STATE OF CALIFORNIA

CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE
915 CAPITOL MALL, ROOM 485
SACRAMENTO, CA 95814
TELEPHONE: (916) 654-6340
FAX: (916) 654-6033

William J. Pavão
Executive Director

MEMBERS:
Bill Lockyer, Chair
State Treasurer

Ana J. Matosantos, Director
Department of Finance

John Chiang
State Controller

Date: August 23, 2011

To: California Tax Credit Allocation Committee (TCAC) Stakeholders

From: Lisa Vergolini, Deputy Director

Re: Cost Containment Forums Report

In July, TCAC held three forums throughout the State to solicit input on costs associated with building affordable housing. The forums were very well attended and TCAC received valuable input from our stakeholders. Many of the commenters were passionate about the work they do to create safe, affordable housing for California's low-income households, including those with special needs.

TCAC received comments at the forums on issues including land costs, local requirements, TCAC scoring of 9 percent (9%) projects and public policies. Often, specific comments on various cost issues directly conflicted with those made by other commenters. Attached to this memo, you will find the notes compiled by TCAC staff summarizing most of the comments received at the forums. Following are summaries of some of the comments on specific topics:

<u>TCAC Scoring:</u>

Some commenters stated that the 9% tax credit scoring system was driving up costs due to the need to buy land near amenities, while other commenters stated that the land cost associated with being near amenities was not a significant cost issue, and TCAC should be defending the policy of building projects near bus lines, grocery stores and medical facilities. Some commenters stated that the 9% tie-breaker scoring change made by TCAC last year encourages lower costs and they indeed lowered costs as a result. Another commenter stated that the 9% scoring system does not reward lower costs enough. Some commented that the 4% projects are just as costly as the 9% projects, so the 9% scoring is not the central issue. Two commenters stated that sustainable building methods add to higher costs of building 9% projects. One commenter stated that if TCAC does not address high costs by changing the scoring, they will come down naturally.

Local requirements:

Prevailing wages were mentioned several times as the primary culprit to increased cost of building affordable housing. In addition, local requirements related to parking and density were said to contribute to development costs. Several commenters stated that local governments have good reasons for some requirements and TCAC should not dictate to the locals. Commenters stated that local governments often choose sites on which to partner with developers, and TCAC should not take issue with additional costs associated with building on those where the local government is paying for those costs.

Other cost drivers:

Several commenters stated that tax credit investors are requiring more due diligence and higher reserves than in the past which are adding costs. Environmental issues with land and the surrounding area of development was mentioned several times as a costly item. Commenters also stated that infill projects can be more costly due to required construction staging.

TCAC received several comments that neighborhood resistance (NIMBYism) can add costs because of the added time to get projects approved and the design requirements needed to gain public acceptance.

Commenters stated that the many different funding sources necessary to develop affordable housing adds to total development costs. In addition, the long timelines in getting projects approved increases costs.

General comments:

TCAC received feedback that the statewide average of $286,000 per unit seemed reasonable. Another commenter stated that TCAC should never award credits to a project with $600,000 per unit costs. Some commenters stated that TCAC should have a cap on total development costs, while others were opposed to a cap.

Many commenters warned that TCAC should not create a scoring system that creates a "race to the bottom" where cheaply built projects win the competition. A few commenters stated that the more cheaply built projects are having trouble a few years into operation and their financial stability is weak. Another commenter stated that TCAC should not put projects that are built more cheaply and have close to market rate rents, ahead of projects that may cost more due to their location but are serving lower income households.

Several commenters stated that TCAC should gather data that compares tax credit projects to market rate projects, accounting for specific and necessary differences. Other commenters stated that one cannot compare the cost of developing affordable housing to market rate because market rate developers do not building three and four bedrooms nor special needs projects. Other commenters added that market rate developers do not construct their buildings with the same longevity goal and are built with less quality.

Commenters agreed on the importance of public perception/education about building affordable housing and the need to compare costs on a regional basis. Most commenters agreed that more information is necessary to be able to show the costs and benefits of building affordable housing. In addition, reviewing all costs region by region was generally agreed upon due to the wide differences among different areas in California.

TCAC is continuing to gather and analyze data associated with the costs to develop affordable housing. In addition, TCAC will be holding a public hearing in September to allow Committee members to hear directly from some stakeholders on the cost issue. All of the input received to date and at the upcoming hearing will be used by TCAC to determine if changes to the tax credit program are necessary. A formal public hearing announcement will be sent out by TCAC shortly.

Thank you to all that participated in the forums and provided input. We appreciate and join in your commitment to affordable housing.

Attachment

Notes: TCAC Cost Containment Forums – July 2011

Comments: Sacramento Forum:

General comments:

- Determine if construction quality is comparable between market rate and affordable & between lower costs deals and high costs deals.
- Worry about outliers on low end of costs also.
- Avoid a “race to the bottom”.
- Some projects, such as special needs will always be more expensive.
- Two very similar projects in Napa have very different costs, why?
- Fees, such as those with 4% bonds cause higher costs for affordable housing projects.
- Increased RDA money may have caused credits per project to go down.
- Lender requirements may have caused costs to creep up.
- Costs increase due to timing, prevailing wages, subterranean parking.

Data

- Look at unfunded application also to look at awarded vs. non-awarded and costs.
- Consider doing another study as was done in 1992 to compare market rate costs.
- Dissect costs by project group (underground parking, spec needs).
- Look at regional costs and compare to market rate.
- Could use HUD and HCD (NSP) as models: require “cost reasonableness studies”.
- Using square feet will be tricky to verify, especially for acq/rehab projects.

Scoring of 9%

- Not sure if “outliers” is the issue, it’s more about scoring.
- Applicants may over-state or understate line items to score well.
- Public policy goals are driving up costs to develop.
- TCAC should get rid of amenities scoring.
- Add cost efficiency to scoring to push down costs.

Land

- Cost of land is too high because of requirement to be near amenities.
- Timing of the projects can affect land costs, as can environmental issues.

Local Requirements

- RDAs require certain things that raise costs.
- Local requirements can include underground parking and other items that hike costs.

Comments: Oakland Forum

General comments:

- Projects are sometimes in and sometimes not for market rate costs.
- Investors are requiring much more due diligence and higher reserves which is driving up costs.
- The more sources we have in a deal the higher the costs.
- Some developers are cutting costs too thin on the lower cost deals and the project are looking really bad after a few years.
- We should not have lower cost projects with rents right near market instead of projects that cost a little more to build and can maintain lower rents.
- Look at the nature of the politics behind the “perception” of high costs.
- The statewide average is reasonable.
- Use the statewide average of $286k per unit to defend cost effectiveness. Some areas will always be more expensive.
- You can’t compare affordable housing to market rate because the market does not building 3 and 4 bedroom units.
- Public policy goals are good and should be defended.
- Don’t shy away from public policy objectives.
- It’s challenging in today’s environment to push public policy goals. Need to be careful on public perception when people don’t have jobs.
- Prevailing wages cause higher costs in some areas.
- Affordable housing is better built than market rate.
- Market rate developers are only in it for the short term and will flip the property.
- There are legitimate reasons for higher costs.
- Green requirements add to costs.

DATA

- Look at projects that have applied several times to see what they changed.
- Break out data my housing type and number of units.
- Must look at data regionally.
- Compare similar projects when looking at costs.
- Find the average units by region.
- Look at rents over time for the more cheaply built TCAC projects, it’s likely they are higher than the better, higher cost projects.
- Focus on credit per project, not total development costs.
- Don’t compare SF to other areas that are dissimilar.
- Look at land cost over several years.
- Look closely at impact fees.
- Don’t use percentages, look at costs and dollar amounts.
- Look at “problem” projects in the TCAC portfolio and see if they were lower cost developments.
- Look at how tie breaker scores changed over time for projects that re-applied.

Scoring on 9%:

- Take deferred developer fee out of costs.
- Lower credit requests were a result of the tie breaker change.
- Tie breaker is better with lower costs.
- Don't count waived fees in your costs.
- Tie-breaker may be pushing number of units down.
- Should get points for being near transit, etc. under sustainable building.
- Don't value public funds so much.
- Competition is affected by density requirements.

Land

- Market rate development can take down a piece of land much more quickly and therefore more cheaply.
- Environmental mitigation can add costs.
- Infill can be expensive because of the staging for construction and parking.

Local Requirements/Issues

- If the locality has requirements and is will to pay for those, TCAC should not dictate further.
- Allow local discretion.
- Local requirements such as parking, density and fees can increase project costs.
- Local agencies that require a lower density cannot compete.
- Nimby-ism is a big issue and it is important the projects are built well and maintained. Sometimes have to spend more to quiet nimbys.
- Locals want certain sites in redevelopment areas developed and that should be ok with TCAC, even it the costs are higher.
- If locals are putting a lot of money in, that is a good thing.

Comments: Los Angeles Forum

General Comments:

- Developing in dense areas (infill) in costly.
- The data in the blog article in incorrect and not good.
- In 2009 and 2010, projects were more costly and those projects are just getting through the system.
- Prevailing wages are the main culprit for high costs.
- TCAC should never award to a project that costs $600k to build.
- There are good reasons for costs.
- Just come up with a cap number, or this is just a waste of time.
- Commenter does not support a cap.
- TCAC should have cap, but allow for an explanation to exceed it.
- TCAC should quantify the benefits of the public policies so that the public can be educated.
- Prop 13 is the cause of many of the issues.
- Costs seem to be somewhat constant.

- We should compare the longevity of TCAC projects to market rate. TCAC projects are built for the long run to last.
- Large number of homeless and special needs projects recently. Those have higher costs.

Data

- Land costs should be removed when describing costs.
- Use mean instead of average for data.
- Off-site costs should not be included in TDC.
- Try to compare to market rate.
- When showing costs, break it out (soft costs, hard costs, land).
- Use final cost certification when comparing costs for market rate.
- If you compare market rate, look at whether that market rate project is successfully operating or failing.
- Units increased because credit pricing was better than expected.

Scoring on 9%

- Tie breaker now is a detriment to have high costs. This should be bringing costs down.
- Maybe score credits per bedroom.
- 1st round of 2011 had a lot of special needs projects, so costs may even be less.
- To be competitive, had to change a 70 unit project to a 50 unit project so the public funds would score better. This caused a lot of additional costs to reconfigure.
- Let us build in outlying areas and not near amenities.
- Not good to put poor people in outlying areas where there are no amenities.
- Current system does not reward higher costs.

Land

- The land market itself should be looked at.
- Environmental remediation is expensive and market rate developers don't touch those sites.
- Some redevelopment agency land is very costly and they didn't use comps.
- Local agencies (LAHD) look closely at land costs to make sure they are appropriate. They are monitored closely by federal agencies on land costs.
- Some sellers increase the price of land once they know it scores in the 9% system.
- Disagree that land cost is increased due to TCAC scoring system only.

Local Requirements/Issues:

- Going forward, won't be able to do any deals in non-RDA areas.
- Some cities are going to say they can only develop one small project due to lack of funds.
- Santa Monica waived fees, didn't require additional EIR work and supported a current project with funding. Should be able to do the project even if it is costly due to location.
- City is committed to affordable housing and the area is just more expensive to build in due to location. TCAC should not decide to abandon certain areas.
- Pasadena has nimby issues that sometimes drive up costs.
- Locals should be able to develop projects in their area as they see fit.
- Don't empower communities that don't want affordable housing by taking them off the hook due to limits on costs.