Development Costs in the LIHTC Program

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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

Highlights of GAO-18-637, a report to the Chairman, Committee on the Judiciary, U.S. Senate

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LOW-INCOME HOUSING TAX CREDIT

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

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

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

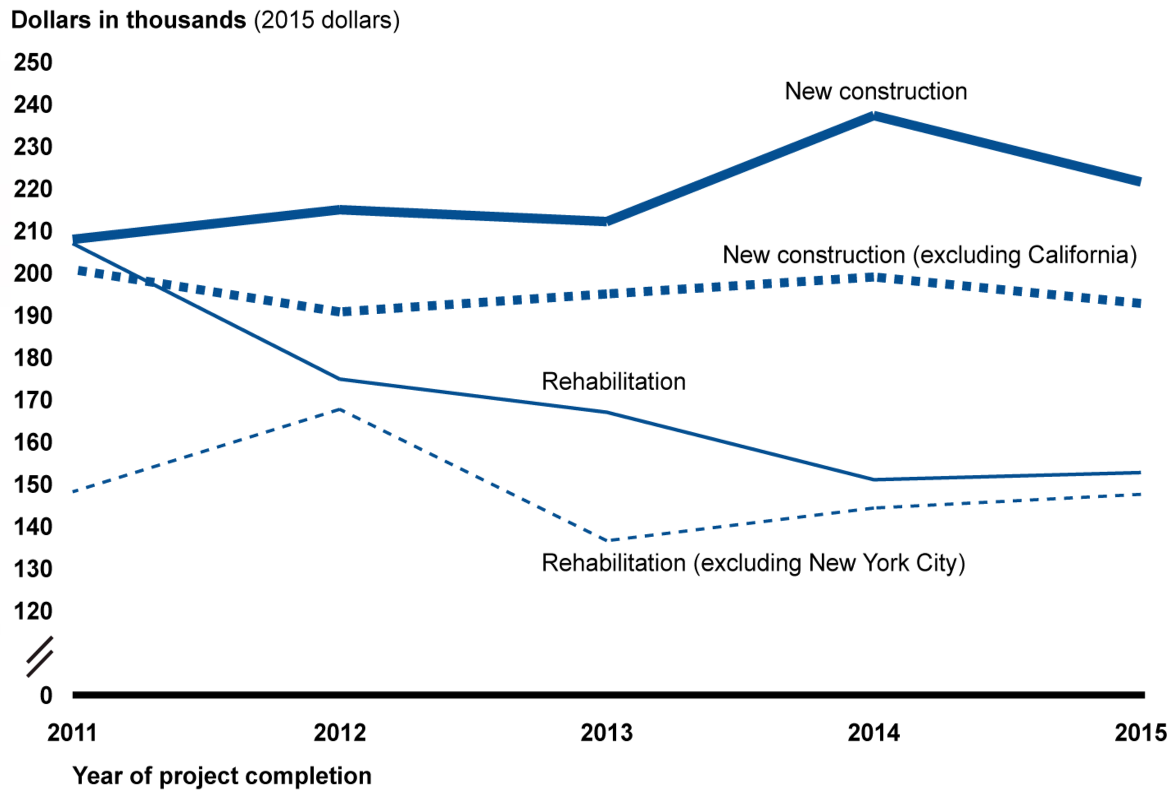
To describe costs and characteristics of LIHTC projects, we

- 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.

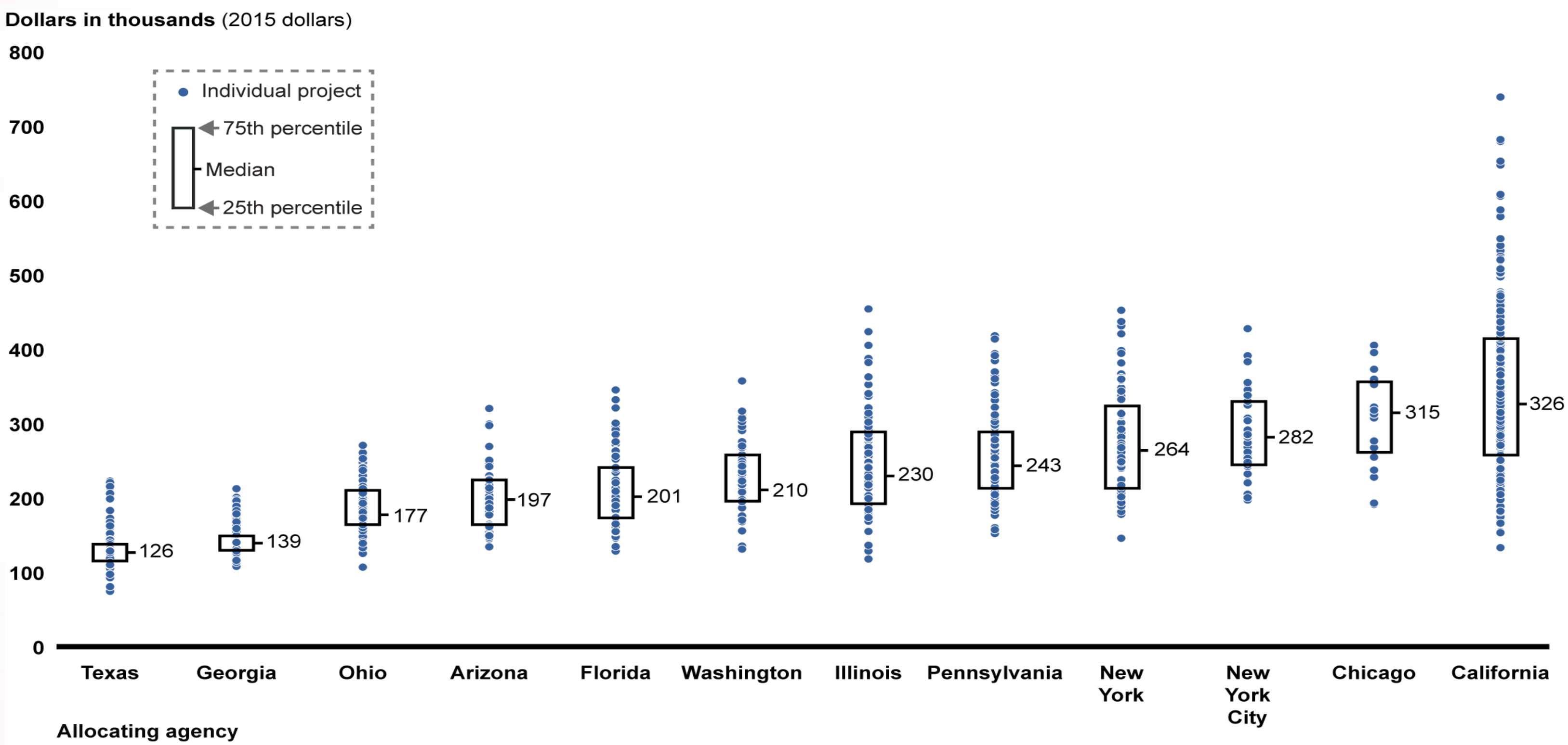
Median Per-Unit Development Cost in Constant Dollars for Selected Allocating Agencies, by Construction Type, 2011–2015



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.

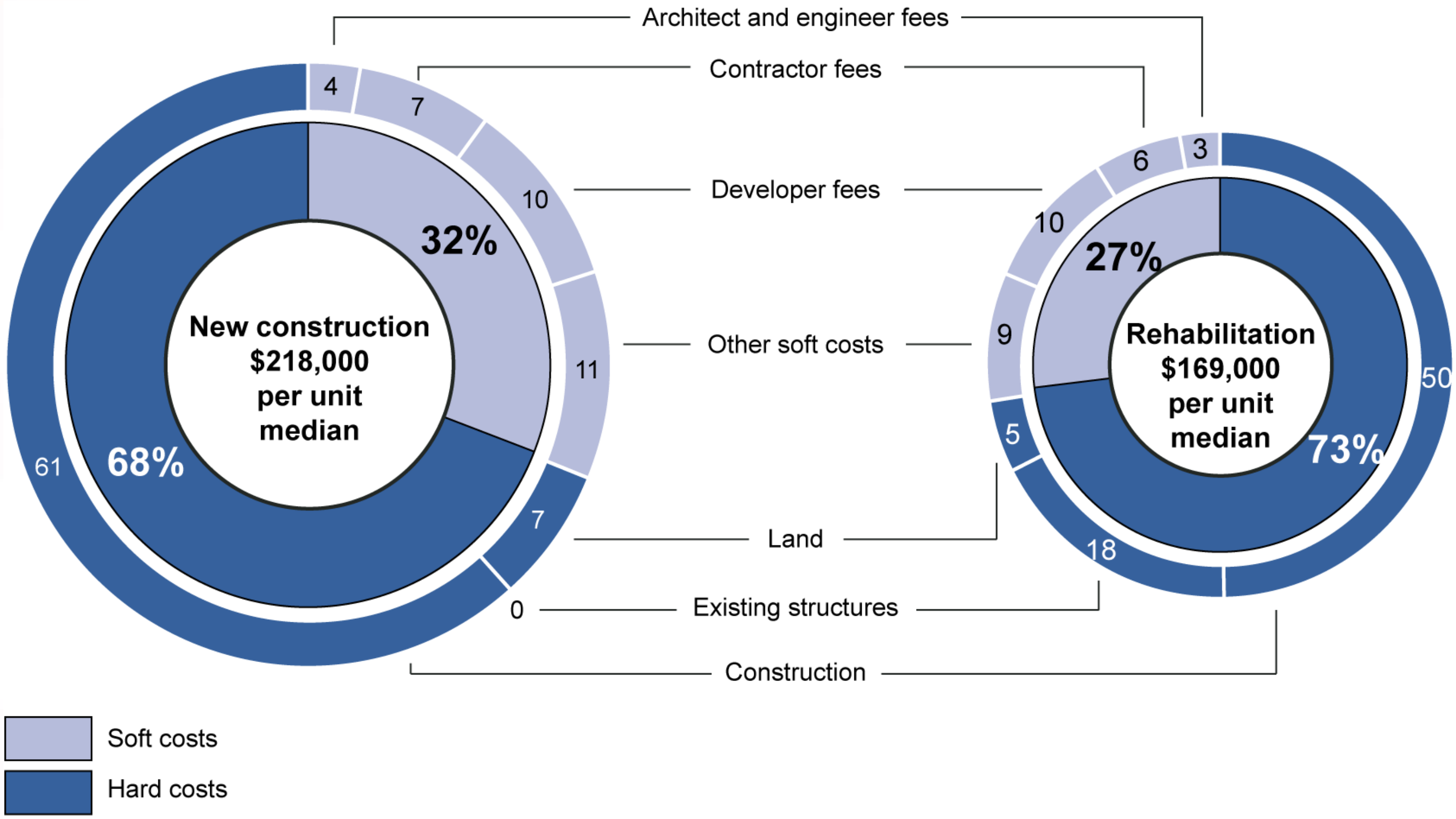
Per-Unit Development Costs for New Construction Projects, by Selected Allocating Agency, 2011–2015



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).

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.

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: General Findings

- A number of the characteristics we collected were associated with **significant increases or decreases in per-unit costs – in general, where you build and what you build matters**

- 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

Cost Containment Approaches – Summary

<u>Types of cost containment approaches, as of 2017</u>

Most of the 57 allocating agencies used 2 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

Cost Containment Approaches – Details

Cost Containment Approaches of Allocating Agencies, as of 2017

	Agencies with each approach	
Type of approach	**Number (out of 57)**	**Percent**
Cost limits	39	68
Credit allocation limits	34	60
Fee limits	51	89
Cost-based scoring criteria	51	89

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

Syndication Costs

- GAO-17-285R – *Low-Income Housing Tax Credit: The Role of Syndicators*
- To augment that work, we attempted to collect and analyze data on syndication costs, but found they were not available
- In discussions with IRS, it became apparent the agency's expectation for the collection of these costs did not align with industry practices

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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