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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 pursue - 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, the challenge is making choices from competing goals.

It was the sense of the Task Force that **cost efficiency**, in order to **promote 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 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 created to be

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more cost efficient. While the Task Force felt that quality 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 may 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). Applicants typically get maximum points in some areas that make them de facto thresholds. Also, some scoring areas, such as Site and Service Amenities have added more (and more difficult) scoring criteria. While it may be that this has elevated project quality as projects continue to achieve maximum scores, it has other implications. Are the standards beyond those that are reasonable for quality rental housing? Are site and service amenities consistent with tenant needs and desires? What are the cost implications of the higher standards?

#### **Economy as a Backdrop**

The Task Force believes that the state of the economy and the federal budget are 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. In addition, Congress is currently considering at least two proposals for analyzing the effectiveness of "tax expenditure" programs. 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.

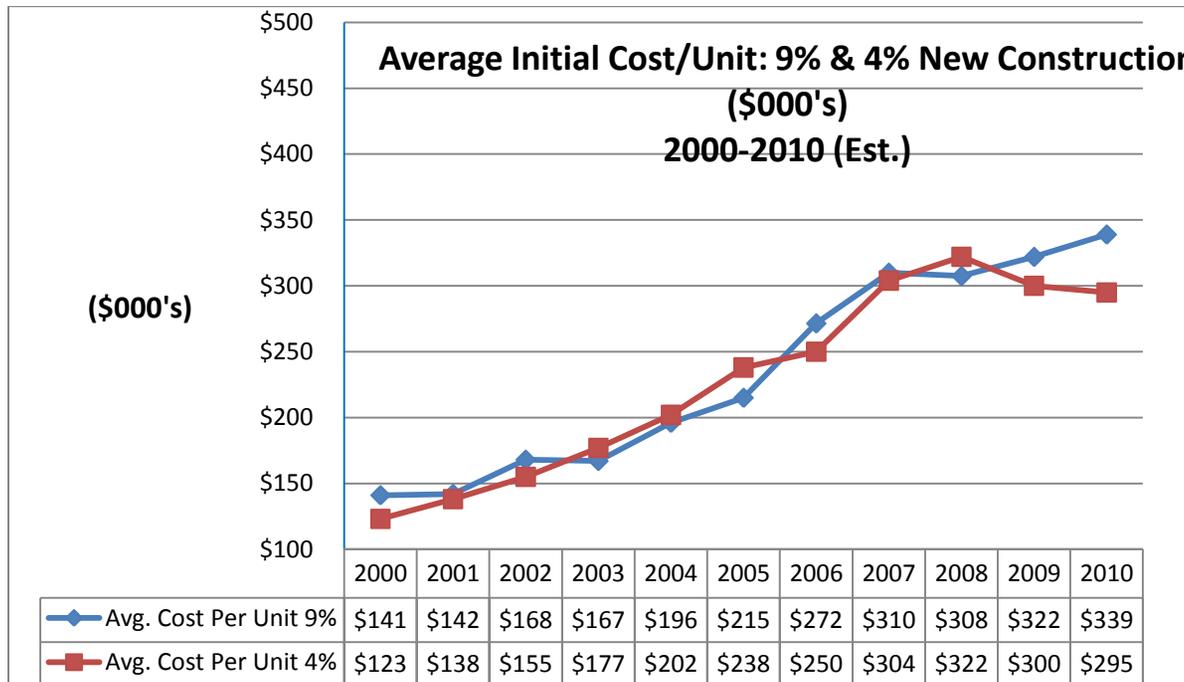
#### **The Need for Change**

TCAC's Annual Reports, annual Financing Breakdowns and data reported for 2010 indicate some trends that suggest fundamental change is needed:

- As **Chart 1** illustrates, the cost per unit for 9% new construction has increased 140% since 2000, and 57% since 2005. The 4% new construction data follow a fairly similar pattern to 2008, with a drop off in cost in 2009 and 2010.

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**Chart 1**

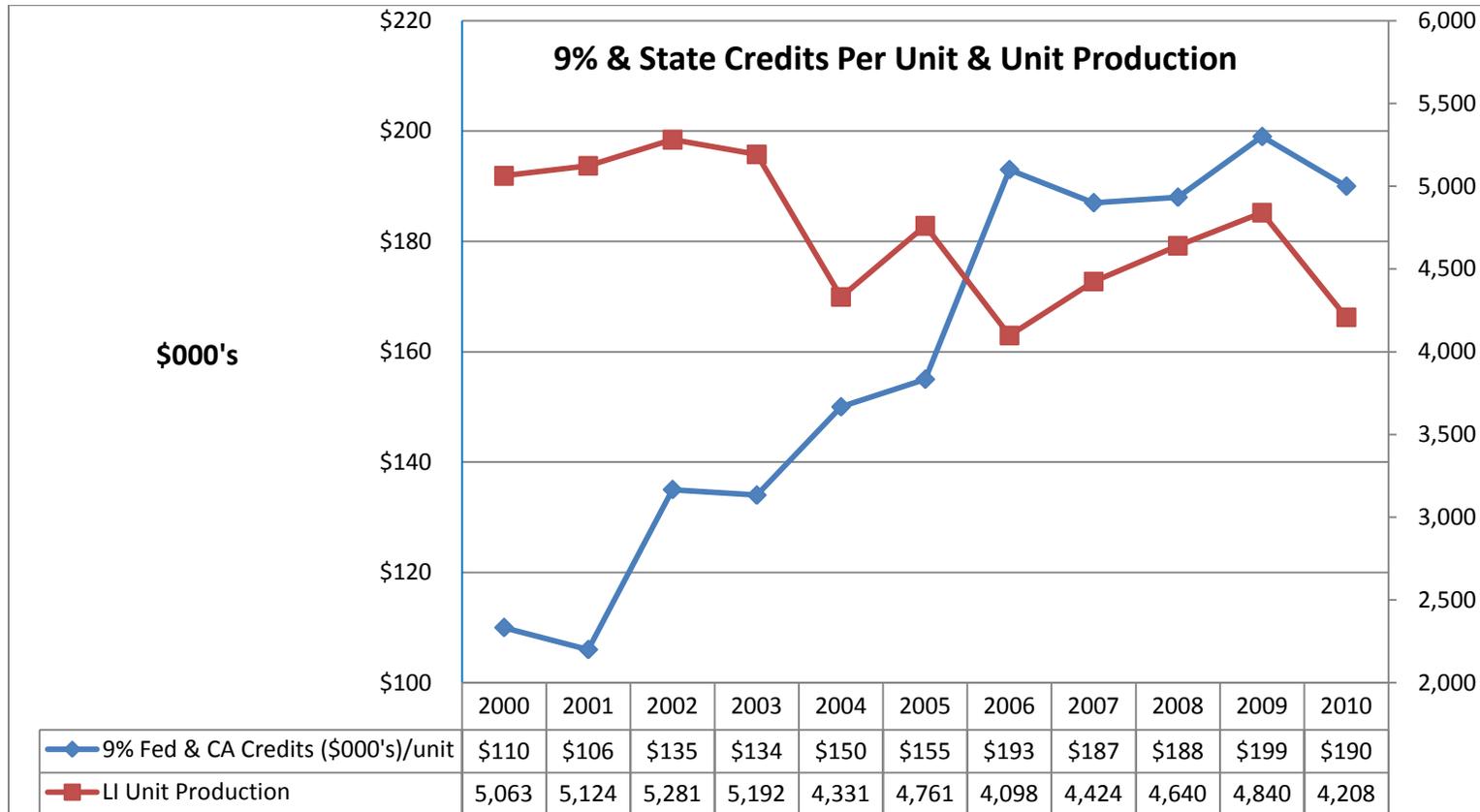


Source: TCAC Annual Reports, 2009 & 2006, TCAC data reported for 2010

- As **Chart 2** below illustrates, credits (CA and Federal) per unit for 9% projects (all project types) increased by 73% from 2000 (\$110K) to 2010 (\$190K). Since 2006, the increase has moderated and 2010 TCAC data indicates that credits per unit will decline to roughly the 2006-2008 levels.
- **Chart 2** also illustrates that, since 2000, while credits per unit and annual allocations were increasing, 9% low income units allocated credits decreased overall. After gains from 2006-2009, fueled in part by the Housing and Economic Recovery Act (HERA) increases in 2008 and 2009, it is projected that 2010 production will decline to the lowest level since 2000, with the exception of 2006.

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**Chart 2**



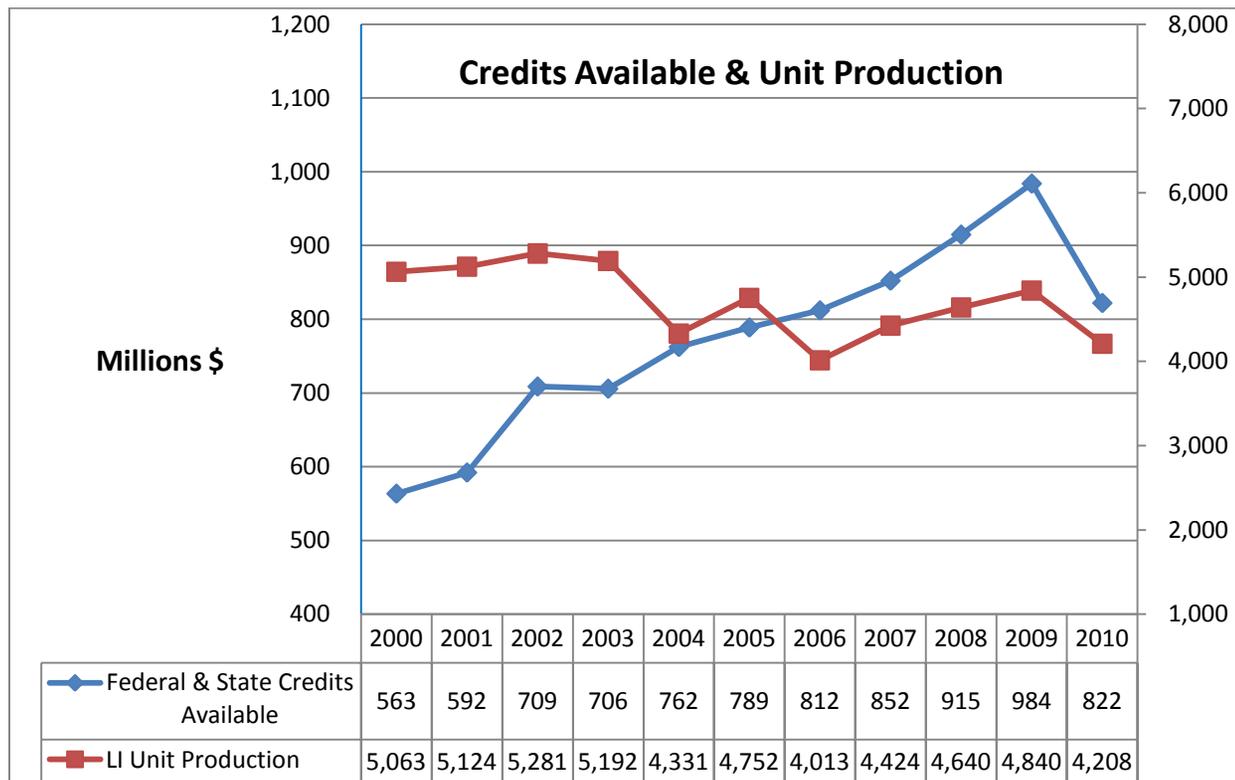
Source: TCAC Annual Reports ,2006 & 2009, and TCAC 2010 reported data

- **Chart 3** compares low income units allocated credits with the amount of 9% federal and state credits available annually. From 2000 to 2009, available federal credits increased by 76%, including HERA adjustments, and 53%, excluding HERA. This was the result of increases

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in the credit per capita, based on inflation, and by \$.20 over 2008 and 2009 under HERA. Credits available in 2010 reflect the end of the HERA increases. Although the long term trend has credits increasing and production decreasing, the trend since 2006 shows production tracking closely the total amount of credit.

**Chart 3**

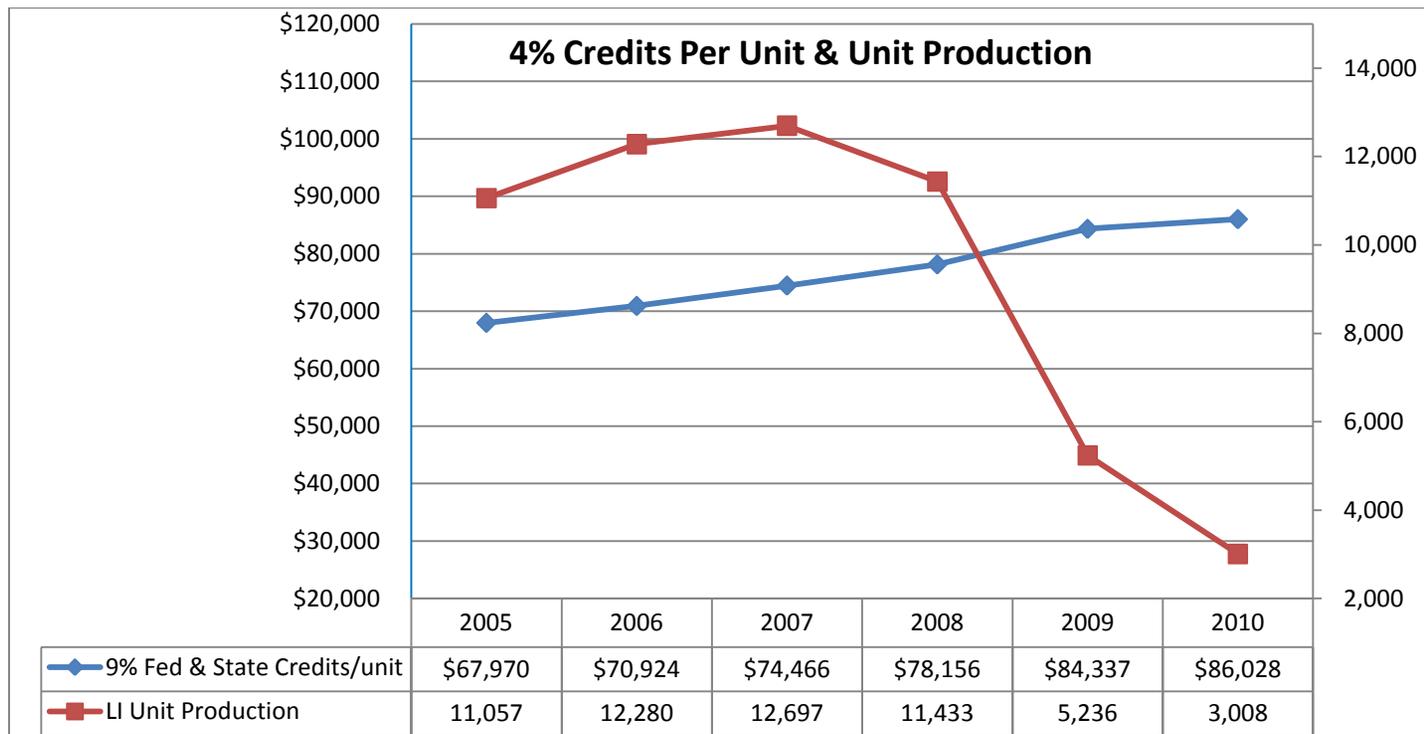


Source: TCAC 2009 Annual Report and TCAC 2010 reported data

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- 4% program production decreased by 53% over the past 5 years, as illustrated in **Chart 4**. Although TCAC reports an increase in late 2010 activity, linear projections for 2010 indicate another steep drop of over 25% from 2009 for the 4% program. The 4% program, accountable for **three times the production of the 9% program in 2006**, will likely **fall below the 9% production level in 2010**.

**Chart 4**



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

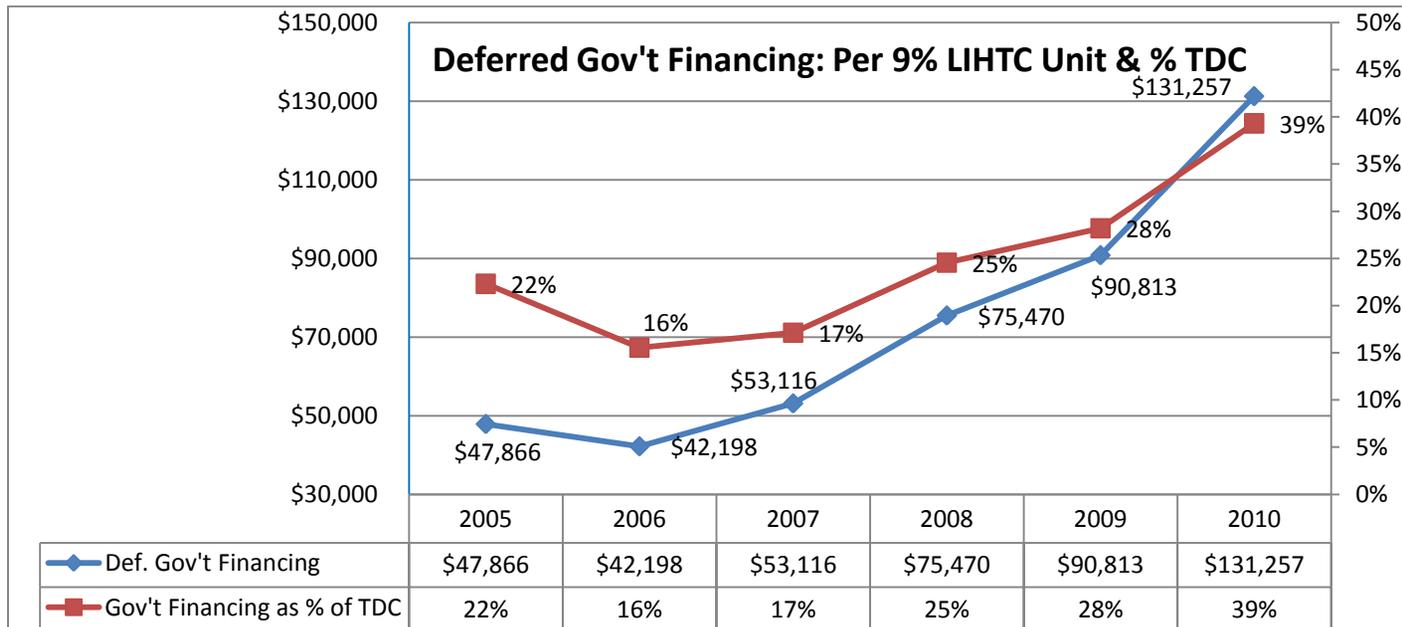
- While the 4% program has been impacted significantly by market forces and resulting diminished investor demand and debt financing, the dramatic contraction of the program underscores the need to find the means to bolster what has historically been the most

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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 5**, 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"). 2010 estimates based on TCAC project staff report data indicate that the public funding levels and the proportion of total development costs funded will increase again significantly to over \$130,000 per unit and 39% of total cost. TCAC reported that public funding of 2010 projects would be \$562 million, an increase of \$123 million since 2009 (28%) and \$212 million since 2008 (60%).

**Chart 5**



Source: TCAC Annual Reports, 2005-2009, "Financing Breakdown"; 2010 estimated from TCAC Staff Report data

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**What the Data Suggests**

While there are many variables at work in these numbers, the Task Force concludes that development costs have increased at a significant rate. Local government, and the tax credit to a lesser degree, are paying for it. With higher cost, overall production has declined, even with substantially increased credits, including those available to the state through HERA. The ability of the tax credit program to hold off even greater production declines in the face of higher costs has resulted from availability of more credits, somewhat larger per unit credit allocations, and by shifting a much larger cost burden to local subsidy sources. A rebound in credit pricing is now also helping generate more equity from the credits, but not keeping up with costs. Credits per unit in 2010 appear to have decreased to a level consistent with 2006-2008, but the increase in costs per unit and the levels of public funding make it difficult to argue that this is greater efficiency in the use of the credit. For localities, the program has become much more costly - over \$200 million in two years - and this is happening at the expense of other programs, including the ability to subsidize 4% projects and other local housing efforts, including homeless and special needs. Efficiency of the program, from the standpoint of cost and leveraging all public resources, is lacking. The allocation system is partly responsible for this as it has not rewarded true cost efficiency, and the data suggests that it may have the opposite effect.

**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

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- 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
- 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>		
(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>Establish a separate competition structure for acquisition/rehabilitation projects through an apportionment or set aside.</i>	<i>-It is difficult to incorporate rehabilitation and new construction projects into the same competitive scoring system. Acquisition/rehabilitation projects are inherently different than new construction, with respect to cost efficiency and credit utilization, and they offer different benefits to evaluate.</i>
<i>City of Los Angeles Set Aside</i>	<i>-Establish a separate set aside for the City of Los Angeles for a portion of its geographic apportionment. -Permit applicants to compete in the set aside or the geographic competition, but not both.</i>	<i>This essentially establishes a reasonable "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 only 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>

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Item	Recommendation	Rationale
<b>Section 10317 State Tax Credit Eligibility</b>	<ul style="list-style-type: none"> <li>-Allocate a greater and substantial portion of CA credits to 4% credit/bond projects</li> <li>-Permit a 130% boost with the CA credit for 4% projects</li> </ul>	<ul style="list-style-type: none"> <li>-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</li> </ul>
<b>Section 10325 Application Selection Criteria</b>		
(1) Leveraging	<ul style="list-style-type: none"> <li>-Score each of the proposed 3 categories below independently with a combined possible <b>point total of 30</b></li> </ul>	
<ul style="list-style-type: none"> <li>(A) Cost Efficiency</li> <li>(B) Credit Reduction</li> <li>(C) Public Funds</li> </ul>	<ul style="list-style-type: none"> <li>-Establish <b>15 maximum pts.</b> for Cost Efficiency (same calculation method).</li> <li>-Permit <b>10 points maximum</b> for Credit Reduction.</li> <li>-Establish <b>15 maximum pts.</b> for Public Funds (same calculation method).</li> </ul>	<ul style="list-style-type: none"> <li>-Leveraging should be achieved primarily through Cost Efficiency, not "voluntary" credit reduction resulting from increases in other public funding, giving the illusion of better credit utilization.</li> <li>-Leveraging should be about leveraging all public resources, not just the LIHTC and should be derived from Cost Efficiency.</li> <li>-The proposed scoring provides an incentive for both Cost Efficiency and Public Funding, and <u>efficient use of credits will be promoted by both.</u></li> <li>-With 15 possible points each for Public Funding and Cost Efficiency, 10 possible points for Credit Reduction, for a possible total of 30, it will be possible for projects to be weighted more</li> </ul>

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		<p>heavily toward Cost Efficiency or Public Funding, depending on the nature of the project. Projects may potentially use these means to get maximum points with reduction of credits. But in any case, projects must score in both Public Funding and Cost Efficiency to be successful.</p> <p>-Threshold standards and local reviews will insure maintenance of project quality.</p>
(3) Negative Points	<p>-Retain existing negative point categories</p> <p>-Evaluate CTCAC's ongoing ability to implement these provisions and assess negative points, particularly as they relate to the integrity of scoring/tiebreakers.</p>	<p>-In addition to the more obvious potential violations, the highly competitive scoring/tiebreaker system has created a difficult area for monitoring potential violations.</p>
(4) Housing Needs	<p>-The Task Force recommends that an industry study group of stakeholders and State officials be formed to develop an effective measure of need that can be incorporated into the allocation process.</p>	<p>-The existing QAP addresses "need" by way of Housing Type goals and what is essentially evidence of market demand. These do not function adequately as measures of need to the extent needed.</p> <p>-California has a number of systems that focus on housing needs, such as the Housing Element and the Regional Housing Needs Assessment (RHNA), that should be considered in the system that allocates the State's largest affordable housing resource.</p> <p>-"Smart Growth", "sustainable"</p>

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		<p>development and "jobs-housing balance" are other important need-related concepts that should be considered.</p> <p>-This is proposed for development in 2011 and implementation in 2012.</p>
(5) Site and Service Amenities	<p>-Continue to score these items but shift them into the <b>threshold</b> category</p>	<p>-Site and Service amenities, as scoring categories, have been functioning as threshold items and should be classified as such.</p> <p>-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.</p>
(A) Site Amenities	<p>-Establish minimum standards ( and score) with less aggressive distance requirements (distances, sq. footages) and incorporate as threshold items</p> <p>-Conduct a resident need survey of affordable and market properties to determine what site amenities are desirable from a resident and marketplace standpoint</p>	<p>-Site amenity scoring requirements have served to limit sites and increase land costs without necessarily reflecting resident desires or market standards for quality housing.</p>
(B) Service Amenities	<p>-Establish minimum standards (and score), with the option to do more if desired.</p>	<p>-"Service-enriched" projects should remain the standard, but with more reasonable set of thresholds and options.</p>
<i>Transit Oriented Development (TOD)</i>	<p><i>-Retain as a point scoring item for bona fide TOD, involving development integrated into or in close proximity to a rail/rapid transit station or stop.</i></p>	<p><i>-Some level of transportation service (i.e., bus line proximity) should be a <u>minimum threshold</u>, whereas actual TOD projects should be rewarded</i></p>

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Item	Recommendation	Rationale
(6) Sustainable Building Methods	<ul style="list-style-type: none"> <li>-Establish minimum standards (and scoring requirement) based on the menu of options and shift into the threshold category.</li> <li>-Eliminate QCT/Revitalization Plan from sustainability list.</li> </ul>	<p><i>separately and additionally.</i></p> <p>-As with site amenities, this area has functioned as a threshold category and should be treated as such. With TCAC's expressed intention of having this category be based on certain program certifications (LEED, Green Communities, etc.), there is even more reason to shift this category to threshold.</p>
(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	-Non rural projects can achieve still achieve low weighted average rents without having to sacrifice the flexibility having the 50% and/or 55% AMI rents.
(9) State Credit Substitution	<ul style="list-style-type: none"> <li>-Shift to <b>threshold</b> category</li> <li>-The exact terms of exchanges should be clarified.</li> </ul>	-No applicant declines this option if a point is needed.
(10) Tie Breakers	<ul style="list-style-type: none"> <li>-<b>1st</b> Tiebreaker - No change</li> <li>-<b>2nd</b> Tiebreaker- Projects "passed over" in previous round for reason of credit availability (up to one project per region or set aside)</li> <li>-<b>3rd</b> Tiebreaker: Lowest average credits per unit and bedroom, calculated as: <b>(credits per unit + credits per bedroom) divided by 2. For purposes of 3rd tiebreaker calculation, the amount of credit used in the calculation will be based on the greater of 1) the Requested Unadjusted Eligible Basis and 2) 90% of the Total Unadjusted Eligible Basis.</b></li> </ul>	<ul style="list-style-type: none"> <li>- This establishes the most efficient use of the credit as the final tiebreaker. With Cost Efficiency built into the "Leverage" scoring, credit utilization for projects reaching the Tiebreaker will reflect some degree of Cost Efficiency (as opposed to the current system, which simply permits the "buying down" of credits with other public sources, without regard to cost.)</li> <li>-This tiebreaker does not limit the amount of public funding permitted. It does limit use of public funding to reduce the credit request.</li> </ul>

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<i>Project Concentration</i>	<ul style="list-style-type: none"> <li>-Establish a scoring category to promote the equitable and sensible distribution of the credits, including:</li> <li>-Negative pts. for applicants in rural and unincorporated areas where there are incomplete/un-leased projects in close proximity ("build and fill" requirement).</li> <li>-Award pts. for areas never having received allocations, or none within an extended time frame.</li> <li>-Create a Project Concentration exception for phased projects.</li> </ul>	<p>-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.</p>
<b>Section 10328 Conditions on Credit Reservations</b>		
(e) Placed-in-service	<p>-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</p>	<p>-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.</p>