

The seal of the State of Washington is visible in the background, featuring a portrait of George Washington and the text "THE STATE OF WASHINGTON" and "1889".

# Affordable Housing Cost Data



Annual Report to the Washington State Legislature Pursuant to  
Chapter 413, Laws of 2019 (SHB 1102, Section 1029 (4))

January 2020

REPORT TO THE LEGISLATURE

**Lisa Brown, Director**

# Acknowledgments

## **Washington State Department of Commerce**

Diane Klontz, assistant director, Community Services and Housing Division

Corina Grigoras, managing director, Housing Finance Unit

## **Washington State Housing Finance Commission**

Kim Herman, executive director

Lisa Vatske, division director, Multifamily Housing and Community Facilities

Margret Graham, communications manager

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Washington State Department of Commerce

Corina Grigoras,  
corina.grigoras@commerce.wa.gov

HOUSING FINANCE UNIT

1011 Plum St. SE  
P.O. Box 42525  
Olympia, WA 98504-2525

[www.commerce.wa.gov](http://www.commerce.wa.gov)

For people with disabilities, this report is available on request in other formats. To submit a request, please call 360.725.4000 (TTY 360.586.0772)

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# Introduction

## Report Requirement

The 2019-21 capital budget appropriation (SHB 1102, Section 1029(4)) requires the following:

*"(b) Beginning December 1, 2019, and continuing annually, the department must provide the legislature with a report of its final cost data for each project under this section. Such cost data must, at a minimum, include total development cost per unit for each project completed within the past year, descriptive statistics such as average and median per-unit costs, regional cost variation, and other costs that the department deems necessary to improve cost controls and enhance understanding of development costs. The department must coordinate with the housing finance commission to identify relevant development costs data and ensure that the measures are consistent across relevant agencies."*

## Overview

Two major programs help fund the development of affordable housing for low-income people in Washington: the Washington State Housing Trust Fund (HTF) and the Low-Income Housing Tax Credit (LIHTC).

- 1. The Washington State Housing Trust Fund:** The Washington State Housing Trust Fund program, which is administered by the Department of Commerce (Commerce), provides capital funding in the form of loans and grants for the development and preservation of affordable housing for low-income people. HTF is funded biennially by the state capital budget, having invested since its enactment in 1986 more than \$1 billion to develop over 50,000 units of affordable housing in all counties of our state. Funded projects commit to housing the intended population for 40-50 years, during which time Commerce provides compliance monitoring and technical assistance.
- 2. The Low-Income Housing Tax Credit:** The Low-Income Housing Tax Credit (LIHTC) program, which is administered by the Housing Finance Commission (the Commission), allocates federal income tax credits to developers to encourage the construction and rehabilitation of affordable multifamily housing. Housing credit in the 9% program<sup>1</sup> is allocated through an annual competitive process in which projects are evaluated and scored according to the Commission's established criteria. The 4% housing tax credit combines tax credit equity with tax-exempt bonds.<sup>2</sup> The IRS governs these programs, and a per capita formula determines annual state allocations. As of 2018, the Commission has supported \$4.6 billion in equity through the allocation of tax credits, creating or preserving 1,140 properties and 86,940 total units.

Commerce and the Commission collaborate on policies and partner on making investments in affordable housing across the state. In any given year, 30-50% of our projects "overlap," meaning they receive both an HTF award and an LIHTC allocation of tax credits.

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<sup>1</sup> Learn more about the 9% tax credit program here: <http://www.wshfc.org/mhcf/9percent/index.htm>

<sup>2</sup> Learn more about the 4% tax credit program here: <http://www.wshfc.org/mhcf/4percent/index.htm>

# Reporting Requirement History

In 2017, the Legislature directed the Joint Legislative Audit and Review Committee (JLARC) to analyze the costs of developing low-income housing (i.e., affordable to households making less than 80 percent of the area median income). In its final report,<sup>3</sup> published in January 2019, JLARC made three recommendations for Commerce and the Commission, as follows:

- ***"Recommendation #1: The Commission should identify and evaluate options for increasing the involvement of for-profit developers in the 9% tax credit program and report their findings to the Legislature. There are a variety of options the Commission could evaluate for increasing the involvement of for-profit developers in the 9% tax credit program. The Commission currently engages for-profit developers in the bond/4% tax credit program, and there may be lessons learned from this experience that can apply to the 9% tax credit program."***
- ***"Recommendation #2: Commerce should collect final development cost data from Housing Trust Fund recipients to improve cost controls. Commerce should implement procedures to collect final development cost data. Commerce may coordinate with other public funders to receive copies of certified final development costs. It should use this data to implement its 2012 recommendation to document and monitor development cost data over time. It should also use this data to inform their cost-containment policy."***
- ***"Recommendation #3: Commerce and the Commission should report development cost data to the Legislature annually. Data should include the total development cost per unit for each project, descriptive statistics (such as average and median per-unit costs), regional cost variation, and other cost data that agencies deem necessary to improve cost controls and enhance the Legislature's understanding of development costs. Commerce and the Commission should coordinate to identify relevant development cost data and ensure that measures are consistent across the agencies. The costs should be published in a format that allows the Legislature and the agencies to track development costs over time."***

Both Commerce and the Commission concurred with all three recommendations.

In 2019, following the JLARC report, the Legislature included JLARC's second and third recommendations in the 2019-21 capital budget appropriation for the HTF (SHB 1102, Section 1029(4)), as follows:

*"(4)(a) The department, in cooperation with the housing finance commission, must develop and implement a process for the collection of certified final development cost data from each grant or loan recipient under this section. The department must use this data as part of its cost-containment policy.*

*"(b) Beginning December 1, 2019, and continuing annually, the department must provide the legislature with a report of its final cost data for each project under this section. Such cost data must, at a minimum, include total development cost per unit for each project completed within the past year, descriptive statistics such as average and median per-unit costs, regional cost variation, and other costs that the*

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<sup>3</sup> Joint Legislative Audit and Review Committee, "19-02 Final Report: Analyzing Development Costs for Low-Income Housing," (2019), <http://leg.wa.gov/jlarc/reports/2018/LIH/f/default.html>

*department deems necessary to improve cost controls and enhance understanding of development costs. The department must coordinate with the housing finance commission to identify relevant development costs data and ensure that the measures are consistent across relevant agencies."*

This Commerce-Commission joint report is prepared in response to JLARC's second and third recommendations and in compliance with the 2019-21 capital budget requirements. JLARC's first recommendation is being addressed in a separate report prepared and submitted by the Commission.

# Construction of This Report

## Part 1: Commerce's Implementation Process

The first part of this report discusses Commerce's plan to obtain third-party certified final development cost data from HTF recipients. Commerce worked with stakeholders to create a preliminary set of guidelines for the HTF-funded projects. As Commerce will begin implementing this new process, modifications to these guidelines may be necessary from time to time to accommodate all project types and situations and correct any unintended consequences. As such, Commerce may need to modify its guidelines and forms to meet its legislative and policy requirements, and will notify contractors of any such changes in writing.

The 2019-21 capital budget proviso states that data for projects under that section should be included in this report. Many of the LIHTC projects analyzed in the second part of this report have also received HTF funding. For its remaining HTF projects (non-LIHTC projects), Commerce is unable currently to provide data. While the Commission has in place a cost-certification process for its LIHTC projects, Commerce has just created the process and guidelines and will begin implementing its own cost-certification process for the non-LIHTC projects starting with its 2019 HTF awards. As such, projects awarded HTF funds in 2019 and in the future will be required to provide third-party cost certifications once their construction phases are complete and the properties are occupied.

Capital projects may take anywhere from a few months to a few years from award to construction completion. As a result, final cost data for the non-LIHTC projects will not be available until that time (anticipated in 2021 or 2022). Additionally, this is a new process and requirement for the HTF clients. Commerce could not impose new requirements on projects already awarded or underway.

## Part 2: Commission's Report

The second part of this report provides the Commission's analysis of total residential project costs for LIHTC affordable housing projects placed in service during state fiscal year 2019 (July 1, 2019, to June 30, 2019). The data and numbers provided come from the Certified Public Accountant-prepared cost certifications that are required for developers to claim the tax credits. This section also sets the benchmark for future legislative reporting, including a series of assumptions and definitions that help provide for consistent measures and data characteristics across the two programs and state agencies.

# Part 1: Commerce's Implementation Process

## Overview

Commerce's implementation process is under way. As of the date of this report, Commerce has completed its planning for how to collect and analyze final project costs, and prepared and published guidelines to its HTF applicants and clients. The following is a summary of the stakeholder engagement process and the guidelines that will help HTF recipients meet the JLARC's second and third recommendations and the capital budget requirements.<sup>4</sup>

The certification of final development costs is a new process for Commerce and the HTF contractors. Changes may be needed from time to time to accommodate all project types and situations and to correct any unintended consequences.

## Coordination with the Housing Finance Commission

The Commission and Commerce are closely collaborating to implement JLARC's recommendations and submit the annual reports to the Legislature.

The Commission already collects certified final cost data for LIHTC projects. Many of the LIHTC projects also include HTF financing. Efforts have been made to coordinate Commerce's collection of certified costs with the LIHTC existing process and minimize costs and efforts for our clients as much as possible.

## Stakeholder Engagement

Commerce consults on HTF policies with the Policy Advisory Team (PAT), which is a subcommittee of the Governor-appointed Affordable Housing Advisory Board. PAT created a subcommittee of stakeholders to work with HTF staff on a plan and guidelines for meeting the new certified development costs requirements. The subcommittee included representation from the multifamily rental and homeownership development community, as well as LIHTC staff from the Commission.

Between March and August 2019, the subcommittee analyzed and discussed JLARC's recommendations and brainstormed ways to meet the capital budget requirements. The main discussion focused on what a "cost certification" constitutes. As such, JLARC staff was consulted to help clarify their recommendation for obtaining "certified" costs. JLARC staff indicated their recommendation is for Commerce to obtain "reliable and verified data" and to follow a process like the LIHTC process, in which a neutral third-party accountant reviews and certifies the project's final development costs.

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<sup>4</sup> More details can be viewed here: <https://deptofcommerce.app.box.com/s/ogusmaw8pd78qsjv5xnx8t38zbluhjf2>



## What Constitutes a Cost Certification?

Commerce staff engaged in scoping discussions with certified public accountants (CPAs) from firms that performed recent LIHTC final cost certifications, to understand possible options and determine the level of third-party review necessary to obtain a final cost certification.

For LIHTC projects, CPAs indicated that adding an HTF-specific worksheet to the LIHTC cost certification to include in their audit would not pose problems or substantially increase the certification cost. The CPAs will concurrently provide their opinion on the LIHTC and HTF information and submit their audit to Commerce at the same time it is submitted to the Commission.

For non-LIHTC projects, stakeholders and staff sought options to minimize cost. Options contemplated included compilations, reviews, exams, agreed-upon procedures, and audits. Alternatives to a project audit did not seem to result in a certification similar to the LIHTC's, as expected by the Legislature. CPAs indicated that "true certification" can be provided only via an audit. The CPAs' estimated cost to audit and certify development costs for a non-LIHTC project ranged from \$5,000 to \$10,000, depending upon the level of engagement needed for the CPA to review internal controls of the organization. CPAs indicated that depending on their level of experience with the organization, the audit can be more or less comprehensive. For example, the level of audit review might be less comprehensive if the CPA is already familiar with and convinced that the organization's internal controls are strong.

## Requirements for Projects Funded in 2019 and After

All future affordable housing projects funded by Commerce's Housing Finance Unit—starting with the 2019-21 capital budget competitively funded and directly appropriated projects, as well as HOME and National HTF projects—will be required to submit an "HTF Certified Final Development Costs" worksheet<sup>5</sup> to Commerce when placed in service. The submission will be accompanied by a certification from a third-party CPA in the form of an audit. This applies to both LIHTC and non-LIHTC projects, as described further below.

The "HTF Certified Final Development Costs" worksheet is a modified version of Form 6A, which is familiar to the HTF and LIHTC contractors. Form 6A is used to submit a new development budget via the Combined Funders Application, as well as to update budgets before contract closeout and after the project is placed in service.

The cost to obtain a third-party final cost certification of a project's final development costs is a reimbursable expense under HTF's current policies (see HTF Handbook<sup>6</sup>). Current contractors and new applicants will be encouraged to track these costs separately in their development budgets.

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<sup>5</sup> Washington State Department of Commerce, "HTF Certified Final Development Costs," (2019), <https://deptofcommerce.app.box.com/s/ogusmaw8pd78qsjv5xnx8t38zbluhjf2>

<sup>6</sup> Washington State Department of Commerce, "Washington State Housing Trust Fund Handbook," (last updated 2018), <https://deptofcommerce.app.box.com/s/f89ytc0qtime7dl6wpqke5h2zl1jwzlm>

## LIHTC Projects

Projects using LIHTC will instruct their cost certification CPA to attach the “HTF Certified Final Development Costs” worksheet to the project’s LIHTC cost certification to meet the HTF-specific requirements. The CPA will provide their opinion on the LIHTC and HTF information and submit their final cost certification packet concurrently to Commerce and the Commission.

## Non-LIHTC Projects

Projects not using LIHTC—both multifamily rental and homeownership— will obtain the third-party final cost certification of their project final development costs in the form of a project audit. HTF contractors will instruct their CPAs to submit the audited “HTF Certified Final Development Costs” worksheets directly to Commerce no more than 90 days after the project is placed in service. According to Section 406 of the HTF Handbook, “A project is considered to be placed in service once a certificate of occupancy, or equivalent, has been issued for the property.”

To save costs, HTF contractors will have the option to obtain the third-party final cost certification of their project final development costs as part of their organization’s annual audit. If this option is selected, the cost certification must be submitted to Commerce no later than 90 days from the end of the organization’s fiscal year that is being audited. For example, if the organization’s fiscal year ends on Dec. 31, the HTF third-party final cost certification is due to Commerce no later than March 30.

## Analysis and Cost Containment Efforts

The HTF’s current cost-containment policy was established in 2012 with input from PAT and a group of stakeholders in response to a legislative proviso. The policy reads as follows (HTF Handbook Section 201.2):

*“Commerce compares projects of similar type, activity, size and geographic location to determine cost reasonableness as follows:*

- *Type: Multi-family or Single-family*
- *Activity: New construction or Rehabilitation*
- *Size: Small (1-25 units), Medium (26-100 units), Large (>100 units)*
- *Location: King/Pierce/Snohomish Counties; Other Metro; Non-Metro (rural)*

*“Project costs are “reasonable” if the per-unit cost is at or below 110 percent of the average per-unit cost of comparable projects within the same funding round. If there are insufficient projects of similar type, activity, size, and location within a funding round to provide for a reasonable comparison, data from up to three prior rounds will be used. (Average per-unit costs will not be published in advance since they cannot be determined until applications have been received).*

*“Commerce may allow higher capital costs if the applicant can demonstrate that these costs would result in sufficient savings over time in operating and maintenance costs to justify the additional expense. Commerce excludes land acquisition and capitalized reserves from the cost comparison.*

*"Note: This cost containment policy is used in the application evaluation and scoring process. When there are not enough applications in a category, scoring for cost containment may need to be omitted on those applications (details are published in the HTF solicitation for applications)."*

As Commerce will begin collecting and analyzing final development costs data, it will use this data and analysis to review and improve its current cost-containment policy in collaboration with the Commission, PAT and program stakeholders.

In preparation, Commerce staff is currently working on improving our database systems and creating custom reports that will be instrumental for analyzing data and trends and shaping future policy.

# Part 2: Commission's Report

## Overview

Since the inception of the federal Low-Income Housing Tax Credit (LIHTC) program in 1987, the Commission has collected and tracked cost data. Developers cannot obtain approval from the IRS for the housing tax credits until their costs are certified. They must submit a CPA-generated report of the total sources and uses of the project's funding to obtain Form 8609 from the IRS, which enables their investors to claim the housing tax credits and thus provide equity for the project.

In addition to the third-party final cost certification process, the Commission has a robust cost-containment strategy, which is essential to the future success and continued credibility of the Housing Tax Credit program. Given the finite resource of the Housing Tax Credit, the primary objective of these cost-containment policies is to balance cost containment with promoting quality development. As referenced in the JLARC report, the Commission follows key national best practices for monitoring and controlling costs.

To this end, in 2012, the Commission developed and established total development cost (TDC) limits to benchmark and analyze costs against metrics. These limits vary by the region to better measure and acknowledge the different cost drivers throughout the state. The Commission reviews these limits annually (and resets them if necessary) using third-party data from Engineering News-Record (ENR).<sup>7</sup> The TDC limits are documented in the Development Cost Limit Schedule<sup>8</sup> as part of the LIHTC application process.

As part of the competitive application process, points are awarded based on a percentage of the amount under the TDC limit and based on the comparative cost of projects in the geographic pool.<sup>9</sup> Projects are subject to the Development Cost Limit Schedule in place at the time of application. As part of the application, projects must provide a detailed breakdown of all anticipated project costs.

## Total Residential Project Cost Versus Total Residential Development Cost

### Total Residential Project Cost

The data included in this report is based on Total Residential Project Cost (TRPC), which includes the total cost of the residential portion of a project, including land, capitalized reserves and offsite infrastructure improvements.

### Total Residential Development Cost

Total Residential Development Cost (TRDC) is the Total Residential Project Cost minus the cost of land, reserves and infrastructure. The Commission uses TRDC for purposes of analyzing projects against limits and determining competitive points because TRDC better reflects the costs over which the

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<sup>7</sup> Engineering News Record, <https://www.enr.com/>

<sup>8</sup> TDC limits (Section 3.2.7): <http://www.wshfc.org/mhcf/9percent/2020application/c.policies.pdf#page=24>

<sup>9</sup> Geographic pools (Section 5.2.2): <http://www.wshfc.org/mhcf/9percent/2020application/c.policies.pdf#page=44>

developer has control. Some developers, for example, may build on donated land, while others may have paid market price.

## Data Definitions

Table 1 shows the key data and criteria that the Commission and Commerce agreed upon for reporting cost data. The definitions are organized by General Project Data, Project Cost Data, Sources of Financing, and "Cost Per" Data.

**Table 1: Data Definitions**

Field	Description
<b>General Project Data</b>	
Sponsor	Project Sponsor (the primary developing organization)
Project Name	Project Name
Program Type	4% or 9% Low-Income Housing Tax Credit program
Project Address	Project Address
Project City	Project City
Project County	Project County
Zip	Project Zip
New Construction OR Acquisition/Rehab	New Construction vs. Acquisition/Rehabilitation of an existing building
Total Units	Includes all physical units in the property: Low-income Housing Units (income- and rent-restricted units); Common Area Units (which include manager-occupied units and sometimes community areas); and Market Rate Units (units renting at market rate without income or rent restrictions).
Total Residential Square Feet	Includes all residential areas including common areas and parking; does not include commercial square footage
<b>Project Cost Data</b>	
Total Residential Project Cost	All costs, including land, capitalized reserves, and infrastructure costs associated with the residential budget. All subtotals below are for residential costs.
Land/Acquisition Subtotal	Cost for acquiring land, buildings and any closing costs
Construction Subtotal	Materials, labor, and associated costs of residential construction; any site or infrastructure work; and contingency
Professional Fees Subtotal	Engineering, architecture, appraisals, market studies, geotech, topography, environmental reports, legal fees, development consultant, developer fees
Financing Costs Subtotal	Loan fees, interest expenses and insurance
Capitalized Reserves Subtotal	Operating and/or replacement reserves

Field	Description
Other Development Costs Subtotal	Real estate tax, insurance, relocation, bidding costs, permits/fees/hookups, impact mitigation fees, development period utilities, nonprofit donation, accounting audit, marketing, leasing expenses, and any carrying costs during rent-up (before a project is fully leased)

#### Sources of Financing

State Housing Trust Fund?	True = The project includes an investment from the Washington State Housing Trust Fund; may also include State HOME funds, National Housing Trust Funds.
State Housing Trust Fund Amount	Amount awarded from the Washington State Housing Trust Fund (through Dept. of Commerce); may also include State HOME funds and National Housing Trust Funds allocated through the Dept. of Commerce.
Private Equity from LIHTC	Private equity generated from federal Low Income Housing Tax Credits
Other State Source	Capital appropriations
Federal Source Summary	HUD Choice Neighborhoods; may also include other federal resources if available direct from the federal level
Local Source Summary	Housing Authority capital funds, local HOME funds (HUD), local housing levies, other city or county investments
Private Source Summary	Tax-exempt private activity bond cap (issued by either Commission or Housing Authority), permanent loans, other federal tax credits, subordinate loans, etc.
Sponsor Source Summary	Deferred developer fee, sponsor loan, sponsor contribution, Net Operating Income (NOI) during lease-up, seller note

#### "Cost Per" Data

Cost Per Unit	Total Residential Project Cost divided by Total Units
Cost Per Total Residential Square Footage	Total Residential Project Cost divided by Total Residential Square Feet

# 2019 Report on Low-Income Housing Tax Credit Projects

## Overview

This section includes data on projects placed in service from July 1, 2018 through June 30, 2019.<sup>10</sup>

## Project Costs

Tables 2, 3 and 4 show average cost data by county, per unit, costs for new construction vs. rehabilitated units, and a breakdown of cost categories. Highlights include:

- Total projects: 51
- Average number of units: 145
- Average cost per unit: \$231,393
- Average cost per square foot: \$264

**Table 2: New Construction Costs per Unit and Square Foot by County**

County	Average Cost Per Unit	Average Cost Per Residential Square Foot
Benton	\$192,643	\$193
Clallam	\$296,191	\$323
Clark	\$246,106	\$338
King	\$288,060	\$315
Pierce	\$241,784	\$246
Snohomish	\$215,204	\$243
Spokane	\$202,181	\$206
Thurston	\$169,639	\$178
<b>Average of All New Construction:</b>	<b>\$246,426</b>	<b>\$273</b>

<sup>10</sup> The full data set can be found here: <https://deptofcommerce.box.com/shared/static/b6i21dnsqpcyilblwjggnq4wewe0luk.xlsx>

**Table 3: Acquisition/Rehab Costs per Unit and Square Foot by County**

County	Average Cost Per Unit	Average Cost Per Residential Square Foot
Acquisition/Rehab:		
King	\$223,898	\$266
Kitsap	\$159,486	\$218
Lewis	\$143,300	\$141
Pierce	\$185,135	\$237
Snohomish	\$270,082	\$324
Spokane	\$144,405	\$212
Thurston	\$310,641	\$198
Walla Walla	\$144,556	\$155
Whatcom	\$148,705	\$239
Yakima	\$149,857	\$204
<b>Average of All Acquisition/Rehab:</b>	<b>\$208,092</b>	<b>\$249</b>

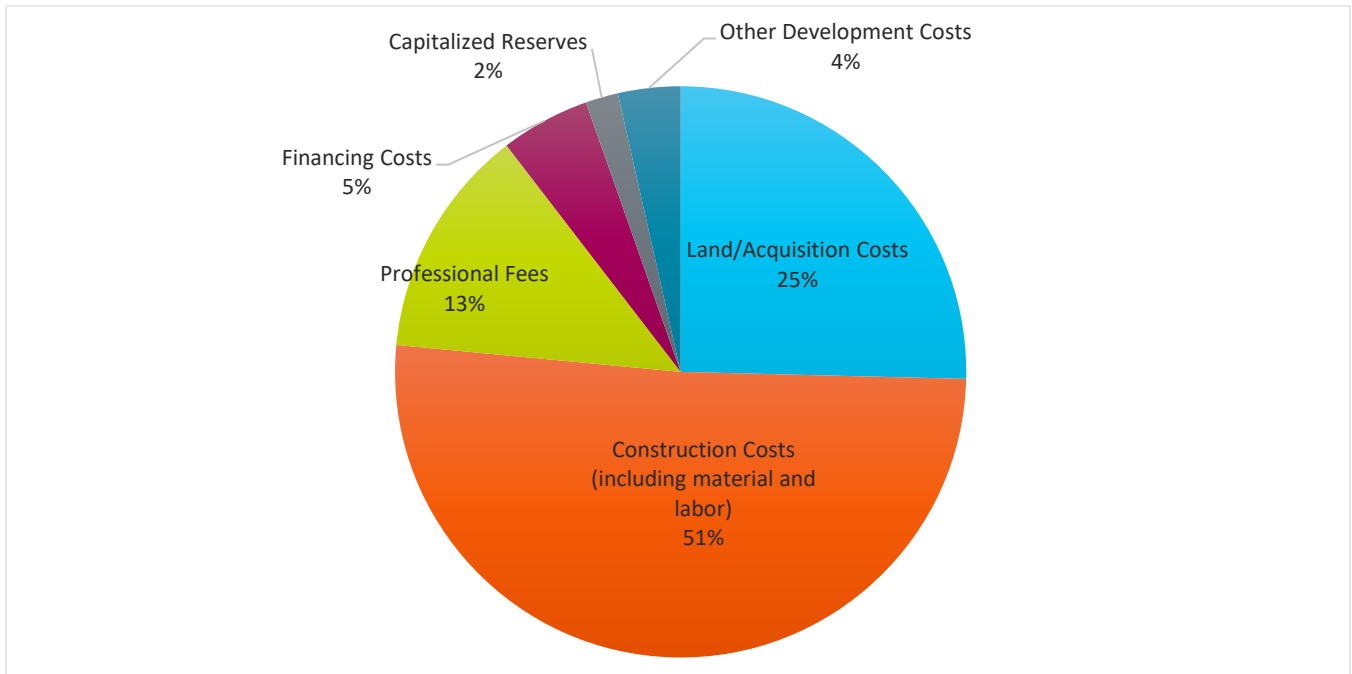
**Table 4: Total Average Costs Including New Construction and Acquisition/Rehab**

Average Cost Per Unit	Average Cost Per Residential Square Foot
\$231,393	\$264



Figure 1 shows project costs by category. Construction costs, including labor and materials, are the major category and cost drivers of these projects. Figure 2 shows the proportion of projects that include a Housing Trust Fund investment. Categories are defined above in Table 1.

**Figure 1: Project Costs by Category**



**Figure 2: Proportion of Projects that Include a Housing Trust Fund Investment**



# Project Funding Sources

Private debt includes tax-exempt bonds issued by the Commission or by the local housing authority. The "State Funds" category is solely made up of state Housing Trust Fund dollars.

**Figure 3: Proportion of Project Funding by Source**

