for Housing Credit developments suggested are likely explained by financing requirements on them that generally do not apply to market-rate apartment developments, such as the need for higher upfront operating reserves and funding to cover the developer’s services. Market-rate apartments can generate capital to pay these costs by charging higher rents. Housing Credit properties by law cannot: They must serve low-income households at restricted rents for several decades.

With respect to development cost growth, the Abt analysis suggests that Housing Credit TDCs during the study period grew at roughly the same average annual rate as overall apartment development costs, based on the RS Means Historical Cost Index: roughly eight percent.

However, other analysis of overall construction cost growth during the time period studied indicates that overall apartment development costs rose much more than Housing Credit development costs. For example, a 2017 report from Fannie Mae indicated that overall apartment construction costs had risen 10 to 30 percent between 2011 and 2016.4

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The Abt study, complemented by other equally credible analysis, suggests that Housing Credit development costs are generally consistent with overall apartment development costs and have grown at the same rate, if not slower, as overall apartment development costs in recent years.

**Housing Credit Data Quality**

While GAO’s analysis describes state agencies’ extensive policies and practices designed to contain development costs, it points out that the 12 agencies it studied for its analysis do not collect all of the same information about the properties they finance, may categorize or define costs in different ways, and use various formats for their data collection. GAO recommends that Congress consider designating a federal agency to maintain and analyze standardized data on Housing Credit costs.

Somewhat differing administrative approaches reflect the devolved nature of the Housing Credit, which authorizes every state agency the flexibility to design a program that best meets its needs and collect the data it believes is necessary to support its own efforts.

It is true that the structure of the Housing Credit program and the resulting limitations on uniform data across states can make academic study of development costs nationwide more difficult to undertake. Should Congress decide that such research is necessary and worthy of federal investment, HFAs stand willing to assist in this data collection.

However, NCSHA questions whether a centralized development cost data system administered by a federal bureaucracy is worth the cost. Cost drivers in different states and regions vary substantially, and some are difficult or impossible to ascertain from quantitative data. While the information may be interesting to have, the utility of comparing development costs in Hawaii to those in Arkansas is not clear.

We do not believe this sort of cross-state comparison is critical for evaluating the success of the program as a whole. It is most important that agencies understand the trends and cost drivers within their own states so that they may make policy decisions that will help them make the most of their resources.

We are also concerned that given GAO’s recommendation, Congress could require the collection of Housing Credit development cost data but not appropriate the funds to implement this mandate. When Congress passed the Housing and Economic Recovery Act (HERA) of 2008, for example, it required state agencies administering the Housing Credit to submit demographic and economic data on Housing Credit tenants to HUD, so that HUD could process and report that information. While HERA authorized $6 million to support this effort, Congress has never appropriated those funds. Without federal resources to cover the cost of developing a centralized database and to help states to provide that data, allocating agencies would be forced to charge
fees to developers to cover those costs, which would result in higher costs per unit and fewer homes developed.

For these reasons, we believe that uniform definitions and a centralized national database are not critical to addressing cost challenges in the Housing Credit program. This is not to say that agencies cannot or should not learn from each other’s experiences. One of NCSHA’s primary functions is to serve as a forum through which our members can share ideas, policy outcomes, and solutions to challenges.

GAO references NCSHA’s Recommended Practices throughout its report, which is one way in which we facilitate exemplary program administration and idea sharing. We also hold multiple conferences throughout the year — at which cost and cost containment are always central features — and provide other opportunities for states to communicate with and learn from each other through online forums, webinars, and other avenues.

**Cost Certification Practices**

In 1993, when NCSHA adopted its original set of Recommended Practices in Housing Credit Administration, one of those practices, Verification of Expenditures and Issuance of Form 8609, encouraged states to require a certified public accountant (CPA) audit of the developer cost certification for Housing Credit properties. Seven years later, in 2000, IRS codified this practice into regulation, requiring a CPA audit of cost certifications for all properties with 11 or more units.

Since 1993, NCSHA has several times revised and added to our Recommended Practices, which now cover the full spectrum of activities in Housing Credit administration. Most recently, in December 2017, NCSHA’s Board of Directors adopted updated practices, which included a modification to the practice on Verification of Expenditure and Issuance of Form 8609. The change to the practice encourages states to require additional cost certification due diligence, which may include audits of general contractors and/or a sampling of subcontractor invoices to verify consistency with the developer cost certification.

While some states had already implemented cost certification practices that include a general contractor cost certification prior to the adoption of our 2017 Recommended Practices, the 2017 Qualified Allocation Plans (QAPs) that GAO looked at in its analysis were all published in advance of the revision to our Recommended Practices. We expect that more of the 2019 QAPs, which are currently under development, will require or encourage general contractor cost certifications.

Moreover, it is important to note that NCSHA’s Recommended Practices are voluntary and that allocating agencies often adapt these practices to best meet their individual circumstances, in keeping with Congress’ intent regarding state administration of the Housing
Credit. While we expect some states that did not do so in the past may begin requiring general contractor cost certifications in future QAPs now that these Recommended Practices have been adopted, others feel that they have enough information to judge the validity of costs based on the developer cost certification.

The developer cost certification required by IRS regulation even on its own is a rigorous process that involves review by an independent CPA of the developer’s general ledger of expenses associated with the project and the monthly draw packages submitted to the lender and syndicator for payment. These draw packages include copies of invoices from the general contractor documenting all costs incurred during the month.

If a state requires, in addition to the developer cost certification, a general contractor cost certification, the CPA would also review copies of invoices from the various subcontractors involved in project development to verify consistency with the general contractor invoice. This review of subcontractor invoices will add to the cost of the CPA certification, though accounting firms have told NCSHA it is not cost prohibitive. However, some states may decide this additional cost is not necessary.

GAO’s report references two instances of fraud perpetrated against the Housing Credit program in Florida — one in which the developer colluded with the general contractor and others to inflate costs, and another in which a developer and related party to the developer submitted fraudulent cost information to the state agency. While we do not know whether increased cost certification due diligence would have prevented these frauds from occurring, the Florida Housing Finance Corporation has since instituted very strict cost certification requirements in response to these crimes.

Although always unacceptable, fraud has been rare over the 30-year history of the Housing Credit, and safeguards are strong. In the small number of known instances of fraud, state allocating agencies have responded swiftly and aggressively, cooperating fully in its investigation and prosecution, as evidenced by the Florida agency’s response to the situations GAO references.

**Syndicator Fees**

We were surprised to see in GAO’s report that IRS officials indicated their regulations require the reporting of all syndication expenses on the project cost certification, including not only lower-tier fees but also upper-tier fees. As GAO notes, “None of the documents IRS pointed to — the regulations, Technical Advice Memorandum, or Revenue Ruling previously cited — draw a clear distinction between upper- and lower-tier expenses, leaving the requirement open to interpretation.”
It has never been NCSHA’s understanding that upper-tier syndication fees must be included in cost certifications, and it is clear from GAO’s report that all of the 12 agencies GAO selected for its report did not believe this was a requirement under the regulation. Representatives from IRS’s Office of Chief Counsel and the Office of Examination Quality and Technical Support have attended and presented at nearly every NCSHA Housing Credit conference since the early 1990s, and this has never been something noted as an expectation.

Our understanding has always been that the cost certification must include costs paid by the project partnership for the individual property. Like all other fund manager fees in the financial services industry, investors pay these upper-tier syndication fees directly; they do not come from the projects in which the fund invests. Moreover, some multi-investor funds invest in multiple Housing Credit properties, thus it would be difficult to attribute upper-tier syndication fees to any individual property. Other fees associated with project financing, such as the fees a lender receives associated with originating, underwriting, or servicing a loan, are also not included in cost certifications.

If IRS clarifies that it requires upper-tier syndication fees to be reflected on individual project cost certifications, HFAs will certainly update their policies and work with accountants and syndicators to ensure this information is included on cost certifications.

In closing, NCSHA appreciates GAO’s careful and thorough review of Housing Credit development costs and its efforts to provide Congress with more information about this essential affordable housing program. We believe the extensive overview of the program GAO has conducted over the last three years supports our assertion that the Housing Credit is a well-designed and well-administered program with measurable outcomes indicating strong success. NCSHA and our HFA members stand ready to work with Congress, IRS, and other stakeholders to make any improvements that may further strengthen the program.

Sincerely,

Stockton Williams
Executive Director