Giving Due Credit:
Balancing Priorities in State Low-Income Housing Tax Credit Allocation Policies

Written by Michael A. Spotts
Research conducted by Michael A. Spotts, NaShawn Johnson and Felicia Kiefer
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The Low-Income Housing Tax Credit (Housing Credit) remains the primary funding source for new construction and preservation of affordable rental housing in the U.S. Since its introduction in 1986, it has financed nearly 3 million affordable homes according to the National Council of State Housing Agencies. In addition to providing homes for working families, Housing Credit properties often include accessible apartments for seniors and persons with disabilities and serve as permanent homes for formerly homeless individuals and families.

Affordable housing programs do much more than provide quality shelter. A growing body of research shows that well-located, quality affordable housing promotes resident health, education and economic mobility. Other studies have found that the costs of providing permanent supportive housing to chronically homeless individuals and other vulnerable populations is exceeded by savings in other public expenditures, including those related to medical care and public safety. In addition to this evidence base, recent actions by the Supreme Court and the U.S. Department of Housing and Urban Development (HUD) have reinforced the need to focus on social equity and resident opportunity when investing in affordable housing.

COST-EFFECTIVENESS AND THE VALUE OF THE HOUSING CREDIT PROGRAM

1 More information and data on the Housing Credit program can be found at the ACTION Campaign website: http://rentalhousingaction.org/.


Additional research on cost savings can be found at: http://shnny.org/research-reports/research/cost-savings.

4 In June 2015, the Supreme Court ruled in Inclusive Communities Project v. Texas Department of Housing and Community Affairs that “disparate impact” analysis – which examines discriminatory effect regardless of intent – is a valid legal tool for proving housing discrimination. The next month, HUD for the first time released comprehensive guidance on the Fair Housing Act’s requirement to Affirmatively Further Fair Housing, or take proactive steps to overcome existing and entrenched patterns of segregation. For more information, visit: http://blog.enterprisecommunity.com/2015/07/community-development-approach.

For more information on Enterprise’s approach to Fair Housing and Community Development, read “An Investment in Opportunity: A Bold New Vision for Housing Policy in the U.S.”

At the same time, the need for affordable housing – and for the Housing Credit – is expanding at a frightening pace. In 2015, an estimated 11.8 million households were severely-cost burdened: that is, they spend at least 50 percent of their income on housing costs. Based on demographic trends alone, this number is projected to increase to 13.1 million by 2025. If increases in rents outpace income growth, as has been the case for much of the last 15 years, the number of housing insecure households is expected to rise even higher.

This housing affordability crisis requires concerted action to expand the supply of affordable rental homes. Unfortunately, despite a reprieve from previous steep funding cuts for core housing subsidy programs in the federal fiscal year 2016 budget, many resources still remain under threat at all levels of government. If we are to ensure that affordable housing continues to provide shelter and promote overall resident health and well-being, it is critical that efforts to stretch scarce Housing Credits focus on cost-effectiveness, as opposed to simply cost reduction.

To that end, Enterprise reviewed the Qualified Allocation Plans (QAPs) for each Housing Credit Allocating Agency (including all 50 states, the District of Columbia, New York City and the U.S. territories) to identify leading practices in balancing cost control with building quality and resident opportunity. The report illustrates overall approaches to managing the Housing Credit program, as well as specific provisions, incentives and tools. We also discuss the numerous options and trade-offs that policy makers and housing developers face, as well as examples where specific incentives and provisions can have unintended effects on ostensibly unrelated priorities. Given these interconnections and the impact of the weighting that states place on individual priorities, it is important to view each element within the broader context of the QAP when translating research into practice.


6 Jakabovics, Andrew, et al.
This report offers the following broad recommendations:

- Agencies should consider the cumulative impact of QAP provisions on costs and quality.
- Point-based incentives and weighting should be structured so that no single provision is effectively mandatory.
- Cost and subsidy limits should reflect differences in development type and location.
- Cost, design and construction standards should account for and encourage long-term savings.
- Funding sources and regulatory compliance should be coordinated and streamlined.
- Agencies should encourage innovation through the use of pilot initiatives.
- Progress toward agency goals should be measured and the results disseminated.

Each of these recommendations is discussed in more detail in the following sections.
Research Background and Methodology

In January 2014, Enterprise and the ULI Terwilliger Center for Housing published *Bending the Cost Curve: Solutions to Expand the Supply of Affordable Rentals* (*Bending the Cost Curve*). In this report, we highlighted the growing demand and diminished resources for affordable housing, necessitating a focus on cost-effectiveness that extends beyond the obligation to be responsible stewards of public resources. In the following years, Enterprise has worked with partners throughout the U.S. to identify barriers to efficient affordable housing development and support the implementation of innovative financial, regulatory and development practices.

It is within this context that Enterprise set out to examine Low-Income Housing Tax Credit (Housing Credit) allocation policies. This study analyzes the extent to which these policies promote cost-effectiveness while working to build and preserve quality affordable housing, defined as physically and financially durable homes in neighborhoods that expand resident opportunity. From April 2015 through March 2016, Enterprise reviewed each allocating agency’s full suite of allocation policies for the 9 percent Housing Credit. This review included Qualified Allocation Plans as well as the associated rules, procedures and policies that influence Housing Credit activities (hereafter referred to collectively as QAPs). As we researched each agency’s QAP, we used the latest enacted version at that point in time. Given that State Housing Credit allocation deadlines can vary significantly, the information we collected spans different calendar and fiscal years (see Appendix B for the full list of the specific QAPs that were reviewed).

Our analysis is informed by organizational and personal experience, as well as by conversations with developers, agency staff and other stakeholders beginning during the *Bending the Cost Curve* research process and extending through the release of this report. We rely heavily on examples from states where we have provided direct research and/or implementation support, particularly Minnesota and Massachusetts. While our study points to the ways in which rules and incentives can influence how and where affordable housing is built and what it costs, it is outside the scope of this work to determine the relative effectiveness of each measure over time. Rather, we illustrate the numerous options and trade-offs faced by policy makers and housing developers.
FINDINGS

As required under the federal legislation and regulations that govern the Housing Credit program, each allocating agency’s QAP includes provisions related to cost control and quality to some extent, though there is wide variation in emphasis, detail and approach. The policy levers utilized are also context-specific, with commonalities often seen between heavily rural or largely urbanized states, to give one example. This is in keeping with the spirit of the program’s decentralized design that allows each state agency to respond to these unique affordable housing needs.

At the most basic level, allocating agencies influence both upfront and long-term cost-effectiveness by setting allowable cost standards and incentives. These can focus on overall costs and/or specific cost categories (acquisition, hard costs, soft costs, individual line items, among others). Moreover, the allocation process itself can go a long way in furthering or inhibiting the efficient use of resources. Agencies set processing timelines, charge fees, oversee compliance and in some cases coordinate multiple affordable housing funding programs. Thoughtfully calibrated processes and programmatic structures can reduce unnecessary costs and allow for more resources to be spent on development characteristics that add value.

There is also significant variability in allocating agencies’ priorities for design and construction characteristics, tenant targeting, location preferences, and other elements that can influence the quality and impact of the development. QAPs include a variety of techniques, including threshold requirements, set-asides, funding incentives, point-based incentives used in competitive application scoring, and pilot programs embedded within the funding competition. Many agencies proactively address the issue of interactivity between these different priorities and efforts to contain costs. For example, some QAPs will adjust cost or eligible basis standards for developments that meet certain characteristics, such as providing deeper levels of affordability or supportive services.
Finally, it is important for interested stakeholders to look beyond the simple presence (or absence) of any given priority, provision or incentive when designing policies or analyzing effectiveness. Factors such as the degree of difficulty of any provision, its relative weight within the QAP scoring system, and the level of competition in a given state matter significantly. For example, an allocating agency may adopt a point-based provision to encourage energy standards beyond the basic minimums. If these incentive-based standards are too stringent, they may be passed over by enough prospective developers to have little impact. However, if the QAP assigns a heavy weighting to this provision within its point framework and/or if the competition amongst developers is especially fierce, such point-based provisions can become de facto binding provisions. Creating a subset of functionally binding point-incentives can “crowd out” other beneficial development characteristics if cost-caps are not reflective of potential incremental costs and/or do not adjust for operational savings. Therefore, it is crucial that each provision be considered within the overall QAP and development context.

The following sections will discuss each of these elements in more detail. While we provide examples of specific provisions, such examples are non-exhaustive in the interest of brevity. More information on each agency’s QAP provisions (including information from prior years and new QAPs moving forward) can be found on PrezCat (www.prezcat.org), an online catalog of state and local affordable housing policies maintained by the National Housing Trust and Novogradac & Company. We group our findings into five categories in which agencies have a significant influence on the cost of providing affordable housing: Agency Processes, Evaluation Methods, Soft Costs, Hard Costs and Economies of Scale. The subsequent section will also address how these and other provisions are balanced with efforts to promote Building Quality and Resident Opportunity.
OVERALL AGENCY PROCESS

In general, real estate development has a baseline “cost of doing business” over which a developer may have only marginal control. A developer can excel at acquiring parcels at a good price, but is still subject to broader market pressures. Smart design and construction management can lower hard costs through material selection and efficient purchasing practices, but most materials are commodities over which the developer has little price control. While there may be case-by-case opportunities for dramatic cost reduction (for instance, utilizing donated or discounted public land), within the current affordable housing development framework there are few individual actions that will dramatically bend the cost curve. Instead, there must be a comprehensive approach that identifies multiple opportunities for small but significant cost savings, which can lead to substantial progress in the aggregate.

Housing Credit allocating agencies are well-placed to systematically support such progress. They serve as both financier and regulator, and their allocation process to a large extent dictates the affordable housing development timeline. Depending on the political context, their status as state-level entities can influence relations with local municipalities, both positively and negatively. Therefore, allocating agencies can ensure that they are working to both optimize the current affordable housing delivery system and leverage their influence and resources to encourage new models that could improve on the existing paradigm.

Massachusetts provides a great example of a comprehensive approach, both in its actions (many of which will be discussed later in this report) and its prioritization of the issue in its QAP. The Boston metropolitan region is considered one of the higher-cost housing markets in the United States, both in terms of development costs and the eventual home prices and rents charged. A recent study by the Dukakis Center for Urban and Regional Policy at Northeastern University provided more evidence to this effect. Studying a multi-state sample of 100 market-rate and affordable developments, the Dukakis Center found that development costs in Massachusetts’ population centers were indeed higher than in other states. In recent years, the urban area cost gap between Massachusetts and other states in the sample substantially shrunk, while this gap in suburban areas has marginally increased. The report cited the high cost of land, the cost of construction, and severely restrictive local zoning as contributing factors to higher costs across the development spectrum.

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In response to these challenges, the state’s affordable housing sector has undertaken a concerted effort to make both the market-rate and affordable housing development process more efficient. In the context of the Housing Credit program, Massachusetts’ QAP includes a six-page appendix that outlines the state-specific need for cost control. The appendix also describes the agency’s activities related to identifying cost drivers; collaborating across jurisdictions, sectors and government agencies; implementing new cost limits, fee calculations and process improvements; and increasing developer capacity. Collaborating agencies/jurisdictions include but are not limited to the Department of Housing and Community Development, Community Economic and Development Assistance Corporation, MassDevelopment, MassHousing, the Massachusetts Housing Partnership, and the city of Boston. Minnesota has also taken a particularly proactive approach to this issue, co-sponsoring the MN Challenge to Lower the Cost of Affordable Housing, an idea competition to support innovative problem solving from interdisciplinary teams of housing professionals resulting in systematic concepts that lower the cost of developing affordable housing in Minnesota, among many other actions.10

Such coordination can be useful in reducing the impact of layered financing for Housing Credit developments. Several agencies combine their Housing Credit allocation process with other sources of debt and/or gap funding, either in full or in part. Montana has adopted a Uniform Application for Montana Housing Loan, Grant and Tax Credit Programs, which standardizes forms and documentation that can be submitted to the relevant agencies for review and evaluation. Minnesota (Multifamily Rental Housing Common Application) and Massachusetts (OneStop Center, which features fully electronic processing) are among at least 40 agencies across the country that take this approach a step further by combining a common application with a common review and allocation of multiple funding sources. This can include debt products that are offered by the allocating agency. Many agencies also utilize the Housing Credit application review to award all or a portion of their statewide allocation of HUD HOME Investment Partnership program funding. Massachusetts has also created MassDocs, a cross-agency effort that creates consolidated loan documents to streamline and reduce costs associated with the loan closing process.

10 The Minnesota Challenge to Lower the Cost of Affordable Housing was co-sponsored by Minnesota Housing, the McKnight Foundation, Urban Land Institute of Minnesota (ULI-MN)/ Regional Council of Mayors (RCM), and Enterprise Community Partners. For more information on the competition and its outcomes, visit www.mnchallenge.com or read the summary report found at: http://www.enterprisecommunity.org/servlet/servlet.FileDownload?file=00P1400000b7MQZEA2.
Coordination of Funding Resources: District of Columbia

In July 2015, the District of Columbia Department of Housing and Community Development, Housing Authority, Department of Behavioral Health (DBH) and Department of Human Services released the Affordable Housing Program Request for Proposals 2015, which coordinated the following funding resources:

- Housing Production Trust Fund
- HOME Investment Partnership Program
- DBH Grant Funds
- 9 Percent Low-Income Housing Tax Credits
- Local Rent Supplement Program
- Housing Choice Voucher Program
- Annual Contributions Contract Program
- DHS Supportive Services Funds

Coordination of funding can go beyond traditional acquisition, construction and preservation sources. Applicants to the District of Columbia can also simultaneously apply for on-going rent and supportive service subsidies through the Local Rent Supplement Program, HUD Housing Choice Voucher Program, Department of Behavioral Health Grant Fund and Department of Human Services Supportive Services Fund, among other sources. Both New York State and Nebraska coordinate funding that can be used to support goals related to resident opportunity (further discussion is included below).

Agencies can also take action to promote an efficient application review process. Delays and poorly-aligned timeframes can add holding costs and/or limit a developer’s ability to be opportunistic in acquiring, developing or preserving certain sites. In some cases, process streamlining can mitigate some of these challenges. One approach is to focus on priority development and preservation efforts. Given the often high demand for transit-oriented and high-opportunity sites, accelerating the timeline may help affordable housing developers be more competitive against market-rate developers. New York State offers accelerated processing and will grant early awards to developments that meet key agency priorities, such as supportive housing, transit-oriented development and “workforce opportunity.” Massachusetts reserves the right to approve applications that are submitted on a rolling basis outside of the once-per-year 9 percent Housing Credit competition. Though not utilized recently, developments serving homeless individuals and families as well as large-scale preservation and new construction efforts are eligible for this flexibility. Better aligning the application with the development timeline allows developers to more readily compete for sites and potentially reduces holding costs or other expenses related to process delays. Finally, there is room for flexibility for agencies to act on a case-by-case basis. Kentucky allows for limited early construction activities before closing is complete if developers are facing “unique circumstances.”

However, it is important for agencies to carefully consider their own capacity before offering a faster track for certain applicants. While those applicants may benefit, the savings could be negated in the aggregate if such reviews delay the processing of the balance of applications. Minnesota has taken a more systematic approach with its Multifamily Remodel Project, which covers all of the agency’s multifamily financing products. The Remodel Project seeks to streamline business processes, reduce production cost and better utilize technology to increase resource efficiency and achieve measurable
reductions in processing timeframes. This effort has led to a number of operational improvements, including the consolidation of over 25 due diligence checklists into a single, redundancy-free document, as well as a 12-15 percent reduction in inspection time through the use of mobile devices, among other outcomes.

Housing Credit developments are complicated, and assembling a comprehensive application package is an expensive endeavor requiring a substantial amount of organizational resources and pre-development capital. Therefore, ensuring readiness to proceed and boosting developer capacity can potentially boost efficiency and effectiveness. At the individual development level, Kentucky, Massachusetts, North Carolina and Tennessee have pre-application review processes, which can give developers the opportunity to refine proposals and/or improve feasibility for either current or future allocation rounds. Yet while application-specific support can be helpful, more meaningful improvements can be made by strengthening overall capacity and encouraging robust competition amongst a sufficient number of effective developers. Massachusetts developers can take advantage of trainings and workshops on a variety of issues, including project management and closing, and will soon be able to access additional resources through the recently-created Massachusetts Community Investment Tax Credit.

Allocating agencies can also use point-based incentives to give high-capacity developers a competitive advantage. Many agencies set thresholds and/or award points based on the number of successfully completed developments. They may also adopt standards and incentives related to the net assets of the developer, an indicator of organizational capacity and stability. In many cases, less experienced developers have the opportunity to partner or contract with a more experienced developer. That being said, it is important to note that placing too much weight on past experience could potentially deter new entries into the field and discourage competition.

After assessing capacity, agencies can streamline compliance based on level of experience to improve cost-effectiveness. For example, Wyoming classifies developers based on past experience, and reduces the construction compliance and reporting burden accordingly. States that are measuring a developer’s net asset levels could consider allowing other exemptions to particularly strong developers. Montana and Kansas allow for a developer to provide a guarantee in lieu of a separate upfront


capitalized operating reserve account for each development. The Massachusetts Housing Partnership’s Housing Reserve Assurance Program provides credit support to allow for developers to provide lower reserve levels. It should be noted that the permanent lender, equity investor and other stakeholders may each set their own reserve requirements. Therefore, in some cases the allocating agency’s policy may not be the deciding factor.

Agencies should also seek to establish an efficient fee and compliance structure. In many cases, the fees levied on developers are meant to support the operations of the allocating agency, and can include application fees, allocation fees and compliance monitoring fees, among other variations. It is important to ensure that allocating agencies receive adequate funding. A lack of agency capacity can delay processing and inhibit the effective due diligence that has made the Housing Credit program successful. Agencies also need sufficient resources to ensure that developers comply with program regulations and standards (including costs) and follow through with commitments to provide supportive services, amenities and/or other development characteristics that were included in the Housing Credit application. Inadequate funding could also limit the crucial role that an agency can play in supporting innovative policy, financing and practice. Agencies should therefore examine the adequacy of their fee schedule for sustaining and advancing the state’s Housing Credit program and calibrate the amounts accordingly.

It is also important to consider the incentives that may be inherent in agency fee calculations and structures, especially when considering these expenses in the context of overall development cost limits. Assessing fees on a per-unit basis puts larger developments at a comparative disadvantage, despite their potential economies of scale in other regards. Similarly, basing fees on a percentage of a given standard (such as the allocation amount or total costs) imposes higher fees on more costly developments, which may be in higher-opportunity areas. That being said, basing fees on a percentage basis does create a further incentive for cost control. Conversely, a flat fee (as opposed to a per-unit fee or fee based on a percentage of allocation, costs or other standard) puts smaller developments – which may be in rural areas or small towns – at a similar disadvantage if there are not separate allocation reservations or set-asides for such developments.

Though fees can impact a developer’s actions, their core purpose is to provide resources for the allocating agency. On the other hand, the core purpose of penalties is to deter certain actions or activities. The most straightforward of these penalties are those based on regulatory non-compliance. Unless there are significant extenuating circumstances, there
are few adverse trade-offs for taking punitive action against a developer that violates tenant income targeting or fair housing rules. However, other penalties may call for a more nuanced approach, including those related to design and construction changes (see the Hard Costs section of this report for additional information on the impact of such penalties) or unavoidable delays in a project’s development timeline.

Finally, allocating agencies should be cognizant of the impact that frequent QAP changes can have on cost-effectiveness. Agencies should be encouraged to make modifications to their policies to account for current conditions and to support innovation in the Housing Credit program. However, development can be a multi-year process, and developers must take QAP incentives into account when undertaking predevelopment activities. Changes to QAP policies and incentives may require expensive changes to plans and specifications. Conversely, developers may choose to defer certain expenses until after receiving an allocation, thus extending the development timeline. Finally, there may be a “learning curve” associated with new practices that can lead to incremental cost increases as developers incorporate new elements and techniques into their existing development model. There are multiple methods to mitigating these costs, including: providing a longer lead time before changes go into effect, evaluating the impact of changes over multiple allocation rounds before making further revision, and/or testing more impactful changes through short-term pilots before applying them to the entire allocation.

EVALUATION METHODS
The most direct action that allocating agencies take to influence cost-effectiveness is to set cost-based thresholds, standards and incentives. Given the competitiveness of the 9 percent Housing Credit, Massachusetts, Maryland and New York City, among others, each begin their review by first determining whether the development would be viable if structured as a 4 percent Housing Credit/tax-exempt bond transaction. This ensures that 9 percent Housing Credits are directed to developments that truly need the deeper subsidy. In the context of proposals involving rehabilitation, agencies often use rehabilitation minimums to ensure that not only is the deeper subsidy necessary from a financial perspective, but also that the physical improvements to the building will extend the life of the building a sufficient length of time and decrease the need for additional infusions of public capital at later dates. Some states set these minimums based on a specific per-unit dollar amount in making this determination, while others base their analysis on the building elements that must be replaced (such as windows and HVAC systems) as determined by a capital needs assessment (CNA). Given that a developer would presumably be conducting a CNA for any rehabilitation effort, it seems that the
latter approach could potentially mitigate against pressures to add project elements in order to meet the per-unit cost target. However, agencies adopting the CNA approach must guard against becoming too prescriptive or inflexible to ensure that it does not require unnecessary replacements or repairs. An alternative approach is to set a dollar-amount minimum as a proxy while allowing developers to justify lower amounts based on the CNA analysis.

Allocating agencies have also adopted a range of approaches to directly measuring and regulating cost-effectiveness. Agencies can measure overall costs, the amount of credits or subsidy being utilized, the development’s eligible basis, or varying combinations of these elements. There are also differing approaches to the level of analysis, including total development costs versus line-by-line analysis, or measuring costs on per-unit, per-development, and/or per applicant basis. Each approach has its benefits and trade-offs, as we discussed in our 2014 Bending the Cost Curve report (see page 17). While some threshold limits are firm, other states, such as Michigan, allow an acceptable range or “safe harbor.”

Most allocating agencies consider both upfront and ongoing costs, but not always in an integrated manner. However, these costs are inextricably linked. Expenditures on more durable materials can reduce replacement expenses. Investments in green building and sustainability measures can reduce utility costs. An analysis by the National Housing Conference and the Center for Housing Policy found a “lifecycle underwriting approach” could make a substantial proportion of buildings physically and financially viable for up to 50 years without the need for recapitalization. This could require a modest increase in upfront costs for physical improvements and to bolster reserves. While such action might marginally reduce the number of units that could be produced in the short term, it could also result in long-term savings that could lead to increased production in later years. While allocating agencies may have different perspectives on the optimal time horizon for underwriting, cost evaluations should balance upfront costs with long-term savings.

While it is important to understand the trade-offs associated with various units of measurement and the time-horizon in which the development is being evaluated, the accuracy of the agency’s cost standards and the incentives to improve overall cost-effectiveness are also important. Agencies may utilize reasonableness reviews (in which expert staff review plans and specifications to determine whether costs are in an acceptable range), threshold standards, point-based incentives, or a combination of these approaches. The chart on page 18 provides an overview of the prevalence of each technique.


14 Brennan, Maya, et al.
Determining Appropriate Units of Measurement and Comparison

Productive policy changes require a foundation of accurate information and data to guide decision making. Total development costs can be (an incomplete metric that fails to account for geography, development type and size) that jurisdictions and funders should look beyond when evaluating the cost-effectiveness of affordable housing. A number of other methods exist for evaluating development costs, each with advantages and drawbacks...The most appropriate measure (or combination of measures) may depend on the priorities of the evaluating agency and the market in question.

- Costs-per-unit is the most straightforward measure of costs, aside from total development costs. However, this metric fails to account for unit size, number of bedrooms, and other characteristics. Developments in markets with high land costs and those with family and supportive units are at a disadvantage using this measure.

- Costs-per-square-foot is another standard comparison. It improves upon costs-per-unit by adjusting for the overall size of the development — larger family units are at less of a disadvantage when this comparison is used. However, this measure does not create an incentive to ensure that building common areas and units are sized efficiently, unless accompanied with an evaluation of overall development costs.

- Costs-per-bedroom is another metric that removes the evaluation bias against larger units designed to serve families. Unlike costs-per-square-foot, this measure creates the incentive to be economical in determining the appropriate size for units — all things being equal, a smaller three-bedroom unit will score better than a larger three-bedroom unit. However, this metric has an inherent bias against smaller units, particularly studios and one-bedroom units. This would make it more difficult to develop housing targeted toward single-person households.

- Cost-per-person-housed is a rarely used metric, but one that most directly addresses the goal of providing affordable housing. Unlike other metrics that measure outputs (developments, units, etc.), this metric directly addresses the outcome of housing low-income people. Similar to cost-per-bedroom, evaluating on this basis adjusts for the household type being served, and provides an incentive to house residents in the most efficient manner possible. However, this metric is less precise, since occupancy figures must be projected and can change over time.

Excerpt from Bending the Cost Curve: Solutions to Expand the Supply of Affordable Rentals by Enterprise and the ULI Terwilliger Center for Housing.
These standards can be determined using multiple methods. Connecticut publishes cost limits developed from industry-wide data sources. Alabama does not publish hard and soft cost standards, but conducts reviews based on historical costs, third-party information and information from the current application round. Michigan, Minnesota and Wisconsin are among the states that have used historical development cost data to inform predictive cost models based on property type, location, tenant targeting and/or other factors. Another method is to *encourage additional competition through “blind bids”* – setting standards or thresholds based on where an application ranks in comparison to other applications in the current funding round.

While thresholds can be important in building public confidence that resources are being utilized effectively, they can create challenges in multiple ways. If they are set too low without any countervailing measures, they may exclude developments in high-property value, high-opportunity areas, or restrict additional development features such as retail or community space that can contribute to community revitalization. In addition, they may not be reflective of rapidly changing market conditions, such as labor shortages resulting in a spike in construction costs. However, if thresholds are set too high without other incentives to reduce costs, there are fewer pressures to innovate to lower costs. Finally, it is important to consider development context when setting costs standards. There can be substantial differences in costs between urban, suburban and rural environments, between high-rise and low-rise construction, and between new construction and preservation. These differences may not be the result of the relative efficiency of the developer. Comparing all applications against a single standard can lead to a skewed analysis of cost-effectiveness, and potentially prevent certain development types from receiving awards.

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15 For example, during our *Bending the Cost Curve* research, we heard anecdotal evidence that a new wave of investment in infrastructure for oil and natural gas extraction was making the skilled construction labor market unusually tight, resulting in significant increases in labor costs.
Several agencies address this challenge by combining approaches: setting an upper bound that prevents outlier developments from monopolizing scarce subsidy, with points awarded to particularly cost-effective developments. For example, Minnesota uses the aforementioned predictive cost model to set thresholds for cost-reasonableness based on development size, type and location, and creates a point-based “blind bid” incentive that awards points for achieving lower costs when compared to similarly situated developments. Developers that receive these points but fail to meet the cost target in practice receive a point deduction for their next Housing Credit application. These adjustments for development context ensure that the agency is not creating a competitive disadvantage for clearly beneficial development types which generally exhibit higher costs (for example, family-sized units and supportive housing). New Hampshire sets per unit limits on both total development costs and total credits awarded, and subtracts points based on the extent to which the development is above the average cost per-unit of applicants within that funding round. Pennsylvania conducts a detailed line-item cost review, sets a per-developer cap on the Housing Credit amount allocated, and awards up to 10 points for applicants that demonstrate costs below the median of all applications submitted. To adjust for development type and market, Pennsylvania bases this analysis on total development costs per square foot for different building types, excluding the cost of acquisition, reserves and commercial space. Preservation applications and those in the Philadelphia area are also considered separately.

**SOFT COSTS**

Many of the aforementioned potential cost savings could be categorized as reductions in soft costs, as they reduce the level of resources needed to assemble and implement a development proposal. Specifically, streamlining the application review process, establishing efficient fee structures, supporting efficient compliance mechanisms, coordinating funding sources, and reducing the impact of layered financing are important factors in lowering the impact of soft costs. Most allocating agencies also set defined limits and establish incentives related to certain soft cost line-items, with a particular focus on developer fees. Developer fees are a crucial source of revenue for affordable housing developers, who are limited in their ability to earn revenues from rents or increases in the underlying property value. Therefore, their main source of compensation is often the developer fee, which is built into the overall deal
structure and often counted as an upfront cost. Without these fees, many developers would not have the resources to assemble and operate affordable housing investments.\footnote{Jakabovics, Andrew, Lynn M. Ross, Molly Simpson, and Michael A. Spotts. 2014. “Bending the Cost Curve: Solutions to Expand the Supply of Affordable Rentals.” Washington, DC: Enterprise Community Partners & ULI Terwilliger Center for Housing. http://www.enterprisecommunity.com/resources/ResourceDetails?ID=0086703.}

Under the traditional Housing Credit financing structure, developer fees are set as a percentage of total costs, which technically creates an incentive for higher costs, absent any counter-vailing measures. In reality, there are many measures that limit this incentive, such as overall cost limits and limited subsidy resources. That being said, agencies have experimented with developer fee limits and calculations in order to create additional incentives for greater cost-effectiveness. For example, some agencies have used a different benchmark to set developer fee maximums. Indiana has adopted developer fee standards based on a set amount per-unit, removing any incentives related to total development costs (see sidebar). New Mexico uses a hybrid structure that caps the developer fee at the lesser of the per-unit dollar amounts or 14 percent of total development costs (exclusive of developer/consultant fees and reserves).

Many states, including Kentucky and New Jersey, also require that the developer defer a portion of the fee, reducing the amount of upfront capital needed for the developer. Instead, the deferred developer fee is often paid out of operating cash flow, creating an additional incentive for strong stewardship of the property. However, many of the costs of planning and executing a Housing Credit development are borne upfront, creating a temporal mismatch between the expenditure and receipt of funds. Deferring too large a portion of the developer fee can lead to resource scarcity, particularly for nonprofit developers, and can limit organizational capacity building. Therefore, deferred developer fee requirements and incentives should be carefully structured.

Some states also set limits for other expenditure categories, such as sub-contractor and consultant fees, contractor/builder profit and overhead, and syndication and intermediary expenses. These may be either explicitly called out in the QAP or included as part of a detailed expert review of cost reasonableness. Minnesota’s “Intermediary Cost” incentive examines these costs holistically and offers points to developers with lower soft costs as a percentage of total development costs.

\begin{center}
\textbf{Alternative Developer Fee Calculation Method: Indiana Housing and Community Development Authority; 2015 Qualified Allocation Plan}
\end{center}

\textbf{New Construction:} Developer fees for new construction developments must be the lesser of total per unit amount listed below or $1,200,000.
1. $18,000 per unit for the first 20 units;
2. $13,500 per unit for the next 35 units;
3. $10,000 per unit for the next 35 units;
4. $6,000 per unit for any unit above 90.

\textbf{Rehabilitation or Adaptive Reuse:} Developer fees for rehabilitation and adaptive reuse must be the lesser of total per unit amount listed below or $1,200,000.
1. $20,000 per unit for the first 20 units;
2. $15,000 per unit for the next 35 units;
3. $12,500 per unit for the next 35 units;
4. $6,000 per unit for any unit above 90.
FINDINGS

HARD COSTS

While creating more efficient agency processes and incentives and reducing soft costs can lead to marginal improvements in cost-effectiveness, acquisition and hard costs (those associated with design and construction) generally constitute the largest expenditure categories. There is therefore an opportunity to make a substantial impact on total development costs by focusing on these categories.

Focusing on hard costs does carry more risks to quality. Similar to improving agency processes, improvements to the development process can eliminate “deadweight losses” (costs resulting from inefficiencies that do not add value). Conversely, achieving upfront hard cost reductions can be a pyrrhic victory if a subsequent reduction in durability leads to increased operational costs and/or necessitates earlier recapitalization of the development. Therefore, any efforts to control costs related to these line items should be adopted after careful consideration of the associated trade-offs and a focus on life-cycle expenditures.

Allocating agencies use a variety of mechanisms that directly influence hard costs. States have an opportunity to optimize building and site standards, unit-size requirements, parking minimums, and on-site amenity incentives to ensure that the value added exceeds their cost of implementation.

It is common for states to list prescriptive design, construction and site preparation standards that may apply in addition to applicable state and local building codes. Our study did not investigate the extent to which these overlapped with other existing codes. In some states, they may not serve as binding constraints if most jurisdictions have adopted more strenuous codes. In others, agency standards may serve as a useful boost to quality if there are jurisdictions still operating under outdated codes. Agencies may also be justified in requiring materials and construction techniques that extend the useful life of the building in order to protect the public’s investment in the property and/or result in operating savings, such as reduced utility expenditures from energy- and water-efficiency measures. Finally, agencies may be acting out of the legitimate desire to ensure that affordable housing units are not aesthetically different from similarly situated market-rate units to avoid stigmatization within the community.

It is important for agencies to carefully review their design and construction standards to ensure that they do not add unnecessary costs, either through direct requirements, a lack of harmonization between codes, or additional compliance burdens. If cross-jurisdictional codes and standards overlap, it can also add to architectural and
engineering costs. The development team must work to incorporate different standards which may be in conflict. It can also add to compliance costs, as developers may need to seek multiple certifications from professionals to prove that the standards have been met. Massachusetts provides a helpful example of harmonizing cross-jurisdictional standards to reduce this burden on developers. In 2014, the city of Boston’s Department of Neighborhood Development, MassHousing and the Massachusetts Housing Partnership engaged architects and contractors to identify cost saving measures and produce a “streamlined and simplified” set of design guidelines for affordable housing.17

Direct requirements for specific materials and construction techniques should clearly add value to the development. Agencies should also establish a reasonably streamlined process by which developers can seek to waive certain requirements if compliance would result in unreasonable additional expenses. While the agency may need to assess a fee for such requests to cover review costs and deter excessive waiver requests (Georgia levies a fee of $1,500), this fee should be calibrated so that it does not serve as a de facto barrier to any waiver.

A glaring example of an opportunity to reform agency standards is parking and garage requirements. As detailed in both in Bending the Cost Curve and in our recent report on Promoting Opportunity through Equitable Transit-Oriented Development, excess parking adds to the cost of development, can reduce unit counts and inhibit economies of scale, and contributes to the degradation of neighborhood walkability and sustainability. Admittedly, some level of parking is needed in most cases, since not all communities have robust transit access and not all low-income households and workers can fully rely on transit. However, constructing excess parking and/or requiring garages rather than on- or off-street spaces diverts scarce resources away from the core mission of serving the housing needs of low-income people. Furthermore, agency-level standards are likely to be redundant, as many municipalities have their own parking standards. While local land use planning agencies are also often guilty of requiring too much parking, they are still in a better position than the state to set minimums based on local needs. Agencies should consider retaining the ability to correct applicants who do not provide for adequate mobility options without adopting blanket statewide minimums.

Agencies should also be cognizant about the risk of inhibiting potentially innovative design and construction techniques. For example, there have been significant advances in developing new products such as cross-laminated timber, and many developers are beginning to experiment with new manufactured and panelized construction techniques. The architectural field has also made significant progress in more effectively utilizing smaller spaces, with “tiny house” and micro-unit structures gaining prominence, particularly as housing for homeless individuals. These smaller unit types can serve important niches in the housing market, but may be insufficient to meet the needs of many households, particularly families with children. However, the same design principles can be used to reduce square footage while still creating livable, multi-room apartments, which can allow the developer to add more units and improve economies of scale. Agencies should work to ensure that minimum unit-size requirements do not inhibit these innovations.

Allocating agencies are also required to ensure that Housing Credit-funded properties are energy efficient and incorporate other cost-effective green and sustainability elements. As such, states have adopted a variety of standards and incentives, including basic energy codes, requirements to use ENERGY STAR appliances, provisions to achieve energy usage reduction targets, and the adoption of comprehensive sustainability standards including but not limited to LEED and the Enterprise Green Communities Criteria (see charts on page 24 for examples of commonly accepted green building provisions).

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GIVING DUE CREDIT: BALANCING PRIORITIES IN STATE LOW-INCOME HOUSING TAX CREDIT ALLOCATION POLICIES

FINDINGS

Commonly Accepted Green Building Programs in States with Threshold Requirements

<table>
<thead>
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<th>Green Building Program</th>
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<tr>
<td>Enterprise Green Communities Criteria</td>
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<tr>
<td>Other</td>
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<tr>
<td>LEED</td>
<td>5</td>
</tr>
<tr>
<td>ICC700</td>
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Commonly Accepted Green Building Programs in States with Incentives

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<td>Enterprise Green Communities Criteria</td>
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<tr>
<td>Other</td>
<td>6</td>
</tr>
<tr>
<td>EarthCraft</td>
<td>2</td>
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</tbody>
</table>

However, the simple presence of energy efficiency or sustainability-related criteria does not ensure cost-effective improvements in a building’s environmental performance. In some cases, developers have noted that certain green building requirements have added costs with minimal return on that investment. Conversely, studies have shown that upfront total development costs may actually be lower in green-certified development compared to others that did not achieve certification, even before accounting for ongoing utility expense reductions and improvements to resident health and well-being. This difference in outcomes and experiences is likely attributable to the different approaches that allocating agencies take in promoting energy efficiency. Whole-building performance targets and sustainability certifications often require more efficient integrative planning processes that can lead to reductions in soft costs that exceed the incremental increases in hard costs. Conversely, requirements or points for specific measures or components do not require such integration, and the aggregate impact of the efficiency measure may suffer as a result.

Allocating agencies face a difficult task in developing appropriate design, construction, green building and sustainability standards that balance quality and cost. Striking this balance is made even more difficult given labor and material cost volatility, utility rate fluctuations, and changes in construction practices. Therefore, it is imperative for agencies to establish feedback mechanisms to identify inefficient standards. Minnesota annually surveys developers, architects and contractors on a range of issues, including provisions that add unnecessary costs. In the context of third-party certifications, the agency should work with both the development community and the organizations that develop these certifications and standards and advocate for necessary improvements.

Most agencies either require or provide point-based incentives for specific project amenities, which can add to hard costs. Many of these amenities – such as supportive service space, outdoor recreational space, high-speed internet connectivity, washers/dryers or laundry facilities – do much to promote resident well-being and opportunity.

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22 Trachtenberg, Alex, et al.
Options for Project Amenities:
2016 Nebraska Investment Finance Authority Low-Income Housing Tax Credits/
Department of Economic Development HOME Funds Application

Point Category: Amenities (A maximum of 6 points are available in this category)

- On-site furnished community room with a minimum of 600 square feet (2 points)
- Washer and dryer installed and maintained in each unit (2 points)
- Garage for each unit at no cost to the tenant (2 points)
- Community garden with a dedicated water source that is paid for by the development owner (1 points)
- Unfinished basement or storm shelter for all units in the development (n/a if points awarded for finished rooms in basement) (1 point)
- Washer and dryer hook-ups in each unit (n/a if points awarded for installed in each unit) (1 point)
- Community laundry room (n/a if points awarded for installed in each unit) (1 point)
- Designated exterior playground area or exercise equipment with sufficient equipment for usage by tenants in all units OR Individual playground equipment for each unit in CROWN developments (1 point)
- Each unit will be equipped with a medical alert / emergency response system at no cost to the tenant (1 point)
- High-speed internet access and owner paid service for each unit (1 point)
- Storage area for each unit that is an enclosed, single, and secure space (1 point)
The costs associated with many amenities – such as outdoor grills and seating areas – may also be minimal in the context of the broader development. However, in a highly-contested funding competition, there is often pressure on developers to add as many amenities as possible, thus pushing aggregate costs upward. Many states have combatted this pressure by setting more narrowly targeted amenity thresholds and establishing an upper-bound on the number of project amenity points a developer can receive. For example, New Mexico uses its 2016 Multifamily Design Standards to set requirements for laundry facilities, site recreational areas and interior community spaces appropriate to the population being served. Nebraska offers six points (out of 59) for project amenities, providing a list of choices from which the developer can select.

In addition to promoting or restricting certain development elements, an agency can examine its approach to handling unforeseen circumstances and cost overruns as a means of promoting cost-effectiveness. This is particularly relevant if the agency has adopted incentives that encourage the developer to “push the envelope” in terms of cost control. Agencies have an interest in minimizing the number of post-allocation design and construction changes. Extensive adjustments may indicate flaws in initial planning, and each change takes time and agency expense to review. However, it is not rare for developers to experience unforeseen circumstances that necessitate design changes or result in cost overruns. Furthermore, encouraging innovation brings trial and error, which means that an agency interested in promoting breakthroughs to design and construction practice must be willing to accept some level of flexibility and even failure. If the penalties for adjustments or cost overruns are excessively punitive, it creates an incentive for the developer to be more cautious in proposing potentially cost saving measures.

Therefore, as with most QAP elements discussed in this report, agencies must strike a difficult balance between consistency and flexibility in the construction monitoring process. Developers generally build a limited amount of construction contingencies into their budget. In the event of unforeseeable cost overruns beyond this amount, an agency may consider awarding additional credits. New Jersey maintains a reserve allocation in part to provide supplemental funding for “hardship” situations. Wisconsin competitively evaluates developers’ requests for additional credits during the subsequent allocation round. Both Nevada and Pennsylvania explicitly restrict applicants for additional credit from claiming additional developer fees, which are generally based on a percentage of total costs.

Finally, allocating agencies can adopt policies that are directly designed to support innovations in developing quality affordable housing. Massachusetts provides points specifically for utilizing cost management techniques such as integrated project delivery,
early-stage value engineering, and cost-effective building approaches such as modular construction, among others. Pennsylvania conducts a parallel Innovation in Design competition as part of its allocation process to encourage “demonstrated innovation in housing which could be illustrated through excellence in design, implementation of current and future energy efficient technologies and materials, and leveraging community and capital resources” (see sidebar for more information).

**PROMOTING (OR INHIBITING) ECONOMIES OF SCALE**

Developers can also achieve substantial per-unit cost savings through economies of scale. Building additional units (assuming local market conditions indicate sufficient need) allows fixed costs such as land, design, legal expenses and (in some cases) funding application fees to be spread among a greater number of units. However, there are numerous barriers to achieving appropriate scale. Local governments and land use authorities often create the most onerous barriers through zoning restrictions, density limits, height maximums and other provisions. Furthermore, while larger developments may be more cost-effective on a per-unit basis, there still may be insufficient permanent and/or gap resources to cover the incremental increase in total costs.

That being said, the removal of discretionary barriers to achieving economies of scale can be effective in stretching scarce resources further. Allocating agencies have adopted a number of policies that have both inhibited and promoted economies of scale. Several states have adopted maximum unit counts. Minimum unit size and excessive parking requirements can also inhibit scale. Heavily weighted community support requirements can give extra power to local stakeholders who oppose dense multifamily housing and/or affordable housing. Many developers must already clear these or similar hurdles at the local level and are further restricted by subsidy limitations, generally making state-level requirements and restrictions redundant and unnecessary.

Still, there may be legitimate reasons for adopting certain requirements. For example, if unit size requirements/incentives focus on bedroom counts rather than square footage, it can help fill a need for family-sized units in a given state. Restrictions on market capture rates (the ratio of the number of units in the development to the number of potential tenant households in the specific market) can reduce the number of units in the development, but can also support financial viability by mitigating vacancy risk. Finally, many of the states that encourage lower-density configurations and/or single-family detached

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**Innovation in Design Competition: Pennsylvania Housing Finance Agency (PHFA) Allocation Plan for the Low-Income Housing Tax Credit Program**

In 2013, the agency announced that ACTION-Housing’s Uptown Lofts development in Pittsburgh would receive a Housing Credit allocation through its Innovation in Design competition. Uptown Lofts was recognized for three development characteristics.

- **Energy-efficiency:** This two-building development incorporated an Energy Demonstration Project to compare development costs and savings associated with high-efficiency building enclosure systems, with one building designed to meet current energy codes and PHFA energy criteria, and the other designed to meet the more aggressive Passive House Certification standards.

- **Supportive services:** 24 units will be dedicated to youths aging out of foster care with accompanying housing and life skills support services.

- **Neighborhood revitalization:** Uptown Lofts is one of several significant reinvestment projects contributing to the revitalization of a previously disinvested community that is situated between two of the city’s most economically vibrant neighborhoods.

housing are largely rural, including Mississippi, Nebraska and North Dakota. These configurations could help Housing Credit units blend into the surrounding communities, and land acquisition costs may be low enough that the benefits of scale are not as significant.

In addition to barrier removal, some allocating agencies have taken steps to proactively support scale. As previously mentioned, Massachusetts reserves the right to award out-of-round application submittals for large-scale preservation and new construction developments. To supplement 9 percent Housing Credit availability, Virginia encourages developers to utilize a dual-partnership structure that allows them to access both 9 percent and 4 percent Housing Credits for the same development.

**BUILDING QUALITY, RESIDENT OPPORTUNITY AND TRADE-OFFS**

Allocating agencies have the dual mandate of being effective stewards of public resources and expanding resident well-being through the construction or preservation of high-quality affordable housing. These are crucial obligations on their own merits, but also because failing at either measure can erode public and political support for affordable housing. Without this support, maintaining or increasing funding levels will be increasingly difficult in a constrained budget environment. Furthermore, negative perceptions of affordable housing – whether because of cost or quality – can amplify the concerns of opponents and make local development approvals more difficult to achieve.

As previously discussed, allocating agencies can promote the long-term physical and financial viability of a development by adopting efficient design, construction and whole-building energy efficiency standards and incentives, and incorporating upfront cost standards that are reflective of long-term operating and replacement costs. An agency may also try to promote durability by incorporating disincentives for subsequent funding requests for the same property. Kansas imposes a reinvestment fee that applies to any property previously receiving a Housing Credit allocation. This reinforces other incentives that promote durability. However, agencies should be careful to ensure that such disincentives do not inhibit legitimate preservation efforts. The vast majority of properties – regardless of market positioning – will need some capital improvements after several decades of normal wear-and-tear. Penalties for such efforts can make it more difficult to preserve the existing affordable housing stock.

Allocating agencies must also work to balance cost-effectiveness with resident opportunity. One approach to achieving this balance is to adopt proactive thresholds and incentives that advance the latter. At a basic level, most agencies have adopted thresholds and point-based incentives that ensure that affordable housing is accessible to a range of housing types (including formerly homeless persons, seniors, persons with disabilities, families with children) and that the physical structure of the buildings and units is appropriate for those
populations. For example, Housing Credit developments must comply with the Americans with Disabilities Act, and states can encourage developers to apply accessibility and/or visitability standards to a proportion of units appropriate for market needs.

Though such provisions can increase the number of affordable units available to persons with disabilities, it is also important to ensure that there is operational support to match the targeted households with the accessible units. Developers with strong property management must try to fill units as soon as possible; holding a unit off-line while waiting to be matched with an appropriate tenant can potentially lead to financial hardship. However, many households with special needs – particularly those transitioning from an institutional setting – may not be able to move immediately. This friction can be mitigated through close partnership between the housing and social services sectors. Another option is for agencies to facilitate the creation of housing locator databases and encourage or require developer participation, as Pennsylvania and Ohio have done. The utility of these services extends beyond accessible housing – it can also help families with children locate affordable housing in good school districts, for example.

Allocating agencies should also work to ensure that their approaches to cost control do not interfere with efforts to expand resident access to jobs, services and life’s other necessities (often, though not necessarily, via robust transit access), provide quality educational opportunities, and advance public health and safety, among other characteristics. Providing such access can be advanced through increasing housing choice in such high-opportunity communities and by working to improve neighborhoods where certain opportunity-enriching characteristics may be lacking (see sidebar).

Just as efforts to contain costs should not promote the lowest common denominator in terms of building quality, agencies should also consider the impact of various thresholds and requirements on location and access to opportunity. In particular, sites in opportunity-rich communities may have higher acquisition costs, and developments involving revitalization may require added investment for other neighborhood services, community facilities and infrastructure. To address this factor, states can adopt location-sensitive cost evaluations. Virginia, among other states, creates separate cost caps for higher-cost urban areas, though it does not account for differentiations in neighborhood characteristics within those areas. Minnesota allows for discretion in awarding higher credit allocations for developments involving concerted community revitalization, as well as developments in growing job centers.
Many states also provide additional resources for developments with certain opportunity-enhancing characteristics. Maryland offers a basis boost for “Family Housing in Communities of Opportunity.” New York state coordinates Housing Credit funding with supplemental resources to support mixed-income and mixed-use development, and administers a separate Neighborhood Revitalization Cross-Subsidy Pilot to finance mixed-income development. Nebraska reserves a portion of its Housing Credits to be coordinated with its Collaborative Resources Allocation for Nebraska (CRANE) Program, which targets “specific long-term, interrelated and coordinated job creation/enhancement, economic growth, joint housing and community development strategies and implementation of plans by Nebraska communities.”

Allocating agencies can also work to ensure that the QAP scoring and weighting structure promote opportunity-enhancing development and preservation efforts. A recent analysis by New York University for the HUD Office of Policy Development and Research found a correlation between QAP provisions and the location of Housing Credit developments, though it called for further research to more fully understand the various other factors within agency policies that influence development and allocation decisions. The sidebar on the following page includes various examples of the point-based incentives intended to promote a wide range of opportunity-related priorities.

In particular, threshold requirements and incentive points for community support should be avoided to remove one barrier to developing in high-opportunity communities. While robust community support is welcome, it is not rare for residents to oppose developments based on concerns about neighborhood change, density, and misperceptions about affordable housing and its residents, among other factors. In some

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cases, local officials may be willing to let a development move forward from a procedural standpoint, but may be unwilling to take a proactive stance affirming its value because of political risk. Requiring the support of elected officials (or giving significant weight to officials with an opposing perspective) risks creating an effective veto based on potentially unrepresentative views.

Likewise, agencies should also carefully consider the weighting of incentives that support local barrier reduction. Wyoming and Wisconsin award points to developers that are able to secure local approval for reductions in barriers and on-site costs (for example, reduced infrastructure requirements, donated or discounted land, streamlined permitting processes, fee waivers and parking reductions, among others). Such local actions can reduce both hard and soft costs, particularly if they are instituted at a systematic (rather than development-specific) level. However, as with explicit community/elected official support, many jurisdictions may not have the political willpower or the resources to institute such changes. While local barrier removal is welcome, its absence should not be a deciding factor in whether a development is able to proceed.

If a point-based incentive is deemed insufficient to achieving a state priority, agencies can ensure that a portion of its Housing Credit allocation is reserved for impactful developments by creating specific reservations or set-asides for certain neighborhood and/or development typologies. Tennessee, Connecticut, Colorado and Washington have all ensured that a portion of credits are directed toward public housing redevelopment and/or Rental Assistance Demonstration preservation efforts. Florida holds a separate competition for revitalization initiatives and Michigan reserves 30 percent of its credits for “eligible distressed areas.” Wisconsin reserves 7 percent of its Housing Credits for “High-Impact” projects, defined by a combination of employment proximity, inclusion in a redevelopment plan, a scarcity of existing affordable housing, and/or coordination with an Emerging Business and Workforce Development Program.

Finally, to ensure that there is an appropriate balance between cost control, quality, and opportunity, states can work to proactively evaluate progress toward meeting agency goals and adjust their allocation procedures and incentive structure accordingly. For example, Minnesota has taken a robust, data-centered approach to cost control. Massachusetts has committed to collecting and analyzing data on efforts to affirmatively further fair housing and the impact of the Housing Credit on distressed communities.
True to the Housing Credit program’s design, allocating agencies have adopted a wide range of approaches to addressing their state’s affordable housing needs. As we previously discussed in the Bending the Cost Curve report, there is no single issue or innovation that will fundamentally change the cost profile of Housing Credit development. Rather, each individual action has incremental cost implications that can have a substantial impact in the aggregate. While the complexity of this situation may seem discouraging, an alternative perspective is that it represents an opportunity for experimentation and innovation, with a crucial role for the collection and sharing of leading practices.

While this report highlights many options for allocating agencies to consider, each state’s development context is unique and there are multiple pathways to achieving common goals. Reflecting this nuance, we offer the following high-level recommendations:

- **Agencies should consider the cumulative impact of QAP provisions on costs and quality.** Studying the interactivity of various thresholds and incentives can mitigate unintended consequences.

- **Point-based incentives and weighting should be structured so that no single provision is effectively mandatory.** This allows developers to plan context-specific proposals. Agencies should continuously evaluate the weighting and point structures to ensure that each reflects the relative cost and importance of the provision.

- **Cost and subsidy limits should reflect differences in development type and location.** This will mitigate one barrier to achieving a balanced approach to affirmatively furthering fair housing.

- **Cost, design and construction standards should account for and encourage long-term savings.** Well-planned up-front investments can ensure a healthy resident environment and reduce the need for additional subsidies as the property ages.

- **Funding sources and regulatory compliance should be coordinated and streamlined.** To the extent possible, agencies should use their leverage as a primary funder of affordable housing to reduce the impact of layered financing, improve the efficiency of the allocation process and coordinate across jurisdictions.
• **Agencies should encourage innovation through the use of pilot initiatives.**
  Systematic improvement generally does not occur without some level of trial and error. Pilots allow agencies to build an evidence base before making decisions that affect their entire operations.

• **Progress toward agency goals should be measured and the results disseminated.** As previously discussed, the presence of a given provision will not necessarily lead to the achievement of the desired programmatic outcome. As agencies establish goals and make changes to QAPs, they should regularly evaluate cost trends and outcomes. These evaluations will establish the effectiveness of pilots and modifications over time and inform future adjustments and initiatives. While data should be continuously tracked, agencies should recognize the benefits of consistency and avoid overly-frequent changes with short lead times. Finally, agencies should disseminate the results of their efforts to expand the knowledge base across the Housing Credit and affordable housing community.

The 2014 *Bending the Cost Curve* report established that there is a concerted effort underway to promote cost-effectiveness in the affordable housing delivery system. Since that time, this effort has continued to gather momentum. Yet as long as prevailing housing insecurity trends show few signs of abating, these successes will continue to be partial, and the need for progress and innovation will continue to grow.
**APPENDIX A: Acknowledgements**

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## APPENDIX B: List of Low-Income Housing Tax Credit Allocation Policies Reviewed

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<th>State</th>
<th>QAP</th>
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<td>The Plan of the Virginia Housing Development Authority for the Allocation of Low-Income Housing Tax Credits (2015)</td>
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<td>Consolidated Request for Proposals for Affordable Housing Projects</td>
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<td>West Virginia</td>
<td>West Virginia Housing Development Fund Low-Income Housing Tax Credit Program 2015 and 2016 Allocation Plan</td>
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<td>Wyoming Community Development Authority 2016 Affordable Housing Allocation Plan (HOME, Tax Credit &amp; Tax-Exempt Programs)</td>
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