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**California Council for Affordable Housing (CAAH)**  
***Recommendations of the Low Income Housing Tax Credit (LIHTC) Program Improvement Task Force***

**Preface**

The CCAH-LIHTC Program Improvement Task Force was initiated on May 25, 2010 in conjunction with the CCAH 2010 Spring Conference. At that conference, approximately 60 CCAH members, representing a wide range of interests in the California LIHTC industry, met to discuss the current state of the LIHTC program and "brainstorm" ideas for program improvements. The group strongly agreed that important parts of the program, principally the credit allocation system, were not working as they should to get the maximum intended benefit out of the program. The group called for CCAH to form a task force to undertake an analysis of the program - including the goals it is intended to meet - and develop recommendations for change. Shortly after the conference adjourned, the 9 member Task Force with consulting support was put in place.

**Task Force Process**

The Task Force felt that it was essential to "step back" and establish its own view of what the LIHTC program is intended to accomplish. These goals would "drive" program priorities and be the foundation for the allocation process. For years, the program has dealt with change incrementally and in the context of an annual cycle that does not, by its nature, permit longer term, comprehensive thinking and change. The Task Force went through a process of individually and collectively ranking a dozen potential program goals. They also assessed what features an allocation system should have, addressing such questions as whether a scoring system with no possibilities for ties is preferable and achievable. Finally, the Task Force worked on a revised scoring system and other specific changes consistent with its decisions on goals, priorities and system features.

**Goals**

In the world of Qualified Allocation Plans, legislation and regulation creating the LIHTC program provide minimal guidance in terms of program "goals" or priorities. This was by design as Section 42 defines the QAP as a plan "which sets forth selection criteria to be used in determining housing priorities of the housing credit agency **which are appropriate to local conditions....**". This certainly left a lot of room for how the plans could allocate credits. The Task Force approached its "goals" discussion, understanding that Section 42 does refer to a number of preferences with respect to a QAP's goals, such as: "**servicing the lowest income tenants**" and "**serve qualified tenants for the longest period**". In terms of selection criteria, Section 42 identifies categories to be considered such as "**project location**", "**housing needs characteristics**", "**project characteristics**", "**populations with special needs**", "**individuals with children**", "**public housing wait lists**", and "**tenant ownership**". Other than the delineation of the minimum nonprofit set aside, Section 42 does not express goals per se. The same holds true for Section 42 guidance

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regarding credit allocation in an amount which is "**necessary for the financial feasibility of the project and its viability...**". In this regard, Section 42 refers also to the "**reasonableness**" of development and operating costs.

Thus, the state allocating agencies have fashioned QAP's to accommodate Section 42 and a variety of other public purposes. The QAP's serve the purpose of structuring more specific goals and priorities; and they also use various requirements to "ration" the credits in the face of high demand on the part of developers who will do what it takes to receive an allocation. If all the state's QAP's have one thing in common, it is that they carry a great variety of public policy desires.

The Task Force considered program goals that included:

- Cost efficiency
- Administrative efficiency ("user friendliness")
- Production
- Need
- Special populations
- Credit utilization
- Public funds utilization
- Financial feasibility
- Local commitment
- Sustainability
- Affordability
- Site and Service amenities

The Task Force accepted that these were all worthy goals in their own right and that many were not mutually exclusive. Nonetheless, just as the program will continue to have more allocation losers than winners, it will be about making choices from competing goals.

It was the sense of the Task Force that **cost efficiency**, in order to **maximize production**, and producing units where **most needed** should be priority goals and be more prominent system "drivers" than other goals above. Leveraging of the tax credits received considerable attention, and it was concluded that effective use of the credit should be achieved primarily through cost efficiency and not by simply substituting one public resource for another to give the appearance of leveraging the credit or effective credit utilization. In connection with cost efficiency, it was suggested by some that localities should be able to fund more costly projects to serve their local goals (higher levels of quality, sustainability, community acceptance, etc.). They should be allowed this choice, without diminishing their chances of winning an allocation. Considerable discussion was focused on project quality and its relationship to cost efficiency, especially where a greater program incentive is

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created to be more cost efficient. While the Task Force felt this was a legitimate concern, the sense was that local requirements and the program's minimum thresholds, as enhanced in these recommendations, build in safeguards to insure quality. The Task Force believes that cost efficiency does not require compromising quality, but concedes that a cost efficiency emphasis in the competition will disadvantage projects seeking a level of quality beyond a certain standard.

Another common thought was to address more goals through the threshold requirements, as opposed to competitive scoring categories (e.g., site amenities, sustainability, services).

### **Economy as a Backdrop**

The Task Force believes that the state of the economy is and will continue to be a "lens" through which the LIHTC and many other programs will be viewed in terms of their effectiveness. Its future may depend on how it is viewed. In fact, recent campaigns to support and improve the LIHTC program are based largely on the impact of the program in creating jobs and stimulating the economy. While affordable housing production, in addition to its social benefit, is a highly effective economic and employment stimulus, there is also vulnerability. If it can be argued that the cost of producing an affordable unit and the attendant commitment of **(all) public resources** is unreasonable, the program could quickly be in jeopardy - especially in a politically charged environment looking for waste in what are offered as stimulus programs. The LIHTC program has the upper hand in the economic and jobs argument, but it must be a program that can defend its cost effectiveness.

### **The Need for Change**

TCAC's Annual Reports and annual Financing Breakdowns indicate some trends that suggest fundamental change is needed:

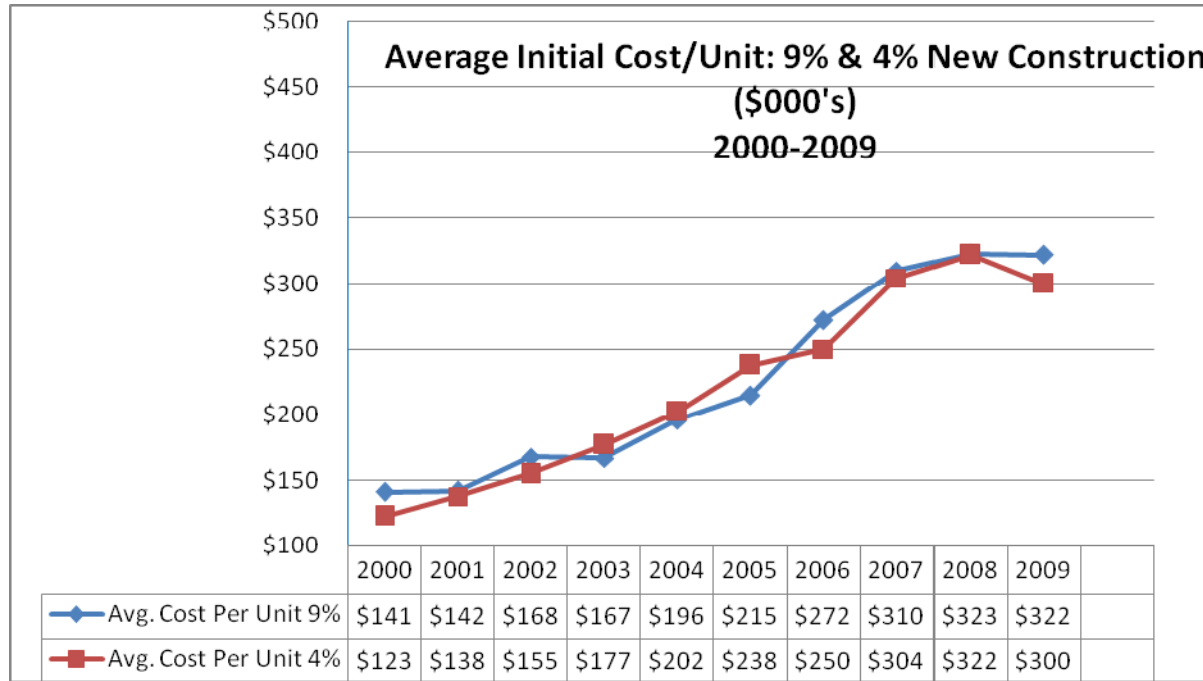
- As **Chart 1** illustrates, the cost per unit for 9% new construction has increased 128% since 2000, and 50% since 2005. The 4% new construction data follow a fairly similar pattern, but with a drop off in cost in 2009.

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**Chart 1**

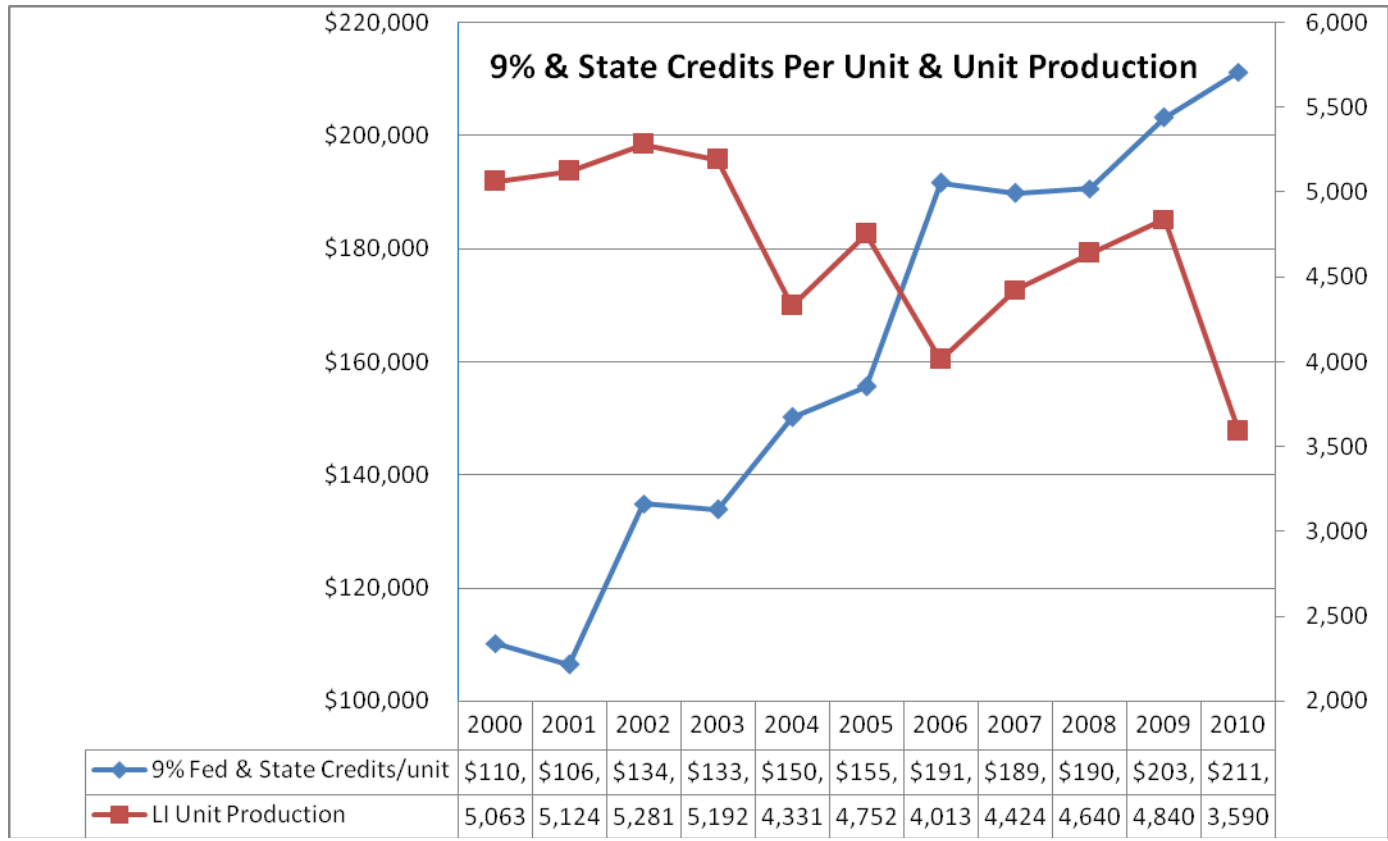


Source: TCAC Annual Reports, 2009 & 2006

- As **Chart 2** illustrates, credits (CA and Federal) per unit for 9% projects (all project types) increased by 91% to \$211,000 over a 10-year period, and 36% since 2005.
- **Chart 2** also illustrates that, while credits per unit and annual allocations were increasing, 9% low income unit production was decreasing overall. After a relatively flat 5 years from 2005-2009, it is likely that 2010 production will be 20% below that of 2000, even with forward allocation of 2011 credits. Important to the 9% program production trend is the fact that, from 2000 to 2009, available federal credits increased by 76%, including HERA (H.R. 3221) adjustments, and 53%, excluding HERA. This was the result of increases in the credit per capita, based on inflation, and by \$.20 over 2008 and 2009 under HERA. Tax credit prices also fell over the last 3 years, but with ARRA "gap funding" utilized to make up lower equity raises.

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**Chart 2**

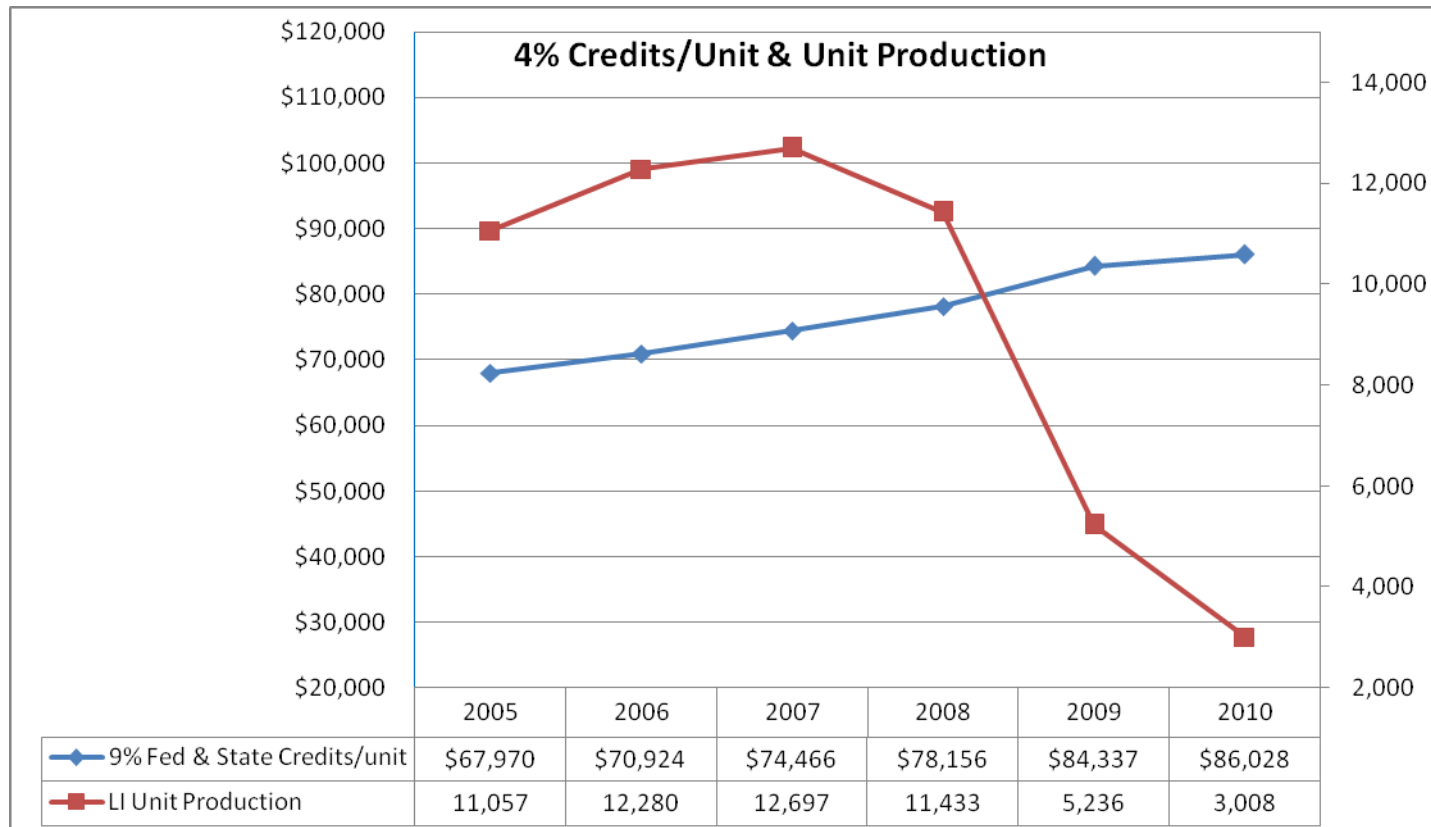


Source: TCAC Annual Reports ,2006 & 2009. 2010 estimate based on CTAC Rd. 1 YTD data, and use of remaining 2010 9% credits and State credits equal to Rd. 1 allocations.

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- 4% program production decreased by 53% over the past 5 years, as illustrated in **Chart 3**. Linear projections for 2010 indicate another steep drop of over 25% from 2009. The 4% program, accountable for **three times the production of the 9% program in 2006**, will no doubt **fall below the 9% production level in 2010**.

**Chart 3**



Source: CTAC Annual Reports ,2006 & 2009. 2010 estimate based on linear extension of TCAC Round 1/YTD data

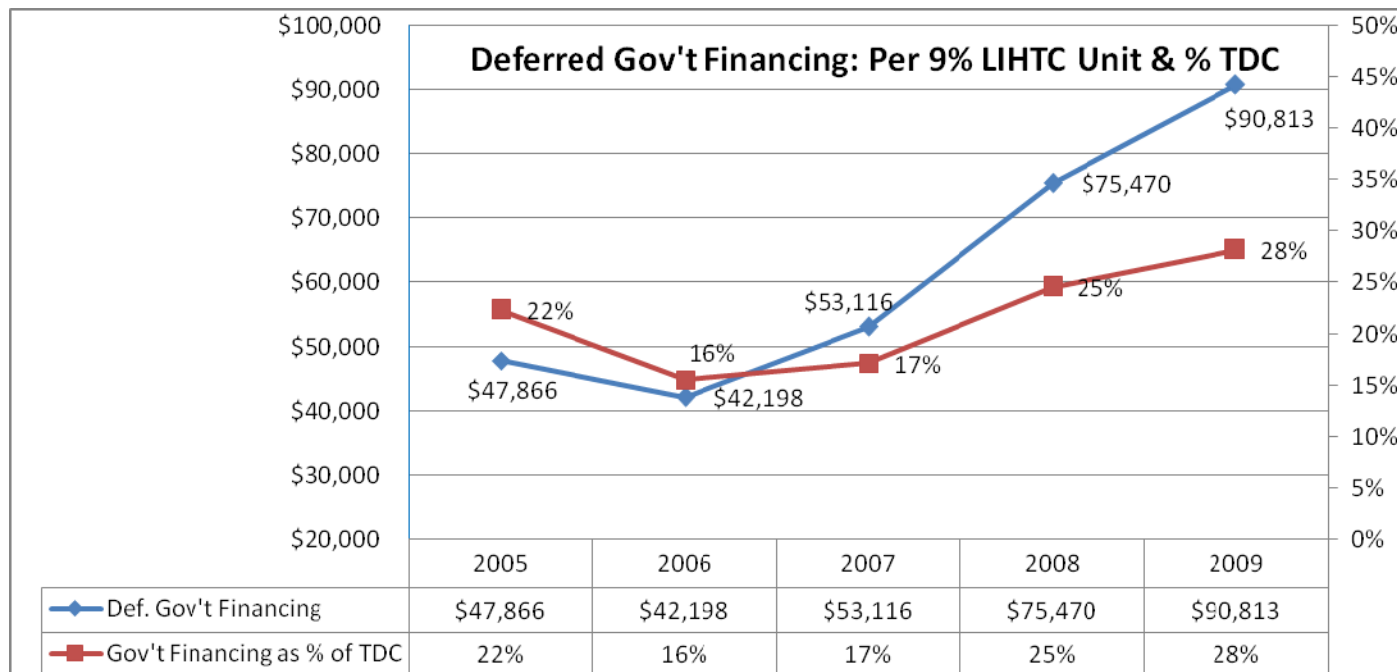
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- While the 4% program has been impacted significantly by market forces and resulting diminished investor demand and debt financing, the dramatic contraction of the program underscores the need to find the means to bolster what has historically been the most productive tax credit program in California. One of these means will be to have more subsidy capital directed to this program, which has suffered from the loss of state funding, the diversion of local redevelopment "set aside" funds, and the use of far greater amounts and proportions of local funds to compete for 9% credits under the current system.
- According to TCAC's annual "Financing Breakdown" data, illustrated in **Chart 4**, during the 2005-2009 period, "**Government Financing**" per unit in the 9% program increased from approximately \$48,000 to over \$90,000 - an increase of 90% (not including ARRA "gap funding"). A sampling of 2010 first round projects indicates that the public funding levels are continuing to increase significantly.

**Chart 4**



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Source: TCAC Annual Reports, 2005-2009, "Financing Breakdown"

There are obviously many variables at work in these numbers, but the Task Force concludes that development costs have increased at an alarming rate and local government, as well as the tax credit, is paying for it. The program is far less efficient. Overall production has declined, even with substantially increased credits, including those available to the state through HERA. The ability of the program to hold off even greater production declines in the face of higher costs has resulted from more total credits, larger per unit credit allocations, and by shifting a larger proportion of costs to local subsidy sources. For localities, this is happening at the expense of other programs, including the ability to subsidize 4% projects and other local housing efforts, including special needs. Efficiency in the program is lacking, and the allocation system is partly responsible as it has not rewarded it, and arguably, may have done the opposite.

**Emphasis on Need**

In the midst of detailed measures of site amenities, services, sustainability, public funding..... and so on, the current system seems to have lost sight of a most obvious priority - housing need. While housing "type" goals address this in a general way, these are not measures of need, per se. The Task Force believes that greater importance must be attached to need, using such criteria as market vs. affordable rent levels, balanced communities, qualified census tracts, revitalization areas, "jobs-housing fit" and the like. Also in relation to need, the system must address the equitable distribution of credits, preventing overconcentration in areas where, arguably, the need is not supportable, and promoting allocations in under-served areas where need clearly exists.

**Type of System**

The Task Force also deliberated over the nature of the competitive system, recognizing that the system must function as a rationing mechanism while promoting certain goals. The types of system characteristics/outcomes discussed were:

- Eliminating or reducing the likelihood of ties
- Administrative efficiency and ease of working with the Plan
- Retaining the existing CTCAC system with a different tiebreaker
- Shifting to all threshold scoring with a tiebreaker lottery
- Employing a tiebreaker lottery for maximum point projects

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- Creating more threshold items with less competitive score categories, different tiebreaker
- Creating separate competitions for certain categories
- Distributing credits to avoid over concentrations and achieve more equitable distribution
- Reducing waste and cost to unsuccessful applicants
- Emphasizing additional geographic apportionment where sensible

The Task Force concluded that the preferred system should be one that:

- Reduces or eliminates tie scores if possible
- Shifts more scoring items to the threshold category, with easing of requirements in some areas
- Revises the tiebreaker
- Creates separate competition for some project types
- Considers establishment of a "set aside" for the City of Los Angeles
- Is re-written and reorganized for better understanding, ease of use.

The following Task Force recommendations are designed to make changes to the regulations consistent with the Task Force's thinking described above.

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**Outline of Recommendations**

*Shaded items* are scoring categories shifted to the **threshold** category as proposed (in some cases they are still scored, but as a threshold requirement). *Italics* = new items.

Item	Recommendation	Rationale
<b>Section 10315 Set Asides and Apportionments</b>		
(a) Nonprofit Set Aside	-Establish a level competition for <u>all types</u> of nonprofit projects	-The nonprofit set aside is, in effect, a homeless set aside and should be open to other competitive projects. -The homeless issue should be a high priority, but with efforts to deal with it in other ways, including use of 4% credits/bonds/CA credits
(i) Housing Types	-Change Housing Type %'s to: 65% Large Family, 20% Seniors, 15% All Other (At Risk, Special Needs, SRO)	-Retain Large Family as a priority goal. -Adjust Seniors commensurate with the growing need.
<i>Acquisition/Rehabilitation</i>	<i>-With the exception of At Risk and Special Needs projects, remove acquisition/rehabilitation projects from the 9% competition. -Alternatively, establish a separate competition for acquisition/rehabilitation projects through an apportionment or set aside.</i>	<i>-It is difficult to incorporate rehabilitation projects into one competitive scoring system with new construction -Rehabilitation should be a priority of the 4% program. With projects that will likely have more 4% credit basis than 9% basis, it makes more sense to have these projects utilize all 4% credits (and CA credits) and bonds. -Redirect local public funding to support of rehabilitation accomplished with 4% credits</i>
<i>City of Los Angeles Set Aside</i>	<i>-Establish a separate set aside for the City of Los</i>	<i>This essentially establishes a reasonable</i>

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	<p><i>Angeles</i>            -Permit applicants to compete in the set aside or the geographic competition, but not both</p>	<p><i>"minimum" credit allocation that will allow the state's largest municipality to plan more effectively their affordable housing program and the use of their resources. This will not benefit the jurisdiction, but also the developers who are partnering with them. A reasonable minimum set aside would not penalize the overall geographic competition.</i></p>
<p><b>Section 10317 State Tax Credit Eligibility</b></p>	<p>-Allocate substantial CA credits to 4%/bond projects            -Permit a 130% boost with the CA credit for 4% projects</p>	<p>-If the CA credit is underutilized and/or undervalued in 9% transactions, it should be directed to the 4% program (with the basis boost permitted) where the additional subsidy is needed to reinvigorate this program</p>
<p><b>Section 10325 Application Selection Criteria</b></p>		
<p>(1) Leveraging</p>	<p>-Score each of the proposed 2 categories below independently with a combined possible point total of 35</p>	
<p>(A) Cost Efficiency            (B) Credit Reduction            (C) Public Funds</p>	<p>-Eliminate Credit Reduction            -Increase pts. for Cost Efficiency (same calculation) to 25 pts.            -Decrease pts. for Public Funds (same calculation) to 10 pts.</p>	<p>-Leveraging should be achieved through Cost Efficiency, not "voluntary" credit reduction resulting from increases in other public funding, giving the illusion of better credit utilization.            -Leveraging should be about leveraging all public resources, not just the LIHTC.            -Threshold standards and local reviews will insure maintenance of project</p>

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		quality.
(2) GP and Management Experience	No change	
(3) Negative Points	-Retain existing negative point categories -Evaluate CTCAC's ongoing ability to implement this category and assess negative points, particularly as they relate to the integrity of scoring/tiebreakers	-In addition to the more obvious potential violations, the highly competitive scoring/tiebreaker system has created a difficult area for potential violations in terms of how projects would score, post completion.
(4) Housing Needs	-Eliminate points for Housing <u>Types</u> , still requiring that one type be elected. -Incorporate a new competitive "Need" point category based on: <ul style="list-style-type: none"> <li>• QCT (5 pts.)</li> <li>• Revitalization Area (5 pts.)</li> <li>• Balanced Communities (5 pts.)</li> <li>• High Concentration Low/Mod Wage Jobs (i.e., "Jobs-Housing Fit" (5 pts.)</li> </ul> -5 pts. maximum	-The existing QAP's need category (Housing Type "goals") does not function as an effective measure of need. There are many ways this could be measured and scored, and the Task Force is recommending 4 criteria.
(5) Site and Service Amenities	-Continue to score these items but shift them into the <b>threshold</b> category	-Site and Service amenities, as scoring categories, have been functioning as threshold items and should be classified as such. -Competition based on an increasing set of more detailed criteria in this area has not limited perfect scoring, and it has gone beyond reasonable standards for a quality housing project.
(A) Site Amenities	-Establish minimum standards ( and score) with less	-Site amenity scoring requirements

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	aggressive distance requirements (distances, sq. footages) and incorporate as threshold items -Conduct a resident need survey of affordable and market properties to determine what site amenities are desirable from a resident and marketplace standpoint	have served to limit sites and increase land costs without necessarily reflecting resident desires or market standards for quality housing.
(B) Service Amenities	-Establish minimum standards (and score), with the option to do more if desired.	-"Service-enriched" projects should remain the standard, but with more reasonable set of thresholds and options.
<i>Transit Oriented Development (TOD)</i>	<i>-Retain as a pt. scoring item for bona fide TOD, involving development integrated into or in close proximity to a rail/rapid transit station or stop.</i>	<i>-Some level of transportation service (i.e., bus line proximity) should be a minimum threshold, whereas actual TOD projects should be rewarded separately and additionally.</i>
(6) Sustainable Building Methods	-Establish minimum standards (and scoring requirement) based on the menu of options and shift into the threshold category. -Eliminate QCT/Revitalization Plan from sustainability list.	-As with site amenities, this area has functioned as a threshold category and should treated as such.
(7) Lowest Income and 10%/units @ 30%/AMI (A) Lowest Income (B) 10%/units @ 30%/AMI	-Permit use of the 50% and 55% AMI categories by non rural projects	
(8) Readiness to Proceed	-Considering the cost associated with unsuccessful projects, reduce this to essential items, shifting some burden to developer to meet deadlines or lose credits.	-The cost in predevelopment expenditures and the time/effort of localities for nearly 200 unsuccessful applications is a major drain on resources that should be minimized.
(9) State Credit Substitution	-Shift to <b>threshold</b> category -The exact terms of an exchange should be clarified.	-Does any applicant not submit to this?

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(10) Tie Breakers	<p>-<b>1st</b> Tiebreaker - No change</p> <p>-<b>2nd</b> Tiebreaker- Projects "passed over" in previous round for reason of credit availability (up to one project per region or set aside)</p> <p>-<b>3rd</b> Tiebreaker: Projects that meet more than one of the proposed "Need" criteria in scoring item (4) above.</p> <p>-<b>4th</b> Tiebreaker: <b>the average of</b>  <b>1. (LIHTC's + Public Funds)/# units and 2. (LIHTC's + Public Funds)/# bedrooms</b></p>	<p>-Beyond retaining the Housing Type Goal tiebreaker, this establishes <b>need</b> and the leveraging of <b>all public resources</b> as the ultimate criteria.</p>
<i>Project Concentration</i>	<p><i>-Establish a scoring category to promote the equitable and sensible distribution of the credits, including:</i></p> <p><i>-Negative pts. for applicants in rural and unincorporated areas where there are incomplete/un-leased projects in close proximity ("build and fill" requirement).</i></p> <p><i>-Award pts. for areas never having received allocations, or none within an extended time frame.</i></p> <p><i>-Create a Project Concentration exception for phased projects.</i></p>	<p><i>-The existing system does not include basic measures to promote the equitable distribution of credits and limit overconcentration where, in some cases, there may be also market feasibility issues</i></p>
(f)(1) Market Studies	<p>-Consider CTCAC-engaged, independent market studies or independent reviews</p>	
<b>Section 10327 Financial Feasibility</b>		
Financial Feasibility	<p>-Require evidence of 15 year Feasibility/Debt Service Coverage for all projects at 1.10 DSC or higher.</p>	<p>-Historically, projections understate operating expenses and overstate DSC coverage. With lower income targeting (and especially for smaller projects), declining debt coverage and an operating deficit situation can easily arise within the 15 year compliance period.</p>

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Item	Recommendation	Rationale
<b>Section 10328 Conditions on Credit Reservations</b>		
(e) Placed-in-service	-Establish a specific timeframe for completion of the PIS process: after submission, 30 day question and response period, followed by 30 days to issue 8609	-PIS process has become extended, with significant consequences for developers. Developers must be accountable for timely submission and response to questions, and CTCAC must be accountable for timely review and issuance, once a package is complete.