

May 3, 2018

To: Housing Advisory Commission
From: Commissioner Thomas Lord
Subject: **Notes on implementing the small sites housing program**

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On May 3, 2018, Ms. Wyant (HHCS, Community Development Project Coordinator) is presenting an update on the “Small Sites Multi-Family Housing Loan Program” for discussion by the full commission.

This note is my individual response to the presentation materials in the HAC packet for May 3. It contains some response to the research and analysis that City staff have done so far.

This note particularly discusses staff’s work in relation to the HAC recommendation passed on March 1, 2018, which concerned an option for the City to directly purchase small sites.

A Small Sites program is important

A Small Sites program was identified by City Council as its highest priority housing referral. That makes sense.

Berkeley's largest supply of affordable housing is its existing "naturally occurring" affordable stock: mainly but not only rent stabilized units in older buildings.

Preserving that stock and its affordability is a key strategy for not losing ground on affordability.

Market forces align against those public policy goals. Owners of older buildings are made more likely to liquidate by factors such as:

- the need for seismic upgrades
- low margins from a tenant mix that skews towards long term tenants
- life circumstance changes, such as small owners who are interested in retiring
- the possible repeal of Costa-Hawkins

If such properties are liquidated, Berkeley may well experience what has been seen in Oakland and in East Palo Alto: the consolidation of ownership of those properties by a few, very large corporations. When that kind of consolidation happens, the rate of displacement is likely to go up. For example, in East Palo Alto, a massive increase in evictions occurred when the new owner of the majority of apartments in the city raised late fees and tightened enforcement.

Conversely, residential property owned in the public interest and democratically controlled can provide housing and community stability, resilience, and opportunity to develop.

In short, a small sites program aligns with many Berkeley goals and sits at the top of the priority list for good reasons.

The staff presentation identifies serious obstacles to a viable small sites program

I want to acknowledge and thank staff for identifying some serious challenges that face a small sites program. These issues are significant and, if they can not be addressed, they indicate the project is likely not to be viable or at least likely not to be efficient and effective.

Referring particularly to the report section titled “**Considerations for Berkeley Program**”:

- For anything beyond a small, one-off building acquisition, significant HHCS, City Attorney’s Office, and Planning Department staff resources are needed but unbudgeted.
- The City’s rules for entering large contracts is, by design and by rule, a slow, multi-month process. Since a small sites program has to compete with other potential purchasers in the market, the City’s lack of agility in this area is significant.
- Two likely outside organizations to partner with the City, BACLT and NCLT, each appear to lack the current capacity to aggressively pursue a small sites program.
- If the focus is limited equity housing cooperatives (LEHC) specifically, it is noteworthy that San Francisco City staff reports anecdotal experience that tenant “accountability and responsibility” in the coop form presents challenges. Presumably this is because tenants are simultaneously learning how to cooperatively manage a property at all, and working with City staff to complete the complex transaction that will secure the property.

Additionally, City staff conducted a financial analysis of a system based on the subsidized purchase and rehabilitation of small properties, for use as housing affordable at 80% of AMI, demonstrating that the per unit subsidy needed from the City would be rather substantial.

Collectively, these factual obstacles, identified and articulated very clearly by City staff, add up to a compelling critique of a particular approach to a small sites program.

The question I will try to take up here is whether there is an alternative implementation strategy that might make the program more feasible and more desirable.

What are the essential elements of a small sites program?

Council's direction was enigmatic or, perhaps, simply vague:

The development of “a Small Sites Program to assist non-profits in acquiring multi-unit properties of 25 units or less. Consider giving priority to the creation of limited and non-equity cooperatives affiliated with a democratic community.”

From my discussions within the Berkeley community and from my general understanding of certain issues, I would interpret the direction as follows. My take on this is consistent with the San Francisco program but doesn't take it as simple recipe to be duplicated in Berkeley:

1. Council is trying to set a long-term strategic direction, not simply do a one-off acquisition. (E.g. “a Small Sites **Program**”). I would draw from this the idea that it is worth considering *partial* implementation as a first, achievable step. We can think about this in terms of what tactics are immediately possible, and what we think the longer term strategy is.
2. Council's strategic view centers the ownership of residential property, aiming for public benefit rather than private profit. (E.g., “assist non-profits in acquiring”). I would not take “non-profits” overly literally. For example, ownership by a suitably chartered B Corporation or even by the City itself could satisfy the directive from City Council. Whatever the ownership structure, the key idea is presumably not to require a perpetual return on capital from the property.
3. The emphasis is on acquiring existing multi-family residential property. I think this should not preclude City staff from considering how small sites acquisition and new development projects might synergize.

4. The City Council prioritizes the concept of democratizing the property management of this housing. Democratic control means that residents of this housing, rather than being in a relation of mutual competition mediated by a landlord, enter into relations of co-operation and organizing.¹ From the perspective of City fiduciaries, cooperative management schemes should be evaluated for their capacity to increase efficiency, to exploit self-help (rather than paid labor) where it make sense to do so, and to build active community support to make the program a success.
5. City staff, looking at the San Francisco example, has identified these elements, which here I am restating more abstractly than the staff report:
 - a. A capacity to identify properties for possible acquisition (in San Francisco, outside agencies perform this work).
 - b. Outside agency partners with the capacity and expertise to carry out complex real estate transactions, and perform outreach and eventually training to tenants. The San Francisco example suggests this outside agency would benefit from having close relations to tenant-serving organizations.
 - c. A financial model of acquisition. In San Francisco this is centered on a level of per-unit subsidy.
 - d. An internal (City staff and Council process) capacity to review and act quickly on possible purchases.
 - e. Access to private capital for acquisitions.
 - f. Policies regarding unit pricing and affordability goals.

¹“Consumers are related to each other only through their common enemy, the seller. As consumers, the tenants of a building are related only through their common landlord. As members of a community, however, they do have a network of social relationships”. *The Urban Housing Problem: Marxist Theory and Community Organizing*, Stephen E. Barton, December 1977; Review of Radical Political Economics.

Two missing elements: transition period property management and ownership

City staff has observed the need to rapidly execute purchases when the opportunity arises, because private buyers may compete for the same properties.

City staff has also observed, based on experience in San Francisco, that a property can not easily be converted over to any form for democratized management “overnight”.

Those two constraints are at odds: the market-imposed need to buy quickly vs. the social need to transition to democratic property management over a period of time.

I would therefore add two additional elements to those listed above. These are:

6. The City or a partner agency should have the capacity to take possession of a property quickly, planning to hold it for a transitional period of perhaps 1-3 years. This will allow properties to be purchased even if the envisioned eventual owners are not ready to take possession. This loosens the temporal connection between an opportunity to buy, and the time-line for conversion of the property.
7. During that transitional period, some entity, presumably *not* the City itself, must be able to provide property management, including essential rehabilitation if any is needed.

Arguably, both of those elements *could* be seen as the internal responsibility of a partner agency such as BACL or NCLT. Yet in Berkeley’s case, since these agencies currently have capacity limitations, it seems somewhat arbitrary to say that they *must* be provided by those entities. We ought to ask, is the project more viable if we consider these elements separately?

“All or nothing”? The swiss watch vs. the toolkit

Roughly speaking, two views might be taken of the long list of essential elements of a small sites program.

One possibility, recognizing that a small sites program requires *all* of those elements, is the “swiss watch” approach. In the swiss watch approach, all of the elements must be brought together and assembled in an intricate mechanism. Each individual part is relatively useless but if they can all be assembled *just right*, then perhaps the “watch” will run.

Another possibility, less risky, and more directly actionable, is the “toolkit approach”. This approach would envision an eventual small sites program as a loose assembly of independently useful tools and capacities.

In the analogy at least: a toolkit approach likely leads to better policy and better use of city resources:

Trying to assemble a swiss watch is prone to all-or-nothing failure and, anyway, even if it succeeds, the result is impressive – but fragile.

In contrast, when assembling a toolkit, at every step along the way there is a simpler job to do (add one more tool) and at every step of the way, even the *incomplete toolkit* can start to be useful.

In the end, if a small sites program is done with a “toolkit” of independently useful capacities, then the small sites program itself should prove more adaptable to changing circumstances over time.

Staging - what should be done first and what can wait?

Some of the essential elements of a small sites program simply make no sense unless others are already in place. For example, this element:

(5)(a) “A capacity to identify properties for possible acquisition (in San Francisco, outside agencies perform this work).”

is not very useful unless this element is already in place:

(5)(d) *“An internal (City staff and Council process) capacity to review and act quickly on possible purchases.”*

Applying similar logic, I think three elements stand out as “where to start”. I can see how the following can be independently useful even before a small sites program is complete. I can’t see how a small sites program can exist without these:

(5)(d) *“An internal (City staff and Council process) capacity to review and act quickly on possible purchases.”*

(6) *“The City or a partner agency should have the capacity to take possession of a property quickly, planning to hold it for a transitional period of perhaps 1-3 years. This will allow properties to be purchased even if the envisioned eventual owners are not ready to to take possession. This loosens the temporal connection between an opportunity to buy, and the time-line for conversion of the property.”*

(7) *“During that transitional period, some entity, presumably not the City itself, must be able to provide property management, including essential rehabilitation if any is needed.”*

Here, I would understand (5)(d) as primarily a City-internal project to create new expenditure rules and perhaps a dedicated account of pre-authorized funds. My understanding is that this would likely require substantial work by the City Attorney’s Office and HHCS. The City Manager and Council would presumably need to devise new rules for approving certain purchases on short notice.

Element (7) might usefully be part of the first RFI.

Element (6) might usefully entail work both internally and with potential partner agencies. (I envision creating a new outside agency to serve as a kind of holding company, but that is not the only possibility.)

Resources: implementation funding, purchase funding, and cross-subsidies

All stakeholders should expect that will take multiple years to fully implement a robust small sites program.

In my view, the \$1 million appropriated by the Council for this project should be regarded as a source of funding for internal staff time working on the implementation. Certainly the City Staff could return to City Council with a recommendation to use a portion of those funds in that way for a specific purpose (such as implementing a fast-track expenditure plan).

When considering rapid purchases, I would encourage stakeholders to consider the possibility of the City itself making all-cash purchases of properties to be held during the transition period. This will lower the financing costs to the City. This will accelerate purchases. And because the City will then have the asset, its purchase costs can be fully recovered if and when the property is sold to some other final entity.

Lastly, a small sites program in Berkeley must emphasize fiscal efficiency. That suggests:

1. Aiming for a *single* (democratic) property management organization that can serve multiple properties.
2. *Not* strictly capping household income levels or all rents, thus allowing the small sites to produce a net operating income which can be used for cross-subsidy among them, and which can be returned to the City to help fund expansion of the problem.

It should be noted that if the program can produce a net operating income, that also opens up the property for efficiently using private capital to help make property purchases.

What should go in the RFI?

In light of the above I think the RFI should emphasize the need for transitional period property management services, and the need for an efficient

“holding company” for properties in transition.

Summary: Concrete suggestions for next steps

Suggestions:

1. Embrace the “toolkit approach”, and set aside the “swiss watch” approach” to implementing a small sites program.
2. Develop an RFI emphasizing the property management function and, perhaps, the temporary “holding company” function.
3. Concurrently begin work on a fast-track expenditure process, possibly including a reserve account to fund purchases.
4. Continue to convene stakeholders to think through and plan the program.