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Louisiana Housing Corporation

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Ms. Victoria Hayes, Director
Office of the Louisiana Legislative Auditor
P.O. Box 94397
Baton Rouge, Louisiana 70804

Dear Director Hayes:

Thank you and the entire team for the workaround cost containment specifically related to Multifamily Revenue Bond financed developments. Louisiana Housing Corporation ("LHC") agrees that additional measures should be established. We are currently revising the 2025 Qualified Allocation Plan, which governs the approval of Low-Income Housing Tax Credits ("LIHTC"), to include a more robust cost containment policy. Nonetheless, all related factors must be considered when determining whether a project's total development costs ("TDC") are reasonable. Additionally, there should be an avenue to approval for developments that exceed ordinary cost measures. Projects with proposed attributes that will contribute to the overall well-being of a community such as being part of a redevelopment or revitalization plan for a community, significant blight reduction and/or serve to provide multiple public benefits may have extraordinary costs that are justifiable.

Please find below responses to the Louisiana Legislative Auditor's Recommendations for your consideration:

1. Affordable Housing:
What does the average Louisiana household spend to purchase a home? "Affordable housing" should not be significantly more than the working class is paying out of pocket for housing.

   a. We recommend defining this term to prevent developments that fall within the luxury price point.

The median home sales price in Louisiana is $226K (Zillow, May 2024) or $268K (Redfin, June 2024). This reflects the median price across the entire state, irrespective of age, condition, location, size, or other factors. While it would appear that an average or median of what Louisianans are paying to purchase single-family homes might be a good reference point, there are reasons it is not a good reference point:

(1) New construction is built to a higher standard than the median; disaster-resilient housing is above median. Housing located outside of the Special Flood Hazard Area is above the median. These are all characteristics of the affordable housing the state invests in.

(2) The purchase price of a home is not the same as the cost of a home. While the public cost of affordable housing (i.e., TDC per unit) is represented as an up-front cost, ownership of housing has costs which occur over time. The cost of multifamily development must be compared to the cost of a purchased home, inclusive of taxes, insurance, and maintenance (and in cases where residents have special needs--supportive services), over time.

In addition to these general dynamics, there are several specific factors and considerations that drive the cost of affordable housing.

(1) **Insurance**—Dramatic increases in the cost of insurance have left existing properties with expenses exceeding revenues. In affordable housing, rents cannot simply increased to address this imbalance. LHC has begun to require insurance reserves in multifamily properties. These reserves provide a cushion when and if insurance costs rise significantly, but they also increase the development cost of the property at the onset. If insurance costs become more stable these reserves can be recaptured by LHC.
(2) **Reserves**—All financial partners insist on various reserves to cushion a property against downturns and unexpected issues during the lifecycle of their investments. These reserves are a significant cost, which is reflected up front in the TDC of a project. The purchase of a single-family home does not come with funded reserves in the event of income loss, increased operating costs, or repair and replacement of building systems.
(3) **Construction Costs**—The use of federal funds in housing (which is the funding source that critically supports the State's investments) requires construction wages comply with the Davis-Bacon Act, which are generally higher than local wages. This alone drives up construction costs significantly. New construction single family homes (market rate) are built without federal funds, and the construction labor costs are lower.
(4) **Soft Costs and Financing Costs**—While tax exempt bonds provide lower interest rates, there are significant placement fees which are capitalized (paid up front reflecting higher TDC). The use of bond financing is required to access federal 4% Low-Income Housing Tax Credits. Additionally, the price of a new single-family home is represented before financing costs (i.e., the purchase of a home is the sales price, but does not reflect closing costs and other transactional costs). The TDC of affordable, multifamily properties includes these significant costs. Lastly, each affordable housing project requires multiple financing sources to partner in a complex, multi-year project; consequently, there are significant legal costs within the development budget to ensure these parties partner effectively.

2. Cost Containment:
Evaluate total development costs against the market.

a. **We recommend requesting a detailed cost estimate from the architect (listed as part of the development team) to be submitted with the bond application.**

Estimations of hard construction costs by developers--when framing transactions in an application for gap financing--rely on past experience, discussions with builders and the architect, the latest trends in pricing and other factors. In stable markets, these estimations are generally reliable (actual hard costs are typically within range of the estimate at application). Factors to consider, include:

- The LHC employs a scoring approach through the PRIME Program that disadvantages high-cost transactions. Awards are prioritized toward transactions that have the lowest ratio of Community Development Block Grant Funds (CDBG) to TDC.
- Developers are strongly incentivized to estimate accurately. If the cost estimate is high, the corresponding request for CDBG is high, and this negatively impacts the scoring. If the cost estimate is low, the transaction will be inadequately sourced (i.e., it will need additional funds to cover the higher-than-normal costs).
- At completion of construction (when the property is 'placed into service'), the LHC funds the lesser of (a) the awarded CBDG, or (b) the gap between total actual costs and other sources. That is, if a deal was awarded $6 million, and at completion the cost review establishes that total costs were $30M and other sources are $25M, then the CDBG is limited to $5M. In this way, regardless of the awarded amount, the CDBG cannot exceed the financing gap. If the total costs are $32M and other sources are $25M and the CBDG award is $6M, the developer must come out of pocket for the $1M shortfall. When there is no CDBG (LIHTC only) the tax credits may be similarly downsized at completion based on actual costs.

The LHC appreciates concerns about high construction costs. These concerns should be viewed in the overall context of controls, incentives and disincentives, risks and obligations, and other dynamics inherent in the overall process.

b. We recommend requiring an appraisal to be submitted with the bond application.
c. These documents should be cross-checked against recommendation one.

The LHC requires appraisals to justify the acquisition cost of land and buildings. Market lenders providing primary debt require appraisals to ensure that their loans do not exceed a particular 'loan to value' ratio. Considerations include regarding the use of appraisals to determine value:

(1) Appraisals estimate value based on either the 'comparable sales' approach or the 'income' approach. The comparable sales approach (common in single-family home appraisals) looks at what similar properties have sold for (adjusted for condition, features, location, etc.) Income-producing real estate is appraised differently and uses an approach in which the net income is determined, and a multiple of this (the 'cap rate') is applied based on market conditions.
(2) Affordable housing carries use restrictions which limit the rents which can be charged. These limitations correspond to lower income, and this corresponds to lower value (relative to the cost to build). For example, if there are two identical buildings and one is 'market' and the other has a 30-year affordability commitment, the market building will have more value because it can produce greater income through its higher rents.
(3) As a result, the 'market value' of affordable housing is limited by its very nature.
(4) It is not unusual for an affordable housing development to 'cost more than it's worth' in a market sales value sense. But affordability itself has value. That is, there are 100 units, and the average (restricted, affordable) monthly rent is $400 below market, and there is a 35-year use agreement, the 'affordability value' of that property would be 100 X $400 X 12 (months) X 35 (years), or

$16.8M. This very real value is not reflected in an appraisal, but it is central to the public-investment economics of the transaction.

The LHC recommends consideration of these factors when determining the utility of requiring appraisals accompany bond applications.

3. Effective Allocation of IRS Credits:
a. Intended to offset rent loss
b. Excess allocation – donation – violation of Article VII
c. Primary benefit must be to the public – LA is not receiving max benefit
d. Recommendations 1 & 2 should correct this issue.

The LHC follows detailed requirements set for in §42 of the Internal Revenue code related to the allocation of credits, and its programs and policies are governed by it. Each 'tax credit allocating agency' (the LHC is the sole allocating agency for the State of Louisiana) establishes these rules in its annual QAP.

These rules protect against any 'excess allocation'. While credits are allocated to an awardee by the LHC (at award) based on estimates of eligible costs, the LHC follows IRS requirements to ensure that at completion the final credits are not more than are legitimately generated by actual eligible costs incurred.

The primary and ultimate beneficiary is the income-qualified Louisiana renter whose rent is materially below market rate. The LIHTC investor (which owns the property) benefits because the federal tax credits they have purchased are worth more than the purchase price to acquire them. However, absent this benefit there would be no incentive for them to invest in the development of affordable housing, which is central to the design of the LIHTC program (leveraging private investment in low-income housing).

Regarding the reference to Article VII, all Low-Income Housing Tax Credits are federal credits, and are not credits against taxes imposed by the State of Louisiana. Additionally, there is no 'donation'—while credits are allocated to a single-asset entity limited partnership that allocation is on the condition they be sold toward generating equity toward the development of the housing.

4. Projects Fully Covered by Public Funds:
a. Layering of different government programs can create scenarios where public funds are used to outright purchase real estate for private citizens/developers.
b. This may not comply with Article VII of Louisiana's constitution (prohibition against donating public funds to private entities…LA has no ownership interest & not receiving a 30-year benefit)
c. We recommend implementing a maximum percentage of public funds that can be applied to a single project.

All affordable housing approved by LHC is housing developed in a 'public/private partnership' in which public financing is combined with private ownership subject to affordability restrictions. The LIHTC program is the most impactful program nationally: 53,032 projects and 3.65 million housing units have been placed into service between 1987 and 2022. The U.S. invests in the creation of affordable housing through the foregone tax revenue represented by these tax credits. Notably, land itself is not a cost which generates equity, so technically the cost of acquiring land itself is not paid for with the credits.

In these arrangements, Louisiana does not have an ownership interest, but it does have a regulatory interest and control, toward ensuring that the public good (affordability) promised by these investments is effectively achieved. Credits purchased by investors with their up-front investment of equity are claimed each year for ten years. Over a fifteen-year period (ten 'credit' years, plus a five-year period during which non-compliance can be retroactively enforced) the LHC monitors properties to ensure compliance with the use restrictions (rent and income limits, as well as physical condition standards). If there is non-compliance, the LHC must notify the IRS, and the IRS may disallow the taxpayer (property owner) from claiming the credits on their tax returns. As a consequence of this 'non-compliance' risk, the owner is highly incentivized to ensure the property meets the requirements of the regulatory agreement it has with the LHC. This regulatory enforcement system, with the 'teeth' of the IRS behind it, has proven over nearly 30 years to be a highly effective means of ensuring the public benefit is achieved.

In the financing of a tax credit transaction, the credits are an indirect source which lead to the direct source of the capital (equity) which is invested by the owner (investor) to acquire the credits. CBDG (and other forms of 'soft' or 'gap' financing such as HOME and Housing Trust Funds) are more clearly a public source of funds. These are almost exclusively Federal funds and are not donated—they are loaned—with corresponding repayment obligations and regulatory requirements.

The percentage of public funds required by a property varies. Factors include:

(1) The 'depth' of affordability (properties serving extremely low-income populations generally require greater levels of public investment);
(2) The level of market debt which can be supported (more in parishes with higher median incomes, less in parishes with lower median incomes; larger units produce higher rents, whereas smaller units (i.e., seniors housing) do not);
(3) The total development costs of the transaction; and
(4) Market issues such as interest rates, insurance premiums, and other factors.

The LHC believes it is useful to track and measure the public cost of any transaction, and to quantify this relative to public policy achievements. However, a blanket limit on the percentage of public funds is likely only to obstruct transactions with high policy outcomes (deeply affordable, resilient construction, etc.).

5. Accountability During the 30-Year Compliance Period:

a. **Properties typically sold at year 16**
b. **Developers entitled to 100% of profit from the sale**
c. **If not sold at 16 years, LHC can approve new rounds of tax credits with an extended compliance period**
d. **LHC stated that properties are typically rundown at 16 years and require significant improvements**

e. **Project cash flows submitted with bond applications support sufficient capital to operate and maintain the facility for the full compliance period**
f. **We recommend holding developers accountable for the full 30-year compliance period. If properties are not in livable condition at year 16, new tax credits should not be approved, as compliance has not been met.**

Fundamentally, the LHC agrees that projects should be viable for the full period of affordability, without the need for additional public financing. However, there are a number of reasons this is not always an option.

Properties typically sold at Year 16—the basic structure of LIHTC investment is that the investor/owner receives tax credits over a 10-year period, in return for 15 years of compliance. After this 15-year period expires the basic investment premise (tax credits in return for an equity investment) has been achieved, and the real estate itself no longer has 'investment value' for the original investor.

Developers are entitled to 100% of profit from the sale—this is not the case. Concerns about windfall proceeds to sellers are not justified by the rules and requirements concerning these sales. Additionally, at Year-15 all properties are encumbered with an extended affordability period of at least an additional 15 years (many are longer). Consequently, the value of the property in Year-15 is severely constrained by its rent restrictions. Most often, properties transfer after Year-15 for an amount equal to the sum of existing debt plus any exit tax liability the seller faces.

If not sold at 16 years, LHC can approve new rounds of tax credits with an extended compliance period—All LIHTC properties can be re-syndicated after Year-15, but doing so requires a sale to new ownership. The original owner Year 1-15 cannot hold the property and receive new tax credits.

LHC stated that properties are typically rundown at 16 years and require significant improvements—All properties require periodic capital investments. In a pure market situation, it is typical for properties to be sold or refinanced periodically (5–10-year cycles) as rents rise and debt capacity increases. In these sales or refinancing transactions, a significant portion of the capital goes to upgrades and repairs of major building systems.

Affordable multifamily housing is significantly restricted in how it is refinanced, and how capital is raised. To address this inability to access capital, the timing and cost of replacements for major capital items are projected and all projects are required to make deposits into a Reserve for Replacement account monthly in order to provide adequate resources for the periodic replacement of building systems over time.

Historically, because of the ability to re-syndicate at Year-15, many properties nationwide have been structured for 15-year viability. That is by requiring only the replacement reserve deposits needed for 15 years of replacement needs, the property requires less public capital to initially develop. In PRIME funding initiatives, the LHC has required higher reserve deposits which are consistent with longer-term viability, resulting in properties we expect to be less dependent on re-syndication in the middle of the 30-year affordability period. One consequence of this is that the properties require more public investment initially to develop (greater reserves correspond to less debt capacity which corresponds to greater need for public investment). However, earlier properties were developed with reserve deposit requirements more typical of 15-year cycles of viability, and some of these properties lack sufficient reserves for likely capital replacement needs during the remaining period of affordability.

An additional consideration is the maturity of primary debt, which often coincides with the 15-year investment period of the tax credit investor. Lending institutions generally look to manage long-term risk by providing loans which mature at 15-18 years. Longer maturities are difficult to obtain and require FHA insurance and very long processing times. Consequently, at Year-15, not only is the investor looking to exit the transaction, but also the lender is expecting a 'balance due on maturity'. All these considerations and factors combine for the need for recapitalization of the property during the period of affordability. The LHC underwrites deals at award to establish the likely refinancing risks at this future event, toward funding transactions which are less likely to require additional investments of public capital to realize the benefits of the 30-year use agreement.

Once again, thank you for being a partner in advancing affordable housing for the State of Louisiana. Fiscal responsibility is absolutely key; however, it is equally important to understand factors not inherent to private market rate home sales. Please consider the aforementioned responses when finalizing your recommendations. Feel free to contact me for further discussion or to answer any questions.

Sincerely,

Marjorianna Willman
Executive Director LHC

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