
A Social Housing Plan for Berkeley

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1 Introduction

This report proposes a social housing program for the City of Berkeley.

In this report “social housing” means housing that is:

- owned by a municipal trust
- operated by a non-profit property management coop in which tenants may democratically participate
- affordable at a wide range of household incomes
- self-financing in the long run (though needing subsidy initially)

1.1 Why social housing?

Berkeley, like many places, is experiencing ongoing crises of economically forced displacement and unaffordable housing. Whole communities have been scattered, forced from the region. Roadways are clogged, daily, with people who work or study in the region but who must drive from hours away because they can't afford to live here. A vast number of households exist under constant, imminent threat of homelessness. Many people become actually homeless.

The problem is not limited to low income households but touches even “moderate income” households - conventionally defined as those with an income between 80% and 120% of the area median. A majority of current residents, in other words, can not afford current rents.

The social housing program described in this report is not a silver bullet that will end the problem overnight but it *is* a program that will help pay for its own expansion and, in the long run, has the potential to prevent future acute housing crises.

As described later in this report, Berkeley's *existing* and emerging affordable housing strategies help, but the social housing program addresses areas that they can not.

2 Overview

Broadly speaking, three concepts characterize the social housing program: the Municipal Land Trust, the Property Management Cooperative, and a rent price and subsidy policy. The bird's eye view:

- The Municipal Land Trust owns the properties and manages most of the money. It establishes a target rate of return for investment in additional social housing and administers a contract with the Property Management Cooperative.
- The Property Management Cooperative manages leases, operates portfolios day to day, establishes the rent price and subsidy policy and supports the democratic participation of residents who choose to participate.
- The rent price and subsidy policy, at the heart of the system, is the key to providing affordable housing. Put simply, a portion of residents who can afford to do so pay rents that exceed operating expenses; that excess revenue subsidizes residents paying lower (sometimes much lower) rents.¹

The next three *subsections* expand the overview of these three concepts. The three subsequent *sections* discuss each in detail.

¹For additional background on this subsidy mechanism, see “Social Housing in the United States” by Peter Gowan and Ryan Cooper (particularly the appendix), published in 2018 by the People’s Policy Project.

2.1 The Municipal Housing Trust

Under this program, social social housing is a portfolio of properties owned by a ***Municipal Housing Trust***, established by the City.

Legally, the Trust is an independent agency. Thus the City of Berkeley is spared entering into “the landlord business”. The Trust is similar to a traditional non-profit land trust.

The Trust does differ from traditional land trusts, however:

1. The Municipal Housing Trust owns the housing, not only the land.
2. The City appoints a simple majority of the Trust’s board.
3. In the event the Trust is dissolved, properties revert to the City or the City’s chosen successor agency, subject to restrictions that preserve affordability.

2.2 The Community Property Management Cooperative

Although the Municipal Housing Trust has ultimate authority over rent pricing, day to day operations are carried out by a second, separate agency, the Community Property Management Cooperative (“the Coop”, for short).

The Coop is responsible for the renting, maintenance, and general administration of portfolio properties.

Residents democratically govern day to day operations of the Coop, but both the City and the Trust retain emergency powers to intervene in the Coop, if necessary, to protect their interests.

2.3 “Cost-plus” rents and subsidy program

Housing owned by the trust is *rented* (not sold) to residents.²

Average rent levels are determined on the basis of *operating cost-plus*. This means that the average rent is set at the sum of:

- *operating costs* (including operating, replacement, and tax reserves)
- a *reinvestment fee* to build a fund for major improvements and adding new properties to the portfolio
- a *solidarity rent fee* which is used to reduce the rent of lower income households

Note that this defines an *average* rent. Some residents pay more, others receive a discount as a form of subsidy.

Solidarity rent allows the program to “self subsidize” and serve a broad range of household income levels without reliance on state or federal tenant-based or unit-based subsidies.

In spite of the add-ons to normal operating costs, the program forgoes a significant portion of the maximal profit that may be available if all units were leased at “market rate”.

²The program can be generalized to include limited equity housing as well. For simplicity, this report considers only rental housing.

3 The Municipal Housing Trust in greater depth

3.1 Housing trust Legal structure

The Municipal Housing Trust might be *thought of* as a form of public utility - a *housing utility* - operating as a franchise of the City. California law does not support this, however. In California, municipal franchises are limited to purposes enumerated in state law. Those allowable purposes do not include a “housing utility”.

Fortunately, there is precedent for an alternative legal structure that will serve just as well or better: the Trust can be formed as a 501(3)(c) non-profit that exists primarily to lessen the burden to the City of Berkeley of managing the social housing portfolio.¹

The Trust is an independent agency but in order that the City maintain ultimate control over the portfolio, the Trust is formed as a membership-based non-profit with two classes of members: *charter members* and *resident members*:

3.1.1 Charter member(s)

There is initially only one Charter Member - the City of Berkeley itself².

¹For many years the City of San Diego used a similarly constructed non-profit to provide the City’s IT services.

²If in the future the City of Berkeley wished to expand the program beyond City limits, it could choose to add other jurisdictions or entities as Charter members.

The City Council, as the sole charter member, appoints a simple majority of board seats. The charter member (City) must approve any proposed changes to the charter and may initiate any such change. Thus, the City controls the Trust's charter and a majority of the board seats.

The City's power is limited in one way: owing to the non-profit status and purposes of the Trust, the City can not undo the dedication of social housing properties to broadly affordable housing.

3.1.2 Resident members

Residents members (all current residents of the portfolio) elect a minority of board members (one fewer the number appointed by Council). Residents thus have non-trivial democratic power in the Trust, but the City is in ultimate control.

3.1.3 Chartered purposes of the Trust and dissolution

The chartered purposes of the Municipal Housing Trust are to:

- relieve government of the burden of developing a social housing portfolio, acting as the portfolio's fiduciary in pursuit of City aims
- provide residents with fit, affordable housing in consultation with residents
- develop educational materials informing residents and the public generally about the program

In the event of dissolution of the Trust, properties revert to the City, the City's designee, or a third part non-profit in that order of priority, subject to the constraint that the affordability of units must be preserved indefinitely

3.2 Operating the Trust

The Trust operates day to day with a very small, professional staff. Their duties are to:

- Negotiate and monitor a contract with the Property Management Cooperative.
- Ensure that rents charged by the Coop are consistent with the fiscal and equity policies established by the Trust's Board.
- Receive gross income from the Coop, defined as gross rents net day-to-day operating expenses (which include maintenance of an operating reserve).
- Maintain a property tax reserve, and, consistent with policies set by the board, maintain a replacement reserve, reinvestment reserve (for acquiring or building additional housing). Remaining revenues (if any) are put into an excess income fund.
- In partnership with the Coop, solicit bids and contract for major restorations, repairs, and improvements as needed.
- Provide periodic fiscal reports and general updates to the board.
- Purchase or contract to build additional residences with board approval.
- Provision appropriate legal representation and insurance for the Trust according to policies set by the Board.
- Periodically transfer excess income, if any, to the City of Berkeley.

3.3 The Trust's relation to City Council

The Trust is an independent 501(c)(3) over which the City of Berkeley, acting through City Council, has certain political control. Specifically,

- A simple majority of the board is appointed by Council, the remainder elected by residents of Trust housing.

- Charter changes must be approved by the City of Berkeley and the City of Berkeley can initiate charter changes.

The recommendation of this report is that the City should appoint 9 members of the board, each council member choosing one board member in accordance with Berkeley's Fair Representation Ordinance.

With narrow exceptions, board meetings are open to residents and the public, and include opportunities for public comment.

3.4 The Trust's relation to tenants

Residents of trust housing participate in Trust governance by electing a minority of board members and by publicly participating in board meetings. This gives tenants the opportunity to participate in decision making about (for example):

- major repairs and improvements
- rent level policies within which the Property Management Coop must operate

3.5 Rationale for the Trust

1. Why have a Municipal Housing Trust when local land trusts and coops already exist?

The Municipal Land Trust system has four key advantages:

- a. Having a single owner of an entire portfolio of land and structures allows for cross-subsidization of rent from higher to lower income residents in a tax efficient way.
- b. Giving the City of Berkeley control over the charter and a simple majority of the board means that the public investment in affordable housing

yields genuinely *public* wealth (in contrast to fully privately owned land and coops).

- c. Having the Trust as a distinct entity spares the City of the burden of entering “the landlord business”.
- d. Consolidation of the portfolio enables economies of scale in property management, and easier access to lines of credit.

2. **Conventional affordable housing developers that leverage HUD funds, tax credits, and state-level funding work great! Why try something new?**

Conventional affordable housing, a product of federal legislation since 1968, has never produced adequate amounts of affordable housing and lately has shown its incapacity to respond to a housing market whose dynamic is to push out a *majority* of current residents.

Conventional subsidy approaches rely on the federal government’s willingness and capacity to provide perpetual returns to capital in the form of tax credits and rental vouchers.

The social housing program designed here can fix neither of those problems overnight but it can help solve immediate problems - serving a broad range of incomes and not relying on fickle HUD policies and funding levels. As it scales, it helps to establish a world in which housing is truly a human right, a useful thing for and by people without simultaneously requiring it to perpetually provide returns to capital.

4 Property Management Coop in greater depth

4.1 Management Coop legal structure

While the Trust legally owns the pool of social housing, day to day operations are carried out by a separate organization: the Property Management Coop.

As with the Trust, the Coop is formed as a membership-based non-profit with two classes of member. In contrast to the Trust, housing residents have greater say over the governance of the Coop - although the City of Berkeley still holds a kind of emergency brake.

4.1.1 Resident members

Residents of the social housing system are one class of members of the Coop. They are able to vote for a *simple majority* of board positions.

4.1.2 Charter member(s)

There is initially only one Charter Member - the City of Berkeley itself¹.

The City Council, as that lone charter member, appoints a minority of board seats.

¹If in the future the City of Berkeley wished to expand the program beyond City limits, it could choose to add other jurisdictions or entities as Charter members.

4.1.3 Chartered purposes of the Coop and dissolution

The Coop's chartered purpose is to relieve government of the burden of providing property management services for the social housing portfolio.

In the event of dissolution, the assets of the Coop are transferred to the Trust or its successor, or the City, subject to the constraint that resident rental contracts must be assumed by that successor. The democratic power of tenants over property management must not be diminished by this transfer.

4.1.4 Coop member powers and staff

Day to day operations are managed by a small staff that is overseen and directed by the board. Decisions by a simple majority of board members is sufficient for these purposes.

Major decisions (such as altering the charter) require a super-majority of the board (and thus the approval of at least some Council-appointed board members).

The City, as the lone charter member, is granted limited emergency power to intervene to protect City interests. The Trust also holds the Coop in check by means specified in the contract negotiated between the Trust and Coop.

4.2 Day to day operations and staffing

The Coop operates day to day with a very small, professional staff. Example tasks:

- listing units, qualifying applicants, and leasing units
- managing cash flows and operating reserve
- performing routine monitoring and maintenance tasks as needed, directly, via sub-contracted services, or through resident volunteerism

- conforming with City inspection and reporting requirements
- facilitating and monitoring tenants who self-organize for reasonable self-help purposes or for assisting other tenants for such needs
- supporting tenants who choose to organize building-specific coop councils
- collecting rents, maintaining an operating reserve, and transferring net operating income to the Trust per contract

4.3 Relation to the Municipal Housing Trust

The relation between Trust and Coop is governed by a negotiated contract that determines the financial relation between the two organizations and broadly defines requirements for maintaining the condition of the properties.

4.4 Relation to tenants

The coop is highly accountable to tenants who collectively have the power to elect a simple majority of the board.

The coop also empowers tenants to organize, to perform self-help maintenance and improvement according to coop standards, and to provide mutual aid for such purposes.

4.5 Relation to City Council

The Council controls a minority of board seats - one fewer than the simple majority elected by tenants.

4.6 Rationale for the Coop

1. Why is property management separated from the Trust?

Having both the Trust and the Coop separates the fiscal management of the properties (the Trust) from the management of their day to day usefulness to tenants (the Coop).

Those two aspects of the housing - a use value for tenants vs. capital for the property owner - are potentially in conflict. For example, the tenants might prefer to skimp on building replacement reserves or saving to expand the portfolio in order to spend lavishly on immediate amenities. Conversely, the property owner might prefer to defer or skimp on routine maintenance in order to acquire more property quickly. There is a natural tension that arises just because the housing is simultaneously capital on the one hand, and a useful home on the other.

Separating the Trust and Coop into two separate agencies manages that tension of competing interests by assigning the two sides to two entities who negotiate a contractual relationship. The City monitors both agencies and (if need be) can step in as the ultimate authority. It is a system of checks and balances.

2. Why should tenants have such power over the Coop?

The Coop is (for the most part) under the democratic control of tenants because of a strong alignment between the role of the Coop, and the interests of tenants.

Residents (we presume) want well maintained homes, their choice of improvements when possible, cost efficient property management which helps to keep rents down, and the freedom to contribute to the maintenance and improvement of their homes if they are so inclined.

From that perspective, no other possibility than democratic property management will do.

3. **So is this one of those coops where residents must do assigned chores and participate in endless meetings? That kind of thing?**

No. The Coop structure allows residents of social housing to participate as little or as much as they please. For tenants with other things to do, living in social housing is scarcely different from ordinary rental housing.

5 Financial structure, internal subsidies

This section presents a moderately detailed business model for social housing. For simplicity of presentation, some simplifications are made. For example, the model is described in terms of homogeneous “housing units” which are all equal in size and quality, though in real life housing units vary in quality and size.

(A glossary of terms used here is provided at the end of this section. Digital versions of this document link terms to their definitions.)

5.1 Where the rent goes

5.1.1 The Coop share of rent revenues

Each month the **Property Management Coop** collects rents from the entire portfolio of units. This is the program’s *gross rental revenue*.

The Coop pays its staff to manage rental contracts, perform routine maintenance, and assist tenants. It pays for materials needed for routine maintenance. Additionally, the Coop deposits a portion of rents in an *operating reserve* fund, as needed.

5.1.2 The Trust's share of rent revenues

The Municipal Housing Trust receives the rent revenues, minus the Coop share of rent revenues. This is the program's *gross rental income*.

In addition to the Trust's own office, staff and material expenses, insurance and taxes, the Trust builds a replacement reserve for major maintenance projects and improvements. Remaining funds are divided, by policy, between a *reinvestment reserve* that is used to acquire or build additional units, and an *excess income* fund that is passed to the City. Note that the program would likely be functioning well if it was providing affordable units efficiently *and* growing the *reinvestment reserve* – with an *excess income* at or near 0.

5.2 How internal subsidies work (“cost plus” rents)

The money flow described above assumes only an aggregate *gross rental revenue*, the sum of rents from all units. In effect, there is an *average program rent* per unit.

As with so-called inclusionary housing, internal subsidies occur because tenants of means pay at or above the program average rent, households with insufficient income pay below the average rent.

Thus, rents near or above the average rent effectively subsidize tenant households in need.

A critical difference from inclusionary housing is that the goal of social housing is to maximize affordability rather than profit. Thus, the *reinvestment reserve* built by the Trust grows slower than it would in a market rate project, in exchange for significantly greater affordability.

The exact mix of below-average and at-or-above average rents is flexible, and a matter of policy.

For short-hand, this system can be called “cost-plus” because the average rent, determined by policy, is given by the (mostly exogenous) operating costs of providing a unit, plus a *solidarity rent* for cross-subsidy uaw, plus a contribution to the *reinvestment reserve*.

(How far does this approach to internal subsidy go? More on that in a later subsection.)

5.3 Cap rate analysis

In conventional real estate financial discussions, *cap rate* (short for “capitalization rate”) is the net operating income of a portfolio divided by the market price of the portfolio. It is a measure of the “returns to capital” realized by property owners. If a property has too low a cap rate its market price is likely too high. If a property has too high a cap rate, its market price is likely too low. Global average return to capital plus risk assessments specific to real estate determine whether a cap rate is “too low” or “too high”. Today, as a mere rule of thumb, a 5-6% cap rate is the Goldilocks range in our region.

The social housing program described here can be viewed through a cap rate lens by regarding two expenditures from rent revenue as the *program net operating income*:

program net operating income = *solidarity rent* + *reinvestment reserve*

The program net operating income, in other words, funds internal subsidies for low income tenants, plus program expansion.

The *program cap rate*, therefore, is that *program net operating income* divided by the *capital cost per unit*.

Cap rate analysis is useful for thinking about the tradeoffs between internal subsidies (i.e. *solidarity rent*), the *reinvestment reserve*, and the amount of *forgone profit*.

Note that, in practice, the *program cap rate* is a policy choice under control of the Municipal Trust. A rate that falls below the market's Goldilocks range (e.g. 2.75% rather than 5.5%) represents profit foregone in order to keep the *average program rent* below market prices.

5.4 Example rent schedule

To illustrate the power of the business model described above, consider the example scenarios that follow. Both scenarios assume:

capital cost per unit = \$500,000

And we assume that the Trust forgoes half the potentially available profit, so that:

program cap rate = 2.75%

For this unit, then:

program net operating income = \$500,000 * 0.0275 ≈ \$13,800

Assuming an effective property tax rate of 0.8%:

assumed taxes = \$500,000 * 0.008 ≈ \$4,000

The hard operating expenses of unit must cover Trust and Coop labor and materials, property taxes, insurance, and business costs such as license fees and insurance. The amount is exogenously given and difficult to estimate. Informal research was used to arrive at this estimate:

assumed hard operating costs = \$5,000

In per-month terms, for one unit:

program net operating income = \$1,150 / mo.

property taxes = \$333 / mo.

hard operating costs = \$417 / mo.

average program rent = \$1,900 / mo.

Note that by the “30% rule”, a rent of \$1,900 / mo. is affordable at the current median household income in Berkeley. A rent of \$1,900 for an average, small, two bedroom unit is also significantly below current market prices.

5.4.1 Scenario 1: maximizing program growth

In scenario 1, all tenants pay the *average program rent* of \$1,900 per unit. The full *program net operating income* of \$1,150 / mo. accumulates in the *reinvestment reserve*.

Since the *reinvestment reserve* accumulates at 2.75% per year, the program can self-finance a 50% expansion in about 15 years, and double its size in about 30.

5.4.2 Scenario 2: maximizing depth of affordability

In scenario 2, no *program net operating income* goes to the *reinvestment reserve*, and all of it goes to subsidizing tenants who can’t pay rent at all.

So, for example, a portfolio might be divided as:

units = 100

of units at \$1,900 per month = 40

of units at \$0 per month = 60

More realistically, few or no units would need to rent at \$0 per month. More likely, even the most deeply subsidized units would yield a rent of a few hundred dollars. Thus, even a portfolio with 60% of the units made deeply affordable can accumulate *a little* towards reinvestment.

5.5 Definitions

Note that some terms that are common in real estate economics are not always used consistently. Thus, the definitions here may be slightly different from what is familiar from another context.

units

The total number of units in the Trust portfolio.¹

average program rent

The average per-unit rent of the program. Individual unit rents may be below or above this average.

The Trust sets a *target average program rent* by policy.

The *realized average program rent* is what the Coop actually collects:

average program rent = *gross rental revenue* ÷ *# units*

5.5.1 *capital cost per unit*

The all-in cost of building or acquiring and rehabilitating a rental unit.

Coop expenditures

The total amount spent by the Property Management Coop. This includes labor and material for routine maintenance, legal expenses, insurance, and contributions to an *operating reserve* fund.

¹For brevity, this presentation assumes units of uniform size and quality. The generalization to a heterogeneous portfolio is straightforward.

excess income

gross rental income (aka Trust income) net *Trust expenditures*.

forgone profit

The difference between the *program net operating income* and the [*net operating income*] that would be typical of a market rate portfolio.

This is reflected in cap rates. The cap rate of a market rate portfolio in the Goldilocks range might be 5.5%. The *program cap rate* for social housing might be set by policy at half that: 2.75%.

gross rental income

What is left from *gross revenue* after *Management Coop expenditures* are paid. This money is transferred to the Municipal Trust.

gross rental income = *gross rental revenue* - *Coop expenditures*

gross rental revenue

The aggregate amount collected in rent. This is the revenue stream of the Property Management Coop.

gross rental revenue = *average program rent* * *# units*

operating reserve

A fund maintained by the Coop, used to close short-term gaps between *Coop expenditures* and [*gross rental rental*] net other obligations.

program cap rate

program cap rate = *program net operating income* / *capital cost per unit*

The program cap rate is a measure of the amount tenants pay to fund internal subsidies and program expansion. It is one of the primary policy choices made by the Municipal Trust.

5.5.2 *program net operating income*

program net operating income = *reinvestment reserve* + *solidarity rent*

The *program net income* is the total amount of revenue available for internal subsidies and program expansion.

reinvestment reserve

A fund maintained by the Trust and used to expand the program through acquisitions and rehab, or through new development

Trust expenditures

The Trust divides *gross rental income* into:

- *contributions to a replacement reserve*
- *contributions to a property tax reserve*
- *insurance*
- *labor and materials*
- *contributions to a **reinvestment reserve***
- ***excess income***

solidarity rent

Rents paid by some units, in excess of operating costs, taxes, and reinvestment reserves.

Solidarity rents are used to reduce rents for tenant households with lower incomes.