

State of Washington
Joint Legislative Audit & Review Committee (JLARC)



Comparing Costs and Characteristics of Housing Assistance Programs

Report 09-1

January 7, 2009

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alternative formats for persons with disabilities.*

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The statutory authority for JLARC, established in Chapter 44.28 RCW, requires the Legislative Auditor to ensure that JLARC studies are conducted in accordance with Generally Accepted Government Auditing Standards, as applicable to the scope of the audit. This study was conducted in accordance with those applicable standards. Those standards require auditors to plan and perform audits to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objectives. The evidence obtained for this JLARC report provides a reasonable basis for the enclosed findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

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Committee Approval

On January 7, 2009, this report was approved for distribution by the Joint Legislative Audit and Review Committee.

Acknowledgements

The cooperation and assistance received from staff of the Washington State Housing Finance Commission and the Housing Division of the Department of Community, Trade and Economic Development was greatly appreciated.

**Comparing Costs
and Characteristics
of Housing
Assistance
Programs
Report 09-1**

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REPORT SUMMARY

Two Basic Approaches to Housing Assistance: Capital Subsidies and Rent Subsidies (Vouchers)

While numerous organizations provide housing assistance, all rely on two basic approaches to help low-income persons find affordable rental housing: capital subsidies and rental subsidies (vouchers). Capital subsidies allow affordable housing providers to produce new units, rehabilitate older units, and offer reduced rents. Housing vouchers help renters afford market rate rental housing. The federal government is the major funder for both approaches.

In the 2007-09 Biennial Operating Budget (SHB 1128), the Legislature directed JLARC to conduct an evaluation and comparison of the cost efficiency of rental housing voucher programs versus other approaches to provide housing assistance.

Voucher Programs Generally Cost Less Than Capital Subsidies, but There Are Other Factors to Consider

In an analysis that accounts for all costs and all sources of funding, JLARC's evaluation of housing assistance programs found that vouchers generally cost less than capital subsidy programs. While this result might imply that state support for capital programs should be eliminated in favor of less costly vouchers, our research does not support that conclusion for two main reasons.

First, housing professionals point out that both voucher programs and capital programs have unique characteristics and benefits, and both are necessary to address specific needs. They point out that vouchers have the advantage of allowing recipients to select units in neighborhoods of their choosing. However, capital programs have the advantage of increasing the long-term supply of affordable units, providing additional services for special needs populations, and revitalizing distressed communities.

Second, a decision to shift state funding away from capital projects would require legislation changing the source of funding. Currently, the state provides funding primarily using bond proceeds, which may only be used for capital subsidies. Also, shifting state funding away from capital projects could have the unintended consequence of reducing the number of households that could be served given a set amount of available state funds. There is a risk that developments receiving significant state funding might not be economically feasible without the state's share of funding. Whether new vouchers funded solely by the state could provide enough units to replace units potentially lost on the capital side could only be determined by analyzing the specific costs of individual capital project proposals.

Better Analysis of Cost Data Is Needed to Inform Decision Making

JLARC's review of housing assistance programs suggests that better analysis of cost data is needed to inform decisions about the best way to allocate state administered funds for low-income housing. An analytic model that evaluates life-cycle costs, like the model that JLARC developed for this study, could provide a valuable tool for comparing alternatives and making decisions. The financing required for low-income housing is complex, typically relying on low-income housing tax credits, tax-exempt bonds, housing trust funds, local government support, contractor concessions, and developer funds. It is not uncommon to have a half dozen or more sources for a single development.

Life-cycle cost analysis is a method of calculating the total cost of an asset over its useful life. JLARC used this approach to compare the cost of vouchers to capital developments, but it would also be possible to compare the cost of two or more competing development proposals. JLARC's life-cycle cost model calculated present discounted values for rental income, development subsidies, forgiven property taxes, and residual land values. These present discounted values were then converted to monthly equivalents to allow direct comparison to monthly voucher costs.

The two state agencies that provide financing for low-income housing—the Housing Finance Commission and the Housing Division at the Department of Community, Trade and Economic Development—already gather much of the information necessary to do life-cycle cost analysis. However, the information is not being used to the best advantage for decision making. By using life-cycle cost analysis to evaluate applications for funding, the Commission and the Housing Division could provide developers with an incentive to be more cost-effective due to competition for funding. This could result in more units being developed for the same amount of money, or the same number of units being developed for less money. It could also help to identify situations where the cost advantages of vouchers outweigh other advantages offered by capital programs. Life-cycle cost analysis would not preclude selection of higher cost developments, but it could provide assurance that any additional costs for capital developments are justified by the specific advantages offered by the individual developments being considered for funding.

Recommendation

The Housing Division at the Department of Community, Trade and Economic Development (CTED) and the Washington State Housing Finance Commission should include life-cycle cost analysis as a part of their processes for evaluating proposals for state-administered funding.

BACKGROUND: TWO BASIC APPROACHES FOR PROVIDING LOW-INCOME HOUSING

In Washington, as in states around the country, there are a large number of public and private organizations that administer housing assistance programs. The Department of Housing and Urban Development (HUD) is the lead federal agency. The Washington State Housing Finance Commission (Commission) and the Housing Division of the Department of Community, Trade and Economic Development (CTED Housing Division) are the primary state agencies involved. In addition to these, counties, cities, housing authorities, and many non-profit and for-profit organizations play roles in funding, developing, and managing housing assistance programs.

While numerous organizations provide housing assistance, all rely on two basic approaches to help low-income persons find affordable rental housing: capital subsidies and rent subsidies. Frequently, low-income housing developers rely on capital subsidies to construct new units or to acquire and rehabilitate existing housing stock. Capital subsidies allow affordable housing providers to charge reduced rents to low-income tenants. Alternatively, agencies may provide a rent subsidy, often in the form of a housing voucher, to help low-income persons afford market rate rental housing. In some instances, a combination of the two approaches is used in order to assist extremely low-income persons.

The following sections provide a brief overview of key capital and rent subsidy programs.

Capital Subsidy Programs

Federal Low-Income Housing Tax Credits

Administered by the state's Housing Finance Commission, housing tax credits are an incentive to private investors to provide capital for affordable rental housing. The Commission awards tax credits to project developers who sell these credits to investors to raise capital for their projects. As a result, the debt that a developer would otherwise have to borrow is lower, and the developer can offer lower, more affordable rents. Investors in the program receive a dollar-for-dollar reduction in their federal tax liability by agreeing to provide low-cost housing for up to 40 years. The properties developed must serve individuals at or below 60 percent of area median income.

Housing tax credits include two types: "nine percent" credits, which are available for new construction and rehabilitation projects that do not have other federal subsidies; and "four percent" credits, for projects with a majority of financing through tax exempt bonds. Under federal rules, the amount of annual credits available in Washington State under the "nine percent" program is limited (currently \$2.20 per state resident per year). The "four percent" credit program is limited by a cap on the amount of tax exempt bonds that can be issued by the state. The Commission allocates credits on a competitive basis, giving preference to developments serving the lowest income tenants, developments with the longest periods of affordability, and developments that contribute to community revitalization plans. In 2007, the

Commission allocated \$141 million of federal tax credits under the nine percent program and an additional \$127 million in tax credits under the four percent program.

Federal Tax-Exempt Bonds

Issued by both the Housing Finance Commission and local housing authorities, federal tax-exempt bonds provide below market-rate financing to nonprofit and for-profit developers who set aside a certain percentage of their units for low-income individuals. Tax-exempt bonds offer more attractive interest rates than conventional financing as a result of the tax-exempt nature of interest earned by investors. Investors purchase housing bonds at low interest rates because the income from them is tax free. Consequently, the debt carrying costs of developers are lower, allowing for increased borrowing or lower financing costs.

There are two types of tax-exempt bonds used to finance low-income rental housing: 1) Multi-family bonds provide below-market financing rates to for-profit developers to help produce apartments for people with low to moderate incomes; and 2) Non-profit bonds can be used to finance property owned by non-profit organizations or a governmental unit. Federal rules place a limit on the amount of multi-family bonds that the state can issue, currently set at \$85 per state resident per year. Non-profit bonds are not limited because they are considered charitable activities. However, they may not be used in combination with housing tax credits.

In fiscal year 2007, the Commission issued nearly \$225 million in bonds through the multi-family bond program and an additional \$566 million through the non-profit bond program. Local housing authorities issued an additional \$139 million in federal tax exempt bonds to finance low-income rental housing.

Washington Housing Assistance Program

Prior to 1986, relatively little had been allocated from the state's budget for creating or preserving affordable housing. In response to major federal funding cuts in the mid-1980s, the Legislature created the housing assistance program as a means to assist low- and very-low income citizens in meeting their basic housing needs. Administered by the CTED Housing Division, the program provides loans and grants for construction, acquisition, and rehabilitation of low-income housing. Loan interest rates may vary from zero to 3 percent and repayment terms may include deferral periods and amortization schedules lasting as long as 40 years. The majority of the program is supported by appropriations from the state's capital budget. Under RCW 43.185.050, allowed uses for housing trust account and other legislative appropriations include new construction, rehabilitation, and rent subsidies (vouchers). However, capital bond proceeds, and moneys from repayment of loans from capital bond proceeds, may only be used for the costs of construction and rehabilitation projects. Administrative costs are appropriated in the operating budget. The revenue source for this account is from the housing trust account which is from project loan repayments.

For the 2007-09 Biennium, the Legislature appropriated \$200 million for the program for housing assistance, weatherization, and affordable housing. As most of this amount is derived

from capital bond proceeds and money from repayment of loans from capital bond proceeds, it may not be used for rent subsidies (vouchers).

Other Capital Programs

While the capital subsidy programs described above are the financing cornerstones for developers of low-income housing in Washington, there are a number of other programs. Low-income housing developers frequently receive capital grants or low-interest loans from cities and counties, many of which use funding that originated at either the federal or state level. Some federal sources include the Home Investment Partnership Program (HOME), Community Development Block Grants (CDBG), Supportive Housing for the Elderly (Section 202), and Supportive Housing for Persons with Disabilities (Section 811). Other capital subsidies originating at the state level include the Affordable Housing for All and Homeless programs, funded from document recording fees and administered by counties and the CTED Housing Division. In 2007, recording fee surcharges produced about \$20 million for counties and \$14 million for the Housing Division to support affordable housing and homeless programs.

Rent Subsidy Programs

Federal Section 8 Vouchers

The federal Section 8 voucher program is the federal government's major program for assisting very low-income families, the elderly, and the disabled to afford housing in the private market. Funded by the U.S. Department of Housing and Urban Development and administered by local housing authorities, households with a Section 8 voucher generally pay 30 percent of their income for rent and utilities. The voucher then pays the rest of those costs, up to a limit called a payment standard. Housing authorities set payment standards within federally mandated boundaries. Washington has 34 local housing authorities that administer the Section 8 voucher program with funds that come directly to them from the federal government. In 2007, there were over 44,000 vouchers in use in Washington, providing more than \$350 million in housing assistance.

Other Rent Subsidies

In addition to the Section 8 housing voucher program, there are several other smaller programs providing rent assistance to Washington residents using a voucher method.

The Tenant Based Rental Assistance (TBRA) program provides homeless and low-income households with security and utility deposits and up to 12 months of rent assistance. While it is a state program, TBRA is funded entirely using federal HOME grants. In 2007, TBRA provided an estimated \$3.3 million in assistance to 825 households.

The Transitional Housing, Operating and Rent (THOR) program is a Washington program that provides rent assistance using a voucher method. The THOR program provides rent assistance and services to homeless families with children for up to two years. It provided an estimated \$978,000 in rent assistance to 245 households during 2007 using state general funds.

Finally, the Affordable Housing for All and Homeless programs, described in the previous section on capital subsidies, allow the use of vouchers in lieu of capital subsidies. While the Housing Division does not maintain a count of the number of vouchers or the amount of voucher assistance provided under these programs, a survey that they conducted in 2006 found few jurisdictions are exercising the voucher option.

The Washington State Housing Finance Commission currently has no authority and receives no financial resources with which to issue rental vouchers.

COMPARING CAPITAL AND VOUCHER HOUSING ASSISTANCE PROGRAMS

To answer the Legislature's questions about housing assistance programs, JLARC developed a model for analyzing the life-cycle cost of low-income housing developments. We collected data necessary for use in the model, including information about permanent financing, property tax subsidies, and expected rental income. JLARC then compared the costs for these capital projects to the costs for vouchers for units with the same number of bedrooms in the same general location. A more complete description of JLARC's methodology is included in Appendix 3 of this report.

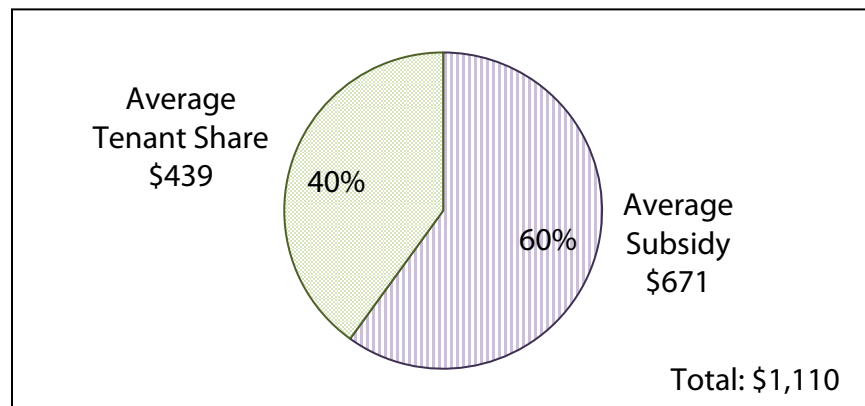
We tested the strength of the results presented in this report to four key assumptions used in our analytic model. We have included the results of our sensitivity analysis in Appendix 4 of this report. In all cases, the average cost of capital developments exceeded the average cost of vouchers.

This financial analysis does not capture all potential costs and benefits of housing program alternatives. The chapter concludes with a discussion of some additional factors to weigh when considering state funding for housing assistance programs.

What Do Capital Programs Cost?

Capital Units Cost an Average of \$1,110 per Month. As illustrated in Exhibit 1, for 50 low-income housing developments completed in 2006, JLARC estimates the average monthly cost for the units produced was \$1,110 per unit. Of this amount, tenants contributed an average of \$439 per month (40 percent) for rent and utilities. Subsidies from various sources paid the balance of \$671 per month (60 percent). A typical housing "unit" is an apartment in a building containing a number of apartments. These figures represent the present discounted values for rental income, development subsidies, forgiven property taxes and land residual values for an average sized unit, based on units of varying sizes (studios, 1-bedroom, 2-bedroom, etc.).

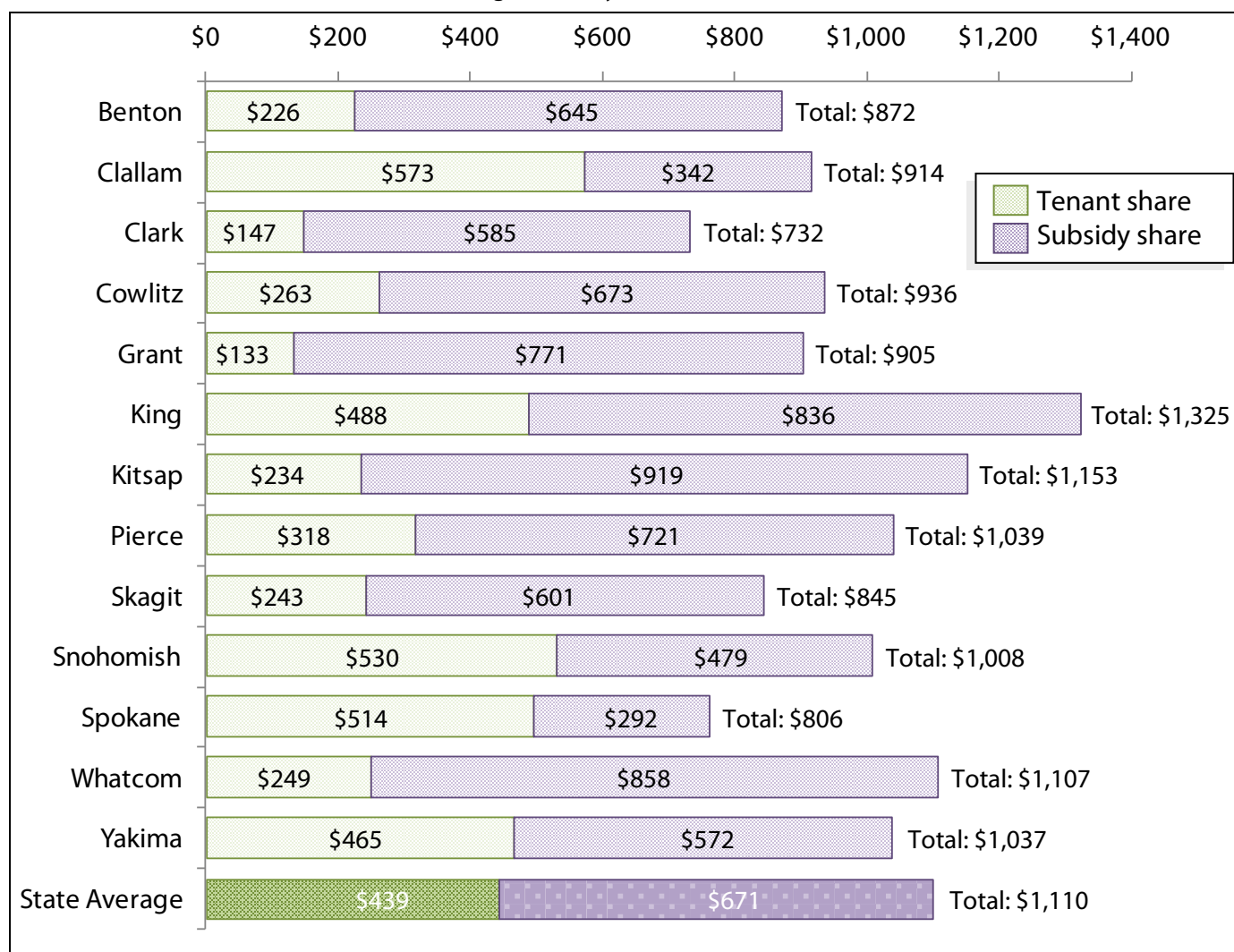
Exhibit 1 – Capital Programs: Cost per Unit
Average Monthly Cost (2008 Dollars)



Source: JLARC analysis of 50 developments completed in 2006. Data from the Housing Finance Commission and the Department of Community, Trade and Economic Development, Housing Division.

Detailed Look at Costs for Capital Developments. Exhibit 2 provides a more detailed look at costs for capital developments, broken down for each of the 13 counties with developments included in JLARC’s sample of 50 developments completed during 2006. The average total monthly cost per unit for capital developments varied from a high of \$1,325 for 19 projects completed in King County to a low of \$732 for a project completed in Clark County. Similarly, the portion of cost paid by subsidies varied widely from a high of \$919 per month for one project in Kitsap County to a low of \$292 per month for three projects in Spokane County. The monthly amount paid by tenants varied from a high of \$573 per month for one project in Kitsap County to a low of \$133 per month for three projects completed in Grant County.

Exhibit 2 – Capital Programs: Cost per Unit by County
Average Monthly Cost (2008 Dollars)

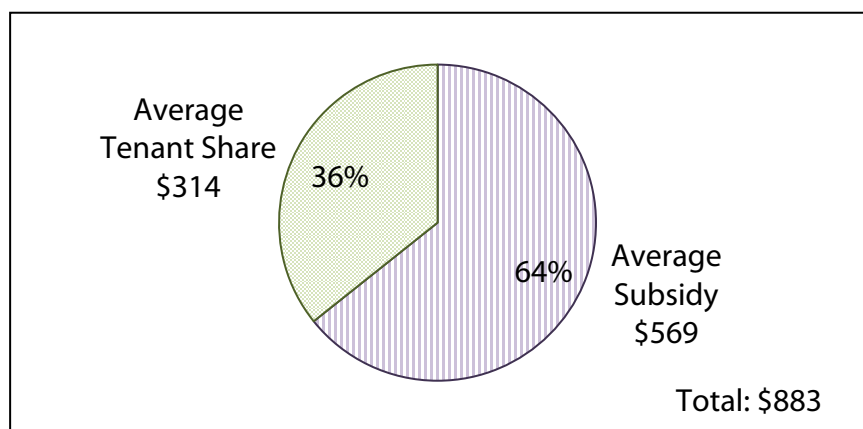


Source: JLARC analysis of 50 developments completed in 2006. Data from the Housing Finance Commission and the Department of Community, Trade and Economic Development, Housing Division.

What Do Voucher Programs Cost?

Vouchers Cost an Average of \$883 per Month. Exhibit 3 shows the average housing assistance voucher cost was \$883 per month for units with the same number of bedrooms in the same general location as the capital projects. The tenant's share of the cost for equivalent units averaged \$314 per month (36 percent), with vouchers covering the remaining \$569 per month (64 percent). These figures represent the cost for vouchers in use in the same general location as the 50 capital projects analyzed in the previous section.

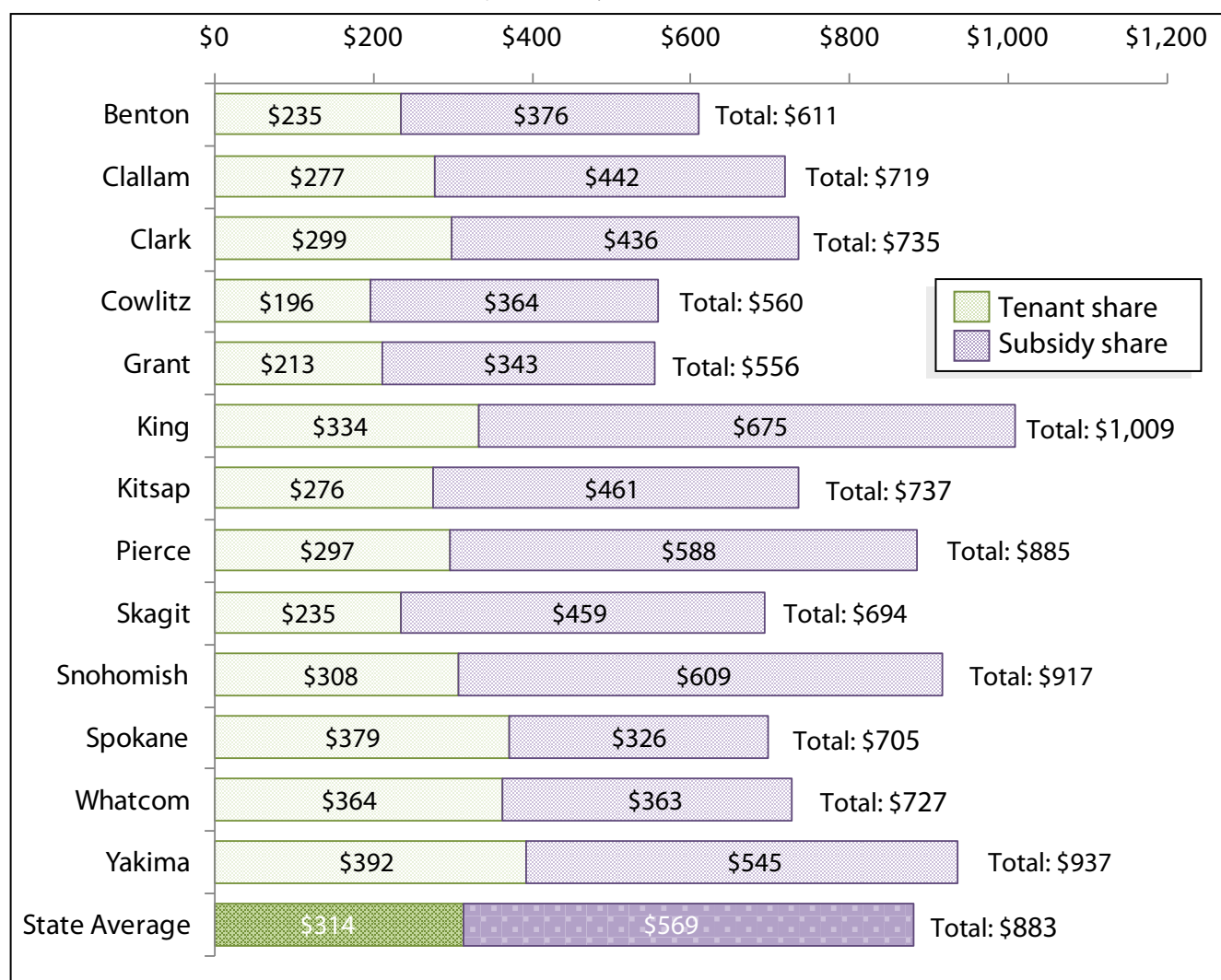
Exhibit 3 – Voucher Programs: Cost per Unit
Average Monthly Cost (2008 Dollars)



Source: JLARC analysis of data from Washington housing authorities.

Detailed Look at Voucher Costs. Exhibit 4 provides the average monthly costs for voucher units broken down by county. The highest total costs for voucher units were in King County, where the average cost was \$1,009 per month. Grant County had the lowest total costs for voucher units, at \$556 per month. The portion of rent paid for by the voucher also was highest in King County, averaging \$675 per month for units of the same size and in the same general location as the capital units analyzed in this report. Spokane County had the lowest voucher payments at \$326 monthly. Finally, the average tenant share was highest in Yakima County at \$392 and lowest in Cowlitz County at \$196.

Exhibit 4 – Voucher Programs: Cost per Unit by County
Average Monthly Cost (2008 Dollars)

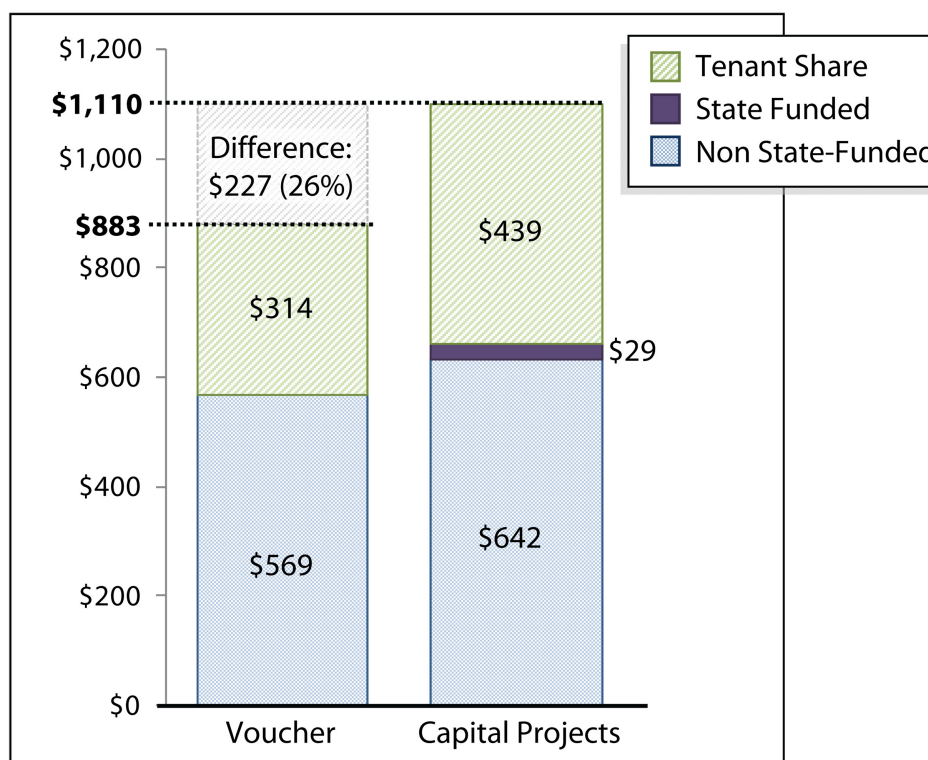


Source: JLARC analysis of data from Washington housing authorities.

How Do Costs for Capital and Voucher Programs Compare?

Capital Units Were 26 Percent More Expensive Than Vouchers. Exhibit 5, below, shows the \$1,110 average monthly cost for capital units exceeded the \$883 equivalent monthly voucher cost by \$227 (26 percent). This exhibit also shows only a relatively small state contribution (\$29 per unit per month) toward the cost of capital units. Contributions to capital units from other sources, including contributions from federal, local, and private sources, averaged \$642 per unit per month.

Exhibit 5 – Capital Unit Costs Exceed Comparable Voucher Costs by 26%

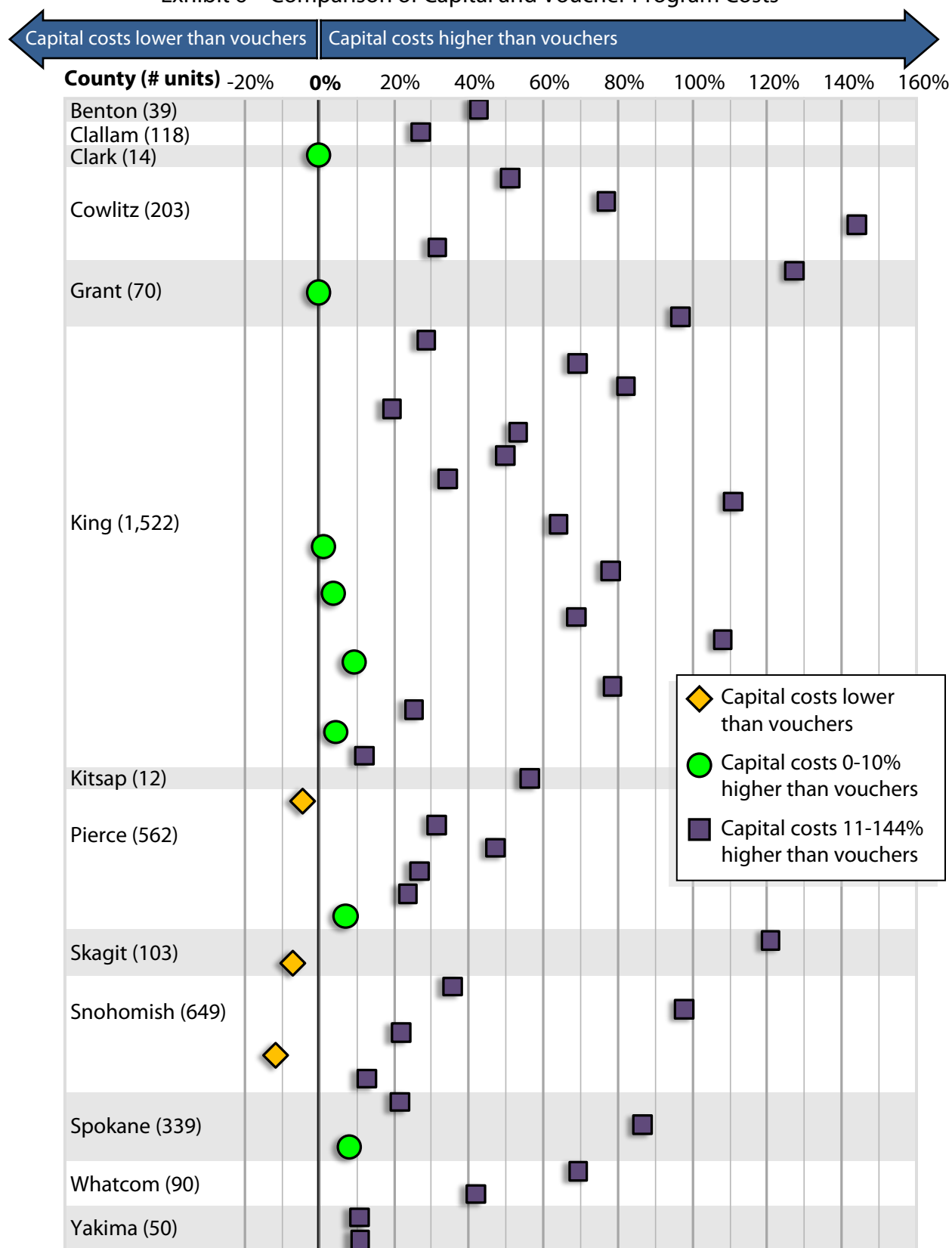


Source: JLARC analysis of 50 developments completed in 2006. Data from the Housing Finance Commission and the Department of Community, Trade and Economic Development, Housing Division.

Most Capital Developments Cost More Than Vouchers. As shown in Exhibit 6, the costs for most capital developments exceeded the costs for vouchers for units with the same number of bedrooms in the same general location. The vertical line at 0% represents a situation where capital development costs per month are equal to voucher costs per month for equivalent units. An individual point represents a single development, and more than one point appearing in a county indicates multiple developments in that county. A point appearing to the left of the 0% line indicates development costs for that project were less than equivalent voucher costs. A point to the right of this line means development costs were higher than equivalent voucher costs.

Comparing Capital and Voucher Housing Assistance Programs

Exhibit 6 – Comparison of Capital and Voucher Program Costs



Source: JLARC analysis of 50 developments completed in 2006. Data from the Housing Finance Commission and the Department of Community, Trade and Economic Development, Housing Division, and Washington housing authorities.

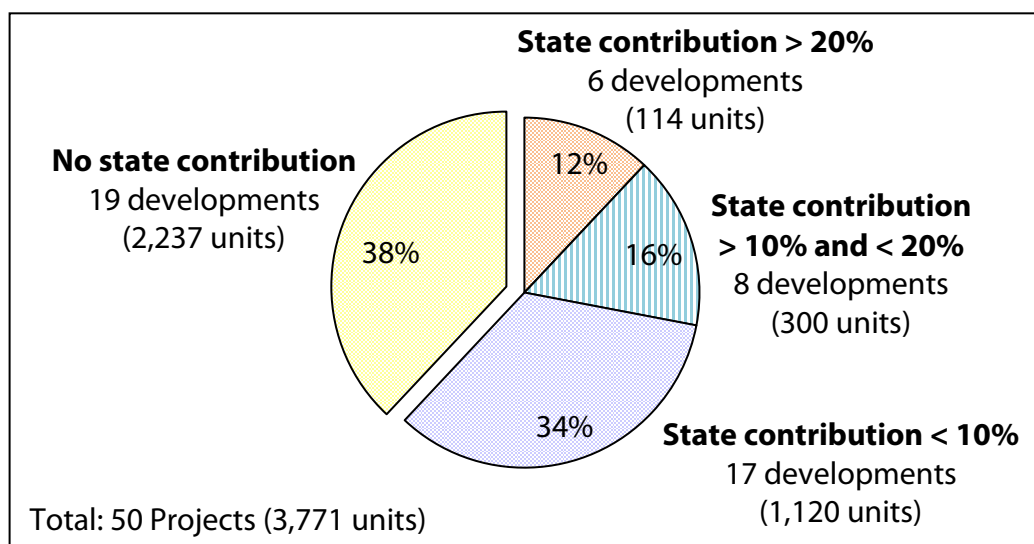
Of the 50 capital properties analyzed for this report, only three (**shown in orange diamonds**) in Pierce, Skagit, and Snohomish Counties had development costs that were lower than the equivalent cost for vouchers. For eight more properties (**shown in green circles**), in Clark, Grant, King, Pierce, and Spokane Counties, development costs exceeded voucher costs by less than 10 percent. Development costs for the remaining 39 properties (**shown in purple squares**) exceeded voucher costs by more than 10 percent, and five of these properties, in Cowlitz, Grant, King, Skagit Counties, had costs that exceeded voucher costs by more than 100 percent.

How Many Developments Get State Funding and How Much Do They Get?

State Subsidies Are Common. Of the 50 capital developments that JLARC reviewed, 31 received at least some state funding, although state subsidies were relatively small for most. A decision to shift state funding away from capital projects could have the unintended consequence of reducing the number of households that could be served given a set amount of available state funds. There is a risk that developments receiving significant state funding might not be economically feasible without the state's share of funding. Whether new vouchers funded solely by the state could provide enough units to replace units potentially lost on the capital side could only be determined by analyzing the specific costs of individual capital project proposals.

Exhibit 7 shows six developments (12 percent) received more than 20 percent of their financial assistance from state sources, eight developments (16 percent) received between 10 and 20 percent, and an additional 17 developments (34 percent) received up to 10 percent from the state. There were 19 developments (38 percent) that received no financial backing from state sources. Also, the developments that received the largest percentages of state funding tended to be the smallest developments.

Exhibit 7 – State Contributions to Capital Developments
As a Percent of Contributions from All Sources



Source: JLARC analysis of data from the Washington State Housing Finance Commission and the Department of Community, Trade and Economic Development, Housing Division.

Other Than Cost, What Else Should Be Considered?

JLARC's model for analyzing housing program costs provides a tool for understanding the relative cost of programs that provide low-income housing. It does not, however, capture all of the potential benefits or costs of various housing programs. Housing professionals that JLARC interviewed for this report consistently felt both capital programs and vouchers have an important role to play in the state's approach to providing affordable rental housing for low-income households.

Readers should note that the type of analysis JLARC conducted for this report does not capture indirect cost savings. For example, costs for police, incarceration, and substance abuse treatment may be avoided by providing appropriate supportive housing for formerly homeless individuals. Housing professionals suggest these kinds of indirect cost savings, as well as non-monetary benefits of vouchers and capital programs, should be considered along with information about costs. However, we do not know whether these possible savings would be more prevalent if housing were provided through capital programs or rent subsidies.

Advantages cited for vouchers include more freedom for recipients to live in a location of their choosing, which can result in a dispersion of assisted households throughout a community. The flexibility to choose location can mean shorter and more convenient commutes to work or to locations that provide needed services. Also, in communities with an adequate supply of affordable housing units, vouchers may provide a faster form of assistance by avoiding the time necessary for construction.

Advantages for capital programs include providing necessary units in locations where affordable housing is in short supply and increasing long-term affordability through restricted rents. Housing professionals mentioned that capital developments provide opportunities for on-site services and housing adapted for persons with special needs that do not exist with vouchers. Housing professionals also believe revitalization of distressed neighborhoods is an advantage of capital projects. They suggest that subsidized affordable housing developments can serve as a sort of catalyst to private developers and can have a transformative effect on entire neighborhoods.

FINDINGS AND RECOMMENDATIONS

Better Cost Data and Analysis Is Needed on an Ongoing Basis

Good management practices require those entrusted with public resources to use those resources efficiently, economically, and effectively. Results of JLARC's review, however, suggest that housing program administrators in Washington often lack complete information about project financing and the analytic tools necessary to fully understand costs and compare alternatives.

As one of the two state agencies involved in the financing of low-income housing developments in the state, the Washington State Housing Finance Commission issues bonds and authorizes federal housing tax credits used in capital developments. JLARC's review found the Commission has a knowledgeable staff and maintains generally good quality records. We noted, however, in some instances the Commission's records lacked important details about the repayment terms for some financing sources for some properties. Commission staff were able to provide this information for JLARC's analysis by contacting developers and other funders directly. Also, during the course of our work, staff indicated the Commission will be developing new procedures to obtain this type of information in the future.

The other state agency involved in financing capital projects in Washington is the Housing Division at the Community, Trade and Economic Development Department, which administers the State Housing Trust Fund program. JLARC found significant gaps in the information available from the Housing Division. While the Commission's funding process includes a requirement that developers submit an audited final cost certification detailing total development costs and all sources of permanent financing, the Housing Division does not have a similar requirement. The Housing Division has no readily available source detailing final development costs and permanent financing terms from all sources. Staff were able to provide necessary information to JLARC through an ad hoc process. Division management explained the Division has been pursuing upgrades to its information systems which could provide an opportunity for improving the accessibility and accuracy of its records.

More complete data is important, however, only if it serves a useful purpose. JLARC noted that neither the Commission nor the Housing Division conduct the kind of analysis that could help them compare costs and consider alternatives. Because capital developments frequently rely on half dozen or more permanent financing sources, it is not possible to make direct cost comparisons without performing the kind of analysis that JLARC did for this report. Consequently, neither agency is able to directly compare differences in costs between developments applying for financing from state-administered sources.

Life Cycle Cost Analysis Can Be a Valuable Tool

Financing for affordable housing is complex. Decisions about how best to use state funds require careful consideration of many factors including cost, specific benefits of projects requesting state assistance, and restrictions tied to the sources of funds. While JLARC's analysis shows vouchers generally cost less than capital programs, there are other factors to consider. For example: some

communities have an insufficient supply of affordable housing and some private sector owners may be unwilling to rent to voucher recipients; housing available in the private market may not be suitable for individuals with special needs; and program rules or statutory restrictions may not allow for the use of vouchers. Even considering these limitations, life-cycle cost analysis could provide a valuable tool for deciding how best to use state-administered funds available for affordable housing.

Life-cycle cost analysis is an economic methodology for selecting the most cost-effective alternative. JLARC used life-cycle cost analysis to compare the cost for units provided through capital programs and vouchers. When used in this way, voucher costs provide a useful benchmark for cost comparisons. JLARC's analysis not only showed that vouchers usually cost less, it also demonstrated a large variation in costs between different capital projects. While some capital projects cost nearly the same or even less than vouchers, most cost more and there was a large variation in cost differences. Life-cycle cost analysis allows funders to understand these cost differences and consider the reasons for them in the context of other benefits. Even when program rules or statutory restrictions do not allow for the use of vouchers, life-cycle cost analysis would allow funders to compare the costs for proposals competing for limited funds. In this way, life-cycle cost analysis could provide a helpful tool to help determine which projects to finance.

Because the state currently provides funding for affordable housing primarily using bond proceeds which may only be used for capital subsidies, a decision to shift state funding away from capital projects would require legislation changing the source of funding. Nonetheless, evaluation of life-cycle costs could help identify lower cost proposals during the capital project application process and it could provide an incentive for cost-efficiency.

Recommendation

The Housing Division at the Department of Community, Trade and Economic Development and the Washington State Housing Finance Commission should include life-cycle cost analysis as a part of their processes for evaluating proposals for state administered funding.

Legislation Required:	None
Fiscal Impact:	JLARC assumes this can be completed within existing resources.
Implementation Date:	July 1, 2009

APPENDIX 1: SCOPE AND OBJECTIVES

COMPARING COSTS AND CHARACTERISTICS OF HOUSING ASSISTANCE PROGRAMS

SCOPE AND OBJECTIVES

MARCH 2008



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Why a JLARC Study of the Costs and Characteristics of Housing Programs?

The 2007–09 Biennial Operating Budget (Substitute House Bill 1128) directed the Joint Legislative Audit and Review Committee (JLARC) to conduct an evaluation and comparison of the cost efficiency of rental housing voucher programs versus other housing projects intended to assist low-income households. JLARC was directed to present the results of its study to the Legislature by December 31, 2008.

Background

Housing Assistance Programs

The State of Washington supports a variety of housing assistance programs intended to assist residents with obtaining affordable, decent housing in a healthy, safe environment. A key objective of state programs is to assist very low-income and special needs households who cannot find affordable, safe, and adequate housing in the private market.

Acting with federal, local, and non-profit partners, the state provides financial support for the construction of new housing and rehabilitation of existing housing units. The state also provides some direct subsidies in the form of vouchers to assist low-income households to pay rent. The Department of Community, Trade and Economic Development and the Housing Finance Commission are the primary agencies responsible for administering state housing assistance programs.

Two Approaches to Assistance: Vouchers and Capital Programs

Under most housing voucher programs, an assisted household generally pays 30 percent of its income for rent and the voucher makes up the difference between the household's contribution and fair market rent.

Under capital programs, federal, state, and local governments provide development subsidies for new construction or rehabilitation and may also provide rent assistance. These capital subsidies can take various forms, including grants, low-interest loans, bonds, and tax credits.

Study Scope

Using the principles of life-cycle cost analysis, JLARC will determine how the costs for housing vouchers compare to costs for capital housing programs (e.g., construction and rehabilitation programs) intended to assist low-income households. In addition, JLARC will examine who pays the costs of each program and highlight program characteristics relevant to state policy makers. The study will also determine how program administrators consider benefits other than cost.

Study Objectives

The study will include answers to the following questions:

- 1) What are the total life-cycle costs for low-income housing provided through capital housing assistance programs (e.g., construction and rehabilitation)?
- 2) What are the total life-cycle costs for low-income housing provided through rental voucher programs?
- 3) How comparable are the costs for housing provided by capital programs versus rental voucher programs?
- 4) How much of the cost of these programs is paid by the state and how much is paid by other government agencies, private organizations, or tenants?
- 5) Are there other benefits or characteristics of voucher and capital programs that should be considered when assessing program costs?

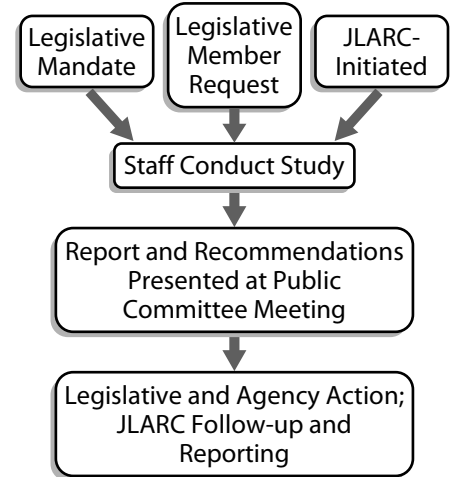
Timeframe for the Study

Staff will present the preliminary report in November 2008 and a proposed final report in December 2008.

JLARC Staff Contacts for the Study

David Dean	(360) 786-5293	dean.david@leg.wa.gov
Fara Daun	(360) 786-5174	daun.f@leg.wa.gov

JLARC Study Process



Criteria for Establishing JLARC Work Program Priorities

- Is study consistent with JLARC mission? Is it mandated?
- Is this an area of significant fiscal or program impact, a major policy issue facing the state, or otherwise of compelling public interest?
- Will there likely be substantive findings and recommendations?
- Is this the best use of JLARC resources? For example:
 - Is JLARC the most appropriate agency to perform the work?
 - Would the study be nonduplicating?
 - Would this study be cost-effective compared to other projects (e.g., larger, more substantive studies take longer and cost more, but might also yield more useful results)?
- Is funding available to carry out the project?

APPENDIX 2: AGENCY RESPONSES

- Department of Community, Trade, and Economic Development
- Washington State Housing Finance Commission
- Office of Financial Management



STATE OF WASHINGTON

DEPARTMENT OF COMMUNITY, TRADE AND ECONOMIC DEVELOPMENT

128 – 10th Avenue SW • PO Box 42525 • Olympia, Washington 98504-2525 • (360) 725-4000

Date: December 10, 2008

TO: Ruta Fanning, Legislative Auditor
Joint Legislative Audit and Review Committee

FROM: Juli Wilkerson, Director

A handwritten signature in black ink that reads "Juli Wilkerson".

SUBJECT: Comparing Costs and Characteristics of Housing Assistance Programs
Preliminary Report

Thank you for the opportunity to review the preliminary report and for your presentation at both the Joint Legislative Audit and Review Committee (JLARC) and House Housing committees recently. I appreciate the time and effort you made to communicate with the Department of Community, Trade and Economic Development's (CTED) Housing Division staff. My comments will follow the format required in your memo of November 25, 2008.

Recommendation:

The Housing Division at CTED and the Washington State Housing Finance Commission (HFC) should include life-cycle cost analysis as a part of their processes for evaluating proposals for state-administered funding.

Agency Position:

Concur

Additional Comments:

We are pleased that the study indicates that both capital construction and vouchers are necessary to meet the affordable housing needs of Washington's low-income families and individuals. There are over 250,000 households with incomes below 50 percent of area median income that pay more than 30 percent of their income for rent (2000 US Census and the US Department of Housing and Urban Development definition of affordable housing). Many of these households also have special needs. Creating long term solutions for affordable housing includes capital construction that will be available for at least 40 years and housing vouchers. Vouchers can be useful when rental owners choose to provide affordable housing and in areas that have a high demand as well as transitional housing opportunities that assist people who are low-income and homeless work towards self sufficiency. While JLARC's presentation suggests vouchers provide the opportunity for people to live in housing or neighborhoods of their choosing, their choices are often limited by less desirable and energy inefficient housing stock. In some instances the supply of housing appropriate to the needs of the family or individual is simply not there and vouchers are returned unused.

Ruta Fanning
December 10, 2008
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We do concur that cost analysis is an important factor in making funding decisions. In fact, the CTED Housing Division collects a wide range of data to determine the viability of projects to move forward during each of the competitive funding rounds for the Housing Trust Fund (HTF.) The life cycle cost tool developed by JLARC during this study appears to provide additional analysis to allow comparison of similar projects. We will assess the tool and test it during future funding rounds to determine if we can improve the selection of viable ready-to-go projects to create affordable housing. While life cycle costing may be useful for comparing project costs we cannot make final decisions on cost alone. We must still weigh the quantitative and qualitative factors and make decisions on the diversity of projects, their target population, the amount of leveraging and the public benefit we achieve.

In the findings and recommendation on page 15, the report states that housing program administrators often lack complete information about project financing and the analytic tools necessary to fully understand costs and compare alternatives. We believe it is more accurate to state the CTED Housing Division compares a wide range of project information to understand costs but does not consider comparable data on vouchers as it is not an allowable alternative. The scope of this study did not assess the underwriting process, the data collected and analyzed during the review stage or the work and due diligence done at the contracting stage. Given the restriction on the types of projects that can be funded with the source of capital funds, the program is only comparing capital projects and therefore would not typically compare the costs of capital projects to the costs of vouchers. The HTF authorizing statute clearly provides the guidance and framework for prioritizing projects which have been consistently applied. In addition, this section points out the HFC funding process includes an audited final cost certification and the HTF does not. While the HTF does collect final cost data, CTED is not under the Internal Revenue Service requirements the HFC must meet. We believe adding the same or similar requirement would further add costs to project development. We will review the HTF final cost requirement to determine potential improvements.

Again, we are pleased the study states both capital construction and vouchers are needed to provide affordable housing for Washington's low-income families and individuals. As housing professionals serving the most vulnerable citizens in the state of Washington, we often witness the difficulty some citizens experience in trying to find suitable housing even with a subsidy. The capital construction projects we invest in are often targeted to special needs households, utilizing supportive services and would not have alternative housing options without the units that are being created by this program. In addition, given the amount of state investment, depicted as only \$29 per unit per month, on Exhibit 5, page 11, this program provides significant leverage of other federal, local, and private resources in the creation of this additional affordable housing stock.

I do appreciate the collaboration we have had with you and your staff during this study. I appreciate your job as auditors and researchers and recognize that comparing the issues in the scope of your work was challenging. Thank you for considering our comments and suggestions as you create the final report. The work of providing safe, decent affordable housing for low-income households is challenging and rewarding and our mission is to do the best job we possibly can with our valuable state resources. We look forward to reviewing the final report.

cc: Will Graham, CTED Housing Division



WASHINGTON STATE
HOUSING FINANCE
COMMISSION

RECEIVED
DEC 10 2008
JLARC

Ms. Karen Miller
Chair
Mr. Kim Herman
Executive Director

Memorandum

To: Ruta Fanning, Legislative Auditor

From: Kim Herman, Executive Director
Washington State Housing Finance Commission

CC: Steve Walker, Director, Tax Credit Division

Date: December 8, 2008

Re: Comparing Costs and Characteristics of Housing Assistance Programs –
Preliminary Report

*Paul Edwards DEPUTY
FOR KIM HERMAN*

Thank you for the opportunity to review your preliminary report. We applaud the efforts of the JLARC staff and the constructive time they put into this complex project. This study is the most comprehensive look at affordable housing development in the greater Puget Sound area done today. Many of the findings have been known to the housing development community for some time. Vouchers and Capital both play an important role in meeting the housing needs in Washington State. No one method is a panacea to curing our affordable housing problems.

My comments will follow the prescribed format outlined in your memo of November 25, 2008.

Recommendation: "The Housing Division at the Department of Community, Trade and Economic Development and the Washington State Housing Finance Commission should include life-cycle cost analysis as a part of their processes for evaluating proposals for state-administered funding."

Agency Position: Concur

Comments: The improvement of data collection statewide is important and hence paramount. Analytical tools that add value to a process should be considered.

The study states on page 15 that the state housing agencies “often lack complete information about project financing and the analytical tools necessary to fully understand costs and compare alternatives.” Both the Washington State Housing Finance Commission and the Housing Division at the Department of Community, Trade and Economic Development are charged with managing capital programs and allocating resources based upon which projects best meet the needs and priorities of the state at a given moment in time. Among these public benefit priorities are serving special needs populations including the homeless, agricultural workers, the elderly, large families and the disabled; achieving geographic dispersion; promoting green building and evaluating total project costs. Underwriting methods to determine financial feasibility and long-term viability is achieved through a multi-tiered collaboration among many different public and private investors and financial institutions. It is unclear at this time whether the proposed life-cycle cost analysis model provides additional value to this process. We intend to take a closer look at the life-cycle cost analysis model to determine its applicability to our process.

Additional Comments:

- **Page 14, Other Than Costs, What Else Should Be Considered?**

Paragraph 3 states that residents receiving vouchers are able to choose the communities in which they live. While technically correct, many voucher holders are not able to find affordable units in all neighborhoods or buildings, and thus voucher concentrations occur in less affluent neighborhoods if there are sufficient units available for rent. Dispersion is thus limited by the location of affordable housing stock. Bond and Tax Credit developed housing may be the only affordable housing developed in more affluent communities.

In addition, while it is prohibited by law in many places, some private sector owners still will not rent to voucher holders. We still see “for rent” advertisements in Washington that specify “Section 8 vouchers not accepted”.

We appreciate the difficulty of your assignment and the high level of cooperation we have had with JLARC staff members on this study. We greatly appreciate your willingness to allow us to work with you as this study has progressed and we look forward to reading the final version.

Thanks and Good Luck!



STATE OF WASHINGTON
OFFICE OF FINANCIAL MANAGEMENT

Insurance Building, PO Box 43113 • Olympia, Washington 98504-3113 • (360) 902-0555

December 10, 2008

TO: Ruta Fanning
Legislative Auditor

FROM: Victor A. Moore *V.A.M.*
Director

**SUBJECT: JLARC PRELIMINARY REPORT COMPARING COSTS AND
CHARACTERISTICS OF HOUSING ASSISTANCE PROGRAMS**

We appreciate the opportunity to review the Joint Legislative Audit and Review Committee's preliminary report on Comparing Costs and Characteristics of Housing Assistance Programs.

Recommendation	Agency Position	Comments
The Housing Division at the Department of Community, Trade, and Economic Development (CTED) and the Washington State Housing Finance Commission (WSHFC) should include life-cycle cost analysis as a part of their processes for evaluating proposals for state-administered funding.	Concur	<p>Life Cycle Cost Analyses (LCCA) are valuable tools for analyzing and determining the optimal choice between similar capital investment opportunities. The Office of Financial Management conducts life cycle cost analysis as part of its legislatively-directed facilities oversight responsibility. We agree that LCCA can provide additional useful information to supplement the other criteria CTED and the WSHFC currently use to evaluate funding applications.</p> <p>We do have three concerns. First, we believe that designing and implementing a life cycle cost analysis program within CTED's current resources and in the timeframe indicated in the report presents a serious challenge. OFM's experience as we developed and implemented our facilities life cycle cost analysis during the 2007-2009 Biennium suggests there are material start-up costs associated with acquiring LCCA expertise, model design, and sensitivity analysis design. But once established, LCCA maintenance costs are minimal.</p> <p>Second, there are a number of technical and structural issues related to how an LCCA model can best be used in these housing programs. For example, capital financing mechanisms used by the WSHFC and CTED do not</p>

Ms. Ruta Fanning
December 10, 2008
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		<p>necessarily result in an ownership relationship between the state and the property or activity supported by the capital investment. In addition, for an LCCA approach to be most useful, more would need to be known about the methodologies related to federal tax credits, bonding authority, and revolving loans so that they can be properly factored into the ownership costs.</p> <p>Finally, given the diverse populations served by these programs and their unique needs, we believe it is important to establish project similarity prior to subjecting the projects to a life cycle cost analysis. Housing for special needs populations may have higher capital costs than housing for other populations. Assuming a housing unit is simply a housing unit could lead to comparisons of dissimilar projects, thus yielding compromised decision data.</p> <p>The Office of Financial Management would like an opportunity to discuss these issues with JLARC in greater detail so that we can better understand the capabilities and uses of the LCCA tool developed by JLARC.</p>
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Again, thank you for the opportunity to review this preliminary report. If you have any questions, please contact John Shepherd at (360) 902-0538.

cc: Julie Wilkerson, Director, Community, Trade & Economic Development
Kim Herman, Executive Director, Washington State Housing Finance Commission
Kari Burrell, Executive Policy Advisor, Office of the Governor
John Shepherd, Budget Assistant, Office of Financial Management

APPENDIX 3: STUDY METHODOLOGY

At the direction of the Legislature, JLARC conducted an evaluation and comparison of the cost efficiency of rental housing voucher programs compared to other programs intended to assist low-income households.

JLARC staff identified major housing programs and the federal, state, and local agencies that administer them. We obtained an understanding of the programs involved by: reviewing written program descriptions, professional literature, studies, program evaluations, and audits; interviewing agency personnel; obtaining and reviewing recent budget and expenditure reports; visiting low-income housing developments; and reviewing pertinent laws, rules, and regulations.

JLARC engaged consultants who are experts in the area of life-cycle cost analysis and capital planning and development. Working with these consultants, we developed a life-cycle cost model to analyze the costs and financing for low-income housing. To obtain information necessary for the model's development, JLARC's staff and our consultant met with and interviewed finance personnel who work in the field of low-income housing. To determine the total cost for capital developments, our model calculated the present discounted values for rental income, development subsidies, forgiven property taxes and land residual values. These present discounted values were then converted to monthly equivalents to allow for comparison to monthly voucher costs. To ensure our model was working as intended, we demonstrated it and explained its features to a university professor with expertise in housing policy and quantitative methods. JLARC also obtained feedback on the model from managers at the Washington State Housing Finance Commission.

JLARC identified 50 low-income housing developments that had received state administered funding and were completed during calendar year 2006. Exhibit 8 shows the location of these developments. For each of these properties, JLARC staff obtained information and documentation showing the total cost for their development, permanent financing and repayment terms from all sources, assessed valuations, property tax subsidies, and expected rental income. We identified the costs and financing for the entire period that each project committed to provide low-income housing. Our review did not attempt to determine whether funding for maintenance and other long-term capital needs was sufficient. For quality control purposes, JLARC provided the results of our analysis and data inputs to the state agencies providing this data. JLARC also engaged our consultants to review our data inputs and results.

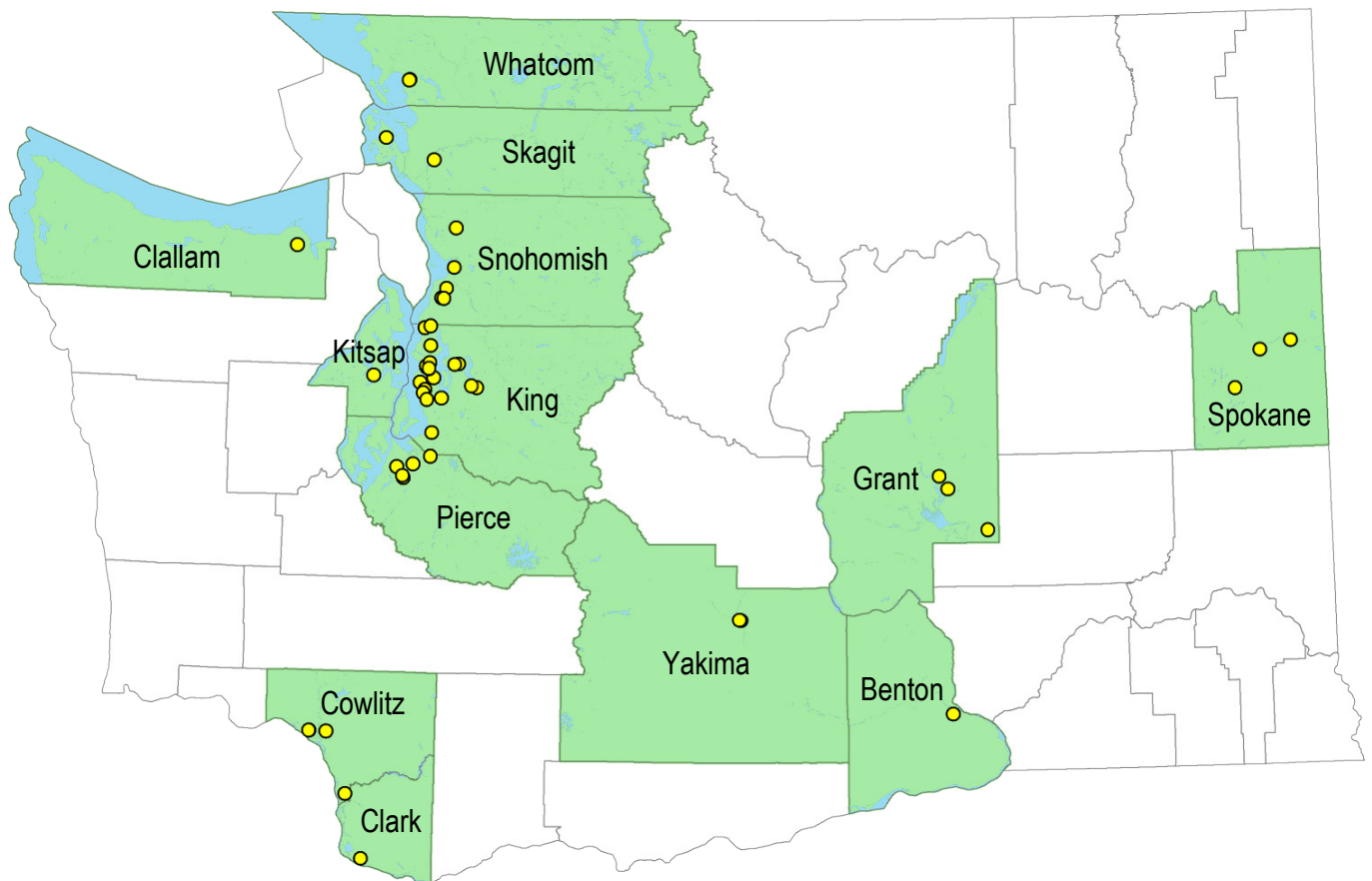
In order to compare the results of our analysis of capital costs, for each of the 50 properties reviewed we obtained voucher data from the appropriate local housing authority. JLARC staff analyzed that data using geographic information system software to identify vouchers in use in the same general location as the capital project. Using this data, we calculated the equivalent cost for vouchers. Vouchers were weighted by the mix of unit sizes (e.g., studios, 1-bedroom, etc.) in the 50 capital developments, in order to ensure per unit costs were comparable.

To identify other non-monetary benefits and characteristics of voucher and capital programs, JLARC staff reviewed professional literature and interviewed knowledgeable sources from the

affordable housing advisory board, the Housing Division at Department of Community, Trade and Economic Development, the Washington State Housing Finance Commission, representatives of the private rental housing industry, housing authorities, county and city governments, and low-income housing developers.

A technical description of JLARC's methodology and analytic model is available upon request.

Exhibit 8 – Location of Capital Developments Reviewed



Source: JLARC analysis of 50 developments completed in 2006. Data from the Housing Finance Commission and the Department of Community, Trade and Economic Development Housing Division.

APPENDIX 4: SENSITIVITY ANALYSIS

To test the strength of the results presented in this report, we conducted a sensitivity analysis to illustrate how our results might vary with different economic assumptions. We tested the following four key assumptions used in our analytic model:

- A vacancy rate of 6 percent;
- A real (before inflation) market financing rate of 4 percent;
- A real (before inflation) discount rate of 7 percent; and
- An assumption that all “cash-flow” loans would be deferred until the end of the loan period, rather than having regular payments applied to the loan.

JLARC’s calculations showed the \$1,110 average monthly cost for capital units exceeded the \$883 equivalent monthly voucher cost by \$227, or 26 percent. Changes in our assumptions about vacancy rates and real market rate financings resulted in only small changes in the percentage difference in the cost gap between capital units and equivalent voucher costs. Changes in the vacancy rate between 4 and 8 percent yielded total cost differentials between 27 and 24 percent, respectively. Similarly, changing the real market financing rate to 3 percent lowered the cost differential to 23 percent, whereas raising the market financing rate to 5 percent raised the cost differential to 28 percent.

We found greater sensitivity to the different subsidies implied by loans allowing repayment from available cash flow. These loans allow developers to delay repayment until the end of the loan term, if cash flow is insufficient to make regular payments. If all payments are delayed to a balloon amount at the end of the loan period, there is a larger public subsidy than if regular payments are made throughout the loan period. By changing our assumption from regular payments (minimum subsidy) to balloon payments (maximum subsidy¹), the statewide cost differential rose from 26 percent to 39 percent.

Our calculations were most sensitive to changes in the real discount rate. Based on advice from our expert consultants, we selected a real discount rate of 7 percent. However, changing our assumption to a real discount rate of 3 percent lowered the cost differential to 12 percent over vouchers. Raising the discount rate to 10 percent raised the cost differential to 34 percent.

To further test our calculations, we created scenarios that varied both the real discount rate and the subsidy amount, the two assumptions that individually demonstrated the most sensitivity in our analysis. These scenarios created a cost differential ranging from 12 percent more than the cost of vouchers to 49 percent more. The full result of those scenarios is demonstrated below in Exhibit 8. In all cases of our sensitivity analysis, the average cost of capital developments exceeded the average cost of vouchers.

¹ A forgiven loan would increase the maximum subsidy, but our approach assumes that contractual obligations for repayment of debt will be met.

Exhibit 8 – Sensitivity Analysis

Real Discount Rate	Minimum Cash Flow Loan Subsidy*	Maximum Cash Flow Loan Subsidy**
3%	12%	22%
4%	16%	26%
5%	19%	31%
6%	22%	35%
7%	26%	39%
8%	29%	42%
9%	32%	46%
10%	34%	49%

*Assumes developer makes regular loan payments.

**Assumes developer delays repayment until the end of the loan term.

Source: JLARC analysis.

