SANTA MONICANS FOR RENTERS' RIGHTS

Serving the Needs of All Santa Monicans Since 1979

July 24, 2023

Re: Agenda Item 13A for July 25, 2023 City Council Meeting (Housing Commission Report) – The Need for Further Study, Including Financial Modeling, to Determine Whether Santa Monica Can Create A Fair, Effective and Efficient Affordable Home Ownership Program

Dear Councilmembers:

Santa Monicans for Renters' Rights ("SMRR") has reviewed with great interest the Santa Monica Housing Commission's May 7, 2023 Report entitled "Creating Equity: Affordable Home Ownership in Santa Monica" ("the Report"). SMRR has long shared the goal of creating affordable homeownership opportunities, in addition to affordable rental opportunities, ***if it can be done fairly, effectively and efficiently***. For example, since 2008 each SMRR Platform (adopted by a vote of the SMRR general membership) has provided:

> The City should facilitate below-market-rate homeownership and rental opportunities for very-low-income and low-income households that live or work in Santa Monica. SMRR opposes condo-conversion schemes that create displacement and harassment risks for existing residents.

SMRR Platform at Plank B.9.

SMRR appreciates the effort that the Housing Commission put into the Report, and SMRR particularly appreciates the Housing Commission's apparently strong agreement with SMRR that any potential program for the conversion of rental housing to ownership housing must avoid displacement and harassment risks for existing residents.[1] However, for the reasons set out in detail below, SMRR believes far more work must be done—including financial modeling (which is completely absent from the Report)—before the Housing Commission, the City Council, or the community can credibly determine whether any of the proposals put forward in the Report represent sensible policy and/or a proper use of the City's limited affordable housing funds. Principles of good and responsible governance require that no decisions regarding potential uses of taxpayer funds (or supporting legal changes) should occur until the additional work necessary for a credible decision is performed by Staff and the Housing Commission, and vetted by the City Council and the community.

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[1] For example, in order to avoid the risks of tenant harassment and displacement, the Housing Commission recommends that a non-profit entity purchase a building before the process of converting it to ownership housing commences. See Report at 20.

I. THE REPORT DOES NOT PROVIDE OR LINK TO INFORMATION ABOUT EXISTING PROGRAMS IN OTHER JURISDICTIONS THAT IS SUFFICIENT TO DEMONSTRATE THAT THE REPORT'S PROPOSALS ARE FAIR, EFFECTIVE AND EFFICIENT USES OF THE CITY'S LIMITED RESOURCES

On the first page of the "Introduction" to the Report, the Housing Commission recognizes the need to demonstrate that an affordable homeownership program can be implemented in Santa Monica in a fair, effective and efficient manner:

> Affordable homeownership may not seem feasible in Santa Monica due to the high cost of living, and therefore a poor use of limited city and federal resources. However, successful programs in similarly costly cities like San Diego[1] and New York City[2] demonstrate otherwise.
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> [1] https://www.sdhc.org/housing-opportunities/affordable-for-sale-housing/
> [2] https://www.nyc.gov/site/hpd/services-and-information/hdfc.page

Report at p. 3.

The Report makes no further reference to the San Diego or New York City programs, or to any other existing local government program (although it does reference HUD rules that govern any federally funded Section 8 homeownership program that a local housing authority may choose to create). However, a review of the information on the cited websites reveals material differences between the San Diego and New York City programs on the one hand, and the Report's proposals on the other hand—as well as the absence of critical financial information. Consequently, SMRR respectfully submits that the Report's citation to the existence of the San Diego and New York City programs does not by itself constitute sufficient analysis to credibly "demonstrate" that the Report's proposals are viable and wise.

The San Diego Program

The San Diego program is 20 years old. It consists of 257 total units, which represents roughly 1/20th of one percent of the total housing stock in San Diego. This is equivalent to roughly 25 units in Santa Monica.

The San Diego units were constructed by private developers in either 2003 or 2006—a time when land and construction costs (as well as the market value of the units) were much lower than they are in Santa Monica today. The units then were sold to eligible lower or moderate income homebuyers at below market prices affordable to them, with the San Diego Housing Authority ("SDHA") taking back a promissory note and second deed of trust for the difference between the below market price paid and the actual market price of the unit at the time of the first sale (an amount that the SDHA presumably paid to the private developer back in 2003 and 2006). The homebuyers paid the purchase price through 30 year fixed-rate mortgages from third-party lenders. The second loan is repayable to the SDHA as a balloon payment at the end of the 45 or 55 deed restriction period.

Unlike the proposals in the Report, the San Diego program guidelines require the purchasers of the units to reside in them as their primary residence at all times (i.e., the homebuyers may not rent the units to others). The guidelines also require (apparently like the proposals in the Report) that any resales of the units during the 45 or 55 year deed-restriction period be made to the same income-type household as originally purchased the unit at a price the SDHA calculates is affordable to such a household (a price that the guidelines state will be below the then current market price). The new homebuyer must agree to abide by all the same program restrictions, and must assume the obligation to repay the original loan by the SDHA at the end of the deed-restriction period.

A large number of critical questions regarding the San Diego program are left unanswered by the cited website. These include, but are not limited to:

Why has San Diego decided not to add any units to this program in the last 17 years?

What did it cost the SDHA to partially finance the original purchases back in 2003 or 2006, and what would it cost to replicate that aspect of the program model today?

What does it cost SDHA to administer the program?

Has SDHA incurred other costs (e.g., protecting the unit from foreclosure to the third-party lender who financed the homebuyers' portions of the purchase price, covering any homeowner association dues or assessments missed by the homebuyers, etc.)?

Why did SDHA elect to require owner occupancy (i.e., preclude the homebuyers from renting to others)?

How many of the original homebuyers have sold their units to date, and were those sales voluntary or compelled to avoid foreclosure (e.g., due to missed mortgage payments, missed Homeowners Association dues or assessments for major repairs, etc.)?

What financial gains, if any, have been obtained by persons who sold their units subject to the affordable price resale requirement?

New York City Program

The New York City program is roughly 50 years old. It consists of more than 1100 limited-equity cooperative buildings that, according to a March 2020 Curbed NY article that SMRR located, include some 25,800 units. These units represent roughly 4/5ths of one percent of the total units in New York City, which would equate to roughly 400 units in Santa Monica.

Many of these buildings were acquired by New York City in the 1970s and 1980s when the landlords abandoned them (an acquisition pathway not available in Santa Monica), and then the City rehabilitated them over time. More recently, some undisclosed number of buildings were constructed (and, while not clear from the relevant website, maybe some other recent buildings were acquired and rehabilitated).

The precise rules governing the original unit purchases apparently vary somewhat among the buildings. Each homebuyer must meet the income restrictions imposed for the particular unit. The precise mechanism for calculating sales price is not disclosed on the cited website (although it necessarily is limited given the income restrictions on eligible purchasers and the nature of the limited-equity cooperative model of affordable homeownership). The source of purchaser financing likewise is not disclosed.

Unlike the proposals in the Report, the typical cooperative building in the New York City program requires the purchasers of the units to reside in them as their primary residence at all times (i.e., the homebuyers may not rent the units to others, although subletting during a temporary absence may be allowed in some buildings). The typical cooperative building also requires (apparently like the proposals in the Report) that any resales of the units be made to the same income-type household as originally purchased the unit (which inevitably limits the resale price well below market price). In addition, a portion of the profit on any resale must be paid to the cooperative as a "flip tax" (which uses the money for repairs and maintenance), although the percentage varies by building.

A large number of critical questions regarding the New York City program are left unanswered by the cited website. These include, but are not limited to:

What did it cost New York City to recently construct new buildings (and, if applicable, to recently acquire and rehabilitate non-abandoned buildings)?

What does it cost New York City to administer the program?

Has New York City incurred other costs (e.g., providing loans to individual homebuyers, serving as a backstop to the cooperative buildings in the event mismanagement or unexpectedly substantial repairs require infusions of funds, etc.)?

How do purchasers finance their purchases?

Why did New York City elect to require owner occupancy (i.e., preclude the homebuyers from renting to others)?

How many of the original purchasers have sold their units to date, and were those sales voluntary or compelled to avoid foreclosure (e.g., due to missed mortgage payments, missed Cooperative dues or assessments for major repairs, etc.)?

What financial gains, if any, have been obtained by persons who sold their units subject to the resale requirements?

Section 8 Homeownership Program

At a later point, the Report quotes in part and cites HUD's online general "Overview" of the Section 8 Housing Choice Voucher Homeownership program:

> The HUD Housing Choice Voucher (HCV) homeownership program allows families that are assisted under the HCV program to use their voucher to buy a home and receive monthly assistance in meeting homeownership expenses. The HCV homeownership program is available only to families that have been admitted to the HCV program and each PHA has discretion to determine whether to implement the HCV homeownership program in their jurisdiction.
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> To participate in the HCV homeownership program, the HCV family must meet specific income and employment requirements (employment requirements do not apply to elderly and disabled families), be a first-time homeowner as defined in the regulation, attend and satisfactorily complete the pre-assistance

homeownership and housing counseling program required by the PHA, and meet any additional eligibility requirements set by the PHA.[47]

[47] https://www.hudexchange.info/programs/public-housing/hcv-homeownership/

Report at 21. Although not mentioned in the Report, the cited website provides links that shed some light on the nature of the existing programs in jurisdictions that have elected to stand up such a HCV homeownership program. This limited information makes clear that mere citation to the potential for such a program is not sufficient by itself to credibly demonstrate that implementing such a program in Santa Monica is viable or wise.

In particular, the website links to a spreadsheet identifying the total number of new and ongoing participants in each existing program for each year from 2015 through 2020. Sorting the spreadsheet to California reveals that the (1) the 42 programs in California have a combined total of about 400 participants, (2) there has been no growth in the number of participants in the programs over that six year period, (3) the City of Los Angeles has a program with just 40 participants, and (4) San Francisco has a program with just four participants.

The website also links to a January 19, 2022 HUD webinar with representatives from what HUD considers high performing programs in Columbus Ohio (a program that had averaged roughly 11 to 14 home purchases per year from the approximately 13,500 voucher holders), Fort Worth Texas (a program that had averaged roughly 13 home purchases per year from the approximately 6,000 voucher holders), Louisville Kentucky (a program that had averaged roughly 25 home purchases per year from the approximately 11,000 voucher holders), and the State of Michigan (a program that had averaged roughly 50 home purchases per year from the approximately 29,000 voucher holders). The representatives from these jurisdictions—which undoubtedly have far lower housing costs than Santa Monica—stated that the very high prices in their markets as of January 2022 and low inventory had largely brought their programs to a standstill at that time. The representatives also discussed the substantial administrative effort historically required to make their programs successful.

This limited data leaves a large number of questions unanswered, including but not limited to the following:

What did it cost Los Angeles to stand up its program?

What does it cost Los Angeles to administer its program?

Are there other costs that Los Angeles (or other jurisdictions) have incurred (e.g., the need for pre- or post-closing financial assistance to the purchaser beyond the voucher payments)?

How do participants in the Los Angeles program finance their downpayments?

What lenders finance the home purchases in the Los Angeles program?

What is the price of a unit that a participant in the Los Angeles program could afford?

What explains why the Los Angeles program consists of just 40 participants?

What explains why there has been no growth in the Los Angeles program from 2015 through 2020?

What financial gains, if any, have participants in the Los Angeles program obtained (note that HUD regulations prohibit participants from leasing or selling the properties while they remain in the program)?

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In short, SMRR believes a much deeper understanding of the existing programs referenced in the Report is a necessary (but not sufficient) precondition to credibly evaluating whether those same or somewhat altered programs could or should be adopted in Santa Monica.

II. **THE REPORT DOES NOT PROVIDE ANY OF THE FINANCIAL ANALYSES OF THE PROPOSED PROGRAMS AND POTENTIAL ALTERNATIVE USES OF CITY FUNDS THAT ARE NECESSARY TO A CREDIBLE EVALUATION OF THE REPORT'S PROPOSALS**

In order to credibly evaluate the broad concepts recommended in the Report, pro forma financial analyses of the proposed affordable homeownership programs also are necessary in order to assess (1) what it would cost the City to design, fund and administer these programs, (2) how many people at what income levels could feasibly utilize these programs, (3) what benefits would the participants in these programs receive, and (4) what risks would the participants take (e.g., incurring large unit or building repair costs, and potentially losing their homes if unable to afford these costs). If these pro forma financial analyses suggest one or more programs could be financially feasible and effective in Santa Monica, similar pro forma analyses would be needed of alternative affordable housing programs in order to compare the cost-effectiveness of the proposed programs and alternative programs. Assuming the comparative pro formas indicated one of the proposed programs could be cost-effective, further financial analysis would be required to determine the potential additional costs (if any) that adoption of the proposed programs would have on remaining renters (e.g., would rents rise from a reduction in supply?).

The Report fails to supply any of this necessary financial analysis, and therefore does not provide a credible basis for evaluating the Report's proposed programs.

III. **IF AND WHEN A CREDIBLE CASE IS PRESENTED FOR THE REPORT'S PROPOSED AFFORDABLE HOMEOWNERSHIP PROGRAMS, OR SOME ALTERNATIVE PROGRAM, ADDITIONAL ATTENTION WILL BE REQUIRED TO ASSURE THE PROGRAMS ARE ADMINISTERED FAIRLY**

Assuming the requisite work discussed in prior sections of this letter indicates that the Report's proposed programs could be effective and efficient, considerable additional work will be required to assure that they are fair. As the discussion in Part I above of existing programs makes clear, only a small number of persons will be able to take advantage of any affordable homeownership opportunities. This means that the process for selecting who obtains these benefits must be fair and must be viewed by the community as fair.

One obvious requirement is that those who have participated and will participate in the evaluation and adoption of the currently proposed and any ultimately adopted programs must be precluded from actually utilizing the programs (as sellers or buyers). Failure to adopt this rule would raise concerns that the evaluation and adoption process was guided by self-interest rather than the community's best interest, and would raise concerns that the selection process itself was rigged to favor insiders. True or not, the appearance of impropriety would be anathema to good governance principles and undermine community support for any ultimately adopted program.

Many additional potential criteria undoubtedly would come to mind, and would have to be vetted both for validity and for legality (for example, prioritizing those with the longest period of residence in the community, requiring residents of existing buildings all consent, etc.). Consideration of such potential criteria is premature until there first is a potentially effective and cost-efficient program to consider.

IV. IF AND WHEN AN APPARENTLY FAIR, EFFECTIVE AND EFFICIENT PROGRAM IS IDENTIFIED, THE CITY SHOULD PROCEED WITH A PILOT PROGRAM TO TEST WHETHER THESE THEORETICAL CONCLUSIONS ARE BORNE OUT IN THE REAL WORLD

Prudence and good government principles dictate that, should it appear possible to stand up a fair, effective and efficient affordable homeownership program, the City should begin with a pilot program in order to determine whether there is proof of concept in the real world conditions prevailing in Santa Monica. Council adopted this approach when it developed the Preserve Our Diversity rent subsidy program, and valuable lessons were learned from both the initial pilot and the expanded pilot programs.

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In sum, SMRR supports the concept of an affordable home ownership program in Santa Monica to the extent it can be fair, effective and efficient. The Report does not yet provide the necessary data from which to make a credible decision about whether that is in fact possible. Council should make no decisions unless and until the requisite data is developed.

Thank you for considering our views.

Sincerely,

Denny Zane
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