To: Kristen Clements and Josh Ishimatsu, City of San Jose
From: Rick Jacobus, Street Level Advisors
RE: COPA Ownership Strategies
Date: January 19, 2023

Executive Summary

Right to purchase policies are preservation strategies that promote the transfer of property ownership into the hands of tenants and/or affordable housing developers by enabling tenants to exercise a first right of purchase. One key question for right to purchase policies is the form of ownership that will result from the transfer. This memo outlines a number of potential legal and financial strategies for structuring tenant ownership/tenant control of existing buildings. The memo outlines concerns and considerations related to each model and recommends that San Jose plan to support a range of models under different circumstances as no one model is appropriate for every case. The following table provides a high level summary of the models considered.

Ownership Model	Description	Advantages	Concerns/Challenges
COPA Rentals	City-approved nonprofit agencies purchase and manage buildings as permanently affordable rental housing.	Faster transactions, no need to create new resident ownership structure, ability to leverage outside housing funding.	Lack of tenant asset building and resident control over management, difficulty finding nonprofits willing to own small buildings, high cost of buildings and need for significant renovations.
Limited Equity Housing Cooperatives (LEHC)	Tenants form a democratically controlled cooperative corporation that owns the building.	Homeownership opportunities for low-income families and individuals, resident control over housing quality and conditions, ability to build equity.	Need for leadership development and ongoing oversight of coops, lack of access to Low-income Housing Tax Credit Financing. Co-op formation can take 2-5 years even when residents have professional support.

Below Market Rate (BMR) Condos	Tenants buy their own unit individually as condominiums.	Providing a familiar form of homeownership, resident control over housing quality and conditions, opportunity to build equity through mortgage paydown and appreciation.	Need for lengthy regulatory approval through the California Department of Real Estate, need for individual residents to qualify for a mortgage, required building inspections can trigger unexpected costly repairs.
Tenants in Common (TIC)	Residents share ownership of the whole building and share responsibility for joint mortgage.	Ability to be set up quickly with no new corporation or subdivision map, security of housing and housing costs over the long term, resident control over housing quality and conditions, opportunity to build equity.	Difficulty for residents to qualify for TIC mortgage, residents responsible for each other's mortgage payments, won't work with LIHTC or most other affordable housing funding programs.
Community Land Trust (CLT)	A nonprofit organization holds ownership of buildings on behalf of tenants with some degree of resident involvement in management.	Ability to retain affordability of housing over time, some degree of resident control over housing quality and conditions.	Residents don't have legal ownership or generally build equity. Many residents are not interested in participating in management.
Permanent Real Estate Cooperative (PREC)	Multi-building corporation formed to provide homeownership like experience but with access to Direct Public Offering financing.	Providing a sense of ownership, resident control over housing quality and conditions, opportunity to build equity through ownership of shares in PREC	Very new model, relatively untested Requires creation of new PREC corporation. Complex securities regulation for Direct Public Offering to investors.

COPA Rentals

This approach involves city-approved nonprofit housing agencies purchasing buildings and managing them as permanently affordable rental housing. Some advantages of this option include faster transactions, no need to create a new resident ownership structure, and the ability to leverage outside housing funding. However, some limitations include the lack of tenant asset building and resident control over management, as well as the difficulty of finding nonprofits willing to own small buildings. These structures are typically financed through a combination of bank loans and public subsidies, but the high cost of buildings in California and the need for significant renovations can make it challenging for nonprofits to purchase buildings without significant public subsidy.

Limited Equity Housing Cooperatives (LEHC)

Cooperatives offer another option for tenant ownership of buildings purchased with City funding. In this structure, tenants form a democratically controlled cooperative corporation that owns the building. Advantages of this option include homeownership opportunities for low-income families and individuals, resident control over housing quality and conditions, and the ability to build equity through mortgage paydown and appreciation. However, disadvantages include the need for leadership development and ongoing oversight of coops. The building is financed through bank loans and public affordable housing subsidies, and in practice, LEHCs often require more subsidy from local sources in order to serve lower income residents, due to the lack of access to federal Low-income Housing Tax Credits.

Below Market Rate (BMR) Condos

In this structure, tenants each buy their own unit individually. Advantages of this option include providing a familiar form of homeownership, resident control over housing quality and conditions, and the opportunity to build equity through mortgage paydown and appreciation. However, disadvantages include the need for lengthy regulatory approval through the California Department of Real Estate, the need for individual residents to qualify for an individual mortgage, and that required building inspections can trigger unexpected costly repairs. In this model, the building is financed through individual mortgages and the city can restrict equity/preserve affordability through deed restrictions if appropriate.

Tenants in Common (TIC)

Under a Tenants in Common (TIC) structure, residents share ownership of the whole building and share responsibility for joint mortgage. Advantages of this option include the ability to be set up quickly with no new corporation or subdivision map, security of housing and housing costs over the long term, resident control over housing quality and conditions, and the opportunity to build equity through mortgage paydown and appreciation. However, disadvantages include difficulty for residents to qualify for TIC mortgage, residents responsible for each other's mortgage payments, and it won't work with LIHTC or most other affordable housing funding programs. The city can restrict equity/preserve affordability through deed restrictions if appropriate. TICs have been popular in San Francisco and Berkeley where local regulations limit the number of buildings that can convert to condominium ownership, but TICs lack some of the features that provide protection to residents and to their lenders, and buyers pay higher mortgage rates.

Hybrid Models

Two newer models offer residents an enhanced 'sense of ownership' under structures that are legally still rental housing.

A **Community Land Trust (CLT)** is a nonprofit organization that holds land for long-term community use, including affordable housing. CLTs often own land under single-family homes but many CLTs also own and manage rental properties. These rentals can look and feel like any other nonprofit rental, or they can be set up to provide some of the feel of ownership. The San Francisco Community Land Trust is one of the 8 community organizations that have been certified by the City of San Francisco to participate in COPA purchases. The new South Bay Community Land Trust may be able to play a similar role in San Jose. The CLT is a membership organization with reserved seats on its board of directors for tenants, which provides some power to tenants who otherwise have no formal legal ownership rights. Residents in these buildings earn no equity.

A **Permanent Real Estate Cooperative (PREC)** is a new model that was created to provide an alternative to the Limited Equity Housing Cooperative. The model was designed to "simulate homeownership as closely as possible" while still offering a more centralized and easily financeable organizational structure. A PREC is incorporated as a consumer cooperative (like REI) but not as a LEHC under California law. This difference allows a PREC to include investor members who are not residents. The East Bay PREC sells shares for $1, which gives the investor a vote in the cooperative but no right to occupy a unit. The EB PREC also issue bonds to finance the purchase and rehabilitation of the property, and the bonds are backed by the rental income. The model is relatively untested and requires ongoing support for resident governance.

Recommendations

The report recommends building local capacity to support COPA transactions using several of the models explored. Depending on the building size and the tenant's financial capacity different approaches may be appropriate. The following table summarizes these recommendations.

Building Type	Approach	Description	Considerations
20+ Unit Buildings	Nonprofit rental with resident option to purchase.	City approved nonprofit developer purchases building and operates it as rental housing. Residents retain an option to purchase later as a LEHC under certain conditions for a specified period of time (ex. 5 years).	Allows for quick action to preserve affordable buildings; gives residents time to consider ownership options and organize a cooperative if they want; successfully preserves affordability whether or not residents later pursue ownership. Some potential nonprofit owners may choose to offer hybrid models that provide a greater sense of ownership.
20+ Unit Buildings	Limited Equity Housing Cooperative	Tenants form a co-op corporation and purchase the building. In rare circumstances with patient sellers, direct purchase by co-op may be possible but interim ownership by an approved nonprofit developer may be more common.	Residents can earn modest equity gains over time; residents can directly control building management, maintenance and monthly costs. City can ensure quality management by requiring a Land Trust or other nonprofit to play a permanent support/stewardship role and requiring use of an experienced property management firm.
4-19 unit buildings with low income (<60% AMI) tenants at high risk of displacement	Hybrid rental (CLT, PREC)	Nonprofit buys buildings and holds them for the benefit of the tenants, structures a program to offer many of the benefits of ownership under an otherwise rental arrangement.	Many experienced nonprofit sponsors are unwilling to own small rental properties because they may never pencil out financially. If an organization were to take this role on, some level of start-up or operating support would be necessary. Many of the low-income tenants at greatest risk of displacement are living in buildings of this type.
4-19 unit buildings – most tenants have strong credit and middle income (80-120% AMI)	Condo Conversion	While condo conversion will take longer than a typical market sale of a rental building, some sellers may be willing to wait in exchange for a higher price. The city could support these transactions by offering shared equity second loans to buyers with the amount based on their income.	For tenants who are in a position to obtain individual mortgages, condo conversion provides a path to traditional ownership and wealth building. City second loans could preserve affordability by recapturing a share of appreciation. For tenants that were unable to qualify/afford to purchase their building, relocation support would be necessary. Relocating more than a few tenants would be impractical due to the expense.

Building Type	Approach	Description	Considerations
1-3 unit buildings – all tenants have strong credit and middle incomes (80-120% AMI)	Tenants-in-common with plan to convert to Condo.	Tenants would quickly form a TIC to purchase the property. After the initial purchase, residents would work with a lawyer to complete a condo conversion.	Provides an immediate path to ownership for the somewhat rare building where the residents would all meet lending criteria. Allows eventual conversion to more traditional (and appropriate) form of ownership.

Additional Recommendations – Capacity building and financing

Developing a COPA policy alone will not be sufficient to support building conversions. The City will need to provide targeted capacity building grants as well as project financing for properties that preserve affordable housing. The following table summarizes these recommendations.

Recommendations	Description
Preservation Project Predevelopment Funding	Issue an RFP to select one or more local nonprofits to receive multi-year contracts for staffing the conversion process and conducting predevelopment activities. This includes hiring experienced real estate developers for evaluating the feasibility of purchasing eligible properties and providing tenant outreach, education and organizing support.
Tenant Support and Organizing	Any of the ownership models will require significant time engaging with tenants individually and in groups prior to purchase. To build adequate capacity, the City will need to enter into a multi-year contract with one or more community-based nonprofits.
Small Project Stewardship Support	Develop alternative mechanisms to provide supplemental funding for property and asset management, tenant support, and ongoing monitoring of smaller buildings. This includes budgeting for stewardship, providing a fixed per-unit conversion fee for successful conversions, and setting aside funding for direct operating grants for qualifying nonprofits.

Opportunity To Purchase Policies

Right to purchase policies are preservation strategies that promote the transfer of property ownership into the hands of tenants and/or affordable housing developers by enabling tenants to exercise a first right of purchase. The process is generally as follows: landlords intending to sell multifamily housing are required to give prescribed notice to tenants, and then allow a specified amount of time for tenants to express interest, make an offer, and secure funding.

One key question for right to purchase policies is the form of ownership that will result from the transfer. Washington DC's Tenant Opportunity to Purchase (TOPA) policy was adopted in 1980 and provides multiple paths to homeownership for building residents. The majority of TOPA purchases have involved conversion of buildings into Limited Equity Housing Cooperatives, but other DC tenants have purchased their buildings as condominiums either with or without affordability restrictions. DC's program also allows tenants to vote to designate a nonprofit or for-profit developer to purchase their building and continue to operate it as rental housing.

The process of creating cooperatives or condominium ownership structures adds significant time and risk to the process of purchasing multi-family properties (which would be challenging enough in any event). As a result, when San Francisco adopted its Community Opportunity to Purchase (COPA) legislation in 2019, they focused on direct purchase by approved community-based nonprofit organizations. Under COPA, a set of pre-qualified nonprofits (with or without the support of building tenants) are given the option to make a first offer on multi-family buildings before they are sold on the market. San Francisco has provided critical operating support for staffing at several nonprofit organizations and has created financing tools to enable these organizations to undertake quick transactions. As a result, nonprofits have used COPA to acquire dozens of buildings, but none have been tenant led and none, so far, are likely to result in homeownership for residents.

As San Jose explores development of a COPA policy, it would like to plan a pathway to homeownership for at least some properties. This memo outlines several alternative ownership models which could be implemented as part of COPA. This report is not intended to serve as a feasibility study. Each of the models described below involve significant financial and legal constraints which will limit their applicability. This memo provides a high level summary of some of those constraints but, if the city decides to pursue any of these paths to ownership, it would make sense to develop more detailed financial feasibility projections and to work with lenders and other stakeholders to outline, in more detail, the likely financing gaps.

COPA Rental Structures

First, it is worth noting some of the benefits and limitations of the rental options for comparison.

A. Non-profit rental

City approved nonprofit housing agencies purchase buildings and manage them as permanently affordable rental housing.

Advantages:	Disadvantages/challenges:
• Relies on existing nonprofit capacity • generally faster transactions • relies on existing financing programs • Does not require creating new resident ownership structure • Ability to leverage outside housing funding (eventually) • Reliable asset management and capital needs planning	• No tenant asset building • No resident control over management • Hard to find nonprofits willing to own small buildings

Who owns the buildings?
Under San Francisco's COPA, the City, through a public application process, designated 8 community-based nonprofit organizations which may receive notices from property owners and have the opportunity to negotiate purchases prior to market sales of multi-family buildings. These buildings, like nonprofit owned buildings acquired under DC's TOPA program, are generally purchased by an LLC created and controlled by a 501(c)3 sponsor. The sponsor will typically be a locally controlled nonprofit led by a racially diverse board of directors including representatives from low-income communities.

How are they financed?
In each building, existing tenant rents will be used to support a bank loan. The amount of money that can be borrowed is dependent on the level of the rents. The higher the rents, the more money is available each month for loan payments which enables the building owner to borrow a larger loan. Because this is true for any buyer of an apartment building, the sales price for a building will generally correspond to the level of rents. It might be possible (and there appear to have been examples in DC) for a nonprofit to purchase a building without any public subsidy, relying almost exclusively on rents to support a private mortgage large enough to finance the whole purchase.

However, in practice, this is unlikely for three reasons. First, multi-family buildings in California are typically selling for prices well in excess of what would be suggested by the current rents. When a private buyer pays more than today's rents can support, this is because they expect that they will be able to either significantly increase rents on the current tenants or successfully evict those tenants. This 'eviction premium' can be very significant in gentrifying communities. A nonprofit purchasing a building with no intention to raise rents or evict tenants generally can't pay the market price without significant public subsidy. Second, the current rents may be unsustainably high for some vulnerable tenants and a nonprofit purchaser may find it necessary to lower some rents to reduce rent burdens. Third, lower rent apartment buildings often suffer from very significant deferred maintenance. Many buyers will plan to fully renovate a building after purchase. For a speculative buyer, a big renovation only helps with increasing rents and turning over tenants. But for a nonprofit attempting to stabilize existing tenants, paying for renovations can be a major challenge.

As a result, nonprofit TOPA/COPA purchases typically require several sources of public subsidy in addition to a bank mortgage. In San Francisco, this funding has come almost exclusively from the city's Small Sites Program. In DC it comes from the City's Housing Trust Fund. San Francisco has been investing in excess of $300,000 per unit preserved. In DC, the costs are lower but still generally higher than the amount that DC invests into new construction of affordable housing units.

For larger buildings, nonprofit ownership creates an opportunity to access Low-income Housing Tax Credits (LIHTC). This is the most significant federal affordable housing subsidy program and, for eligible projects, can provide more than half of the cost of a project. Using tax credits, significantly reduces the amount of funding needed from local government – allowing a city to support more units. However, the LIHTC program is complex and generally competitive and it is very hard to use in preservation projects and only possible to use in larger properties. Even for projects where LIHTC would be appropriate, tax credits can't be secured quickly enough for TOPA/COPA transactions. In DC, however, a number of TOPA projects have been initially financed with entirely local funds and then refinanced several years later with LIHTC financing. Often TOPA buildings require significant renovation, and this strategy often involves a nonprofit buying the building and operating it without renovation while pursuing tax credit refinancing to repay some of the initial city funding and pay for renovations. For larger properties, this is the most efficient strategy for managing limited city subsidy funds. But it does not offer tenants any ownership opportunity.

How do tenants benefit?
For tenants, the primary benefits are stable housing and limited rent increases. Tenants generally have little say in management of nonprofit housing. Tenants generally have no equity or asset building opportunities in these buildings but it is worth noting that living in stable housing with below market rents often provides tenants with the opportunity to build assets through other means including by saving money that would have otherwise gone to rent.

How are properties managed?
Nonprofit buildings are generally managed by third party property management firms. Generally, each building requires an on-site resident manager who lives in one of the building units.

Nonprofits have struggled to adapt this management structure for small buildings. Scattered smaller buildings are more difficult and more expensive to manage. Many of California's most experienced housing nonprofits started out developing small rental properties but have stopped pursuing smaller properties because of the management issues. A small building may require as much management as a larger building but provide only a fraction of the revenue to pay for management. San Francisco's Small Sites Program has been led by community-based nonprofits with only limited property management experience. The larger nonprofits that manage the great majority of the City's affordable housing have, so far, declined to participate in Small Sites development.

What about For Profit rentals?

DC's TOPA policy also allows tenants to vote to designate a for-profit buyer to complete the purchase on their behalf. DC tenant advocates point out that this provision has been used by real estate investors seeking an advantage in purchasing buildings for speculative ownership. Private purchasers have paid tenants for their votes, purchased buildings and in some cases, later evicted the tenants or dramatically raised their rents. In some cases, tenants may have been misled but in others, tenants have clearly understood that they were being paid to 'buy out' their rights in their buildings. A 2012 report states that most tenants have received payments of around $20,000 but some have received as much as $100,000. While this outcome is clearly contrary to the intent of TOPA, it is worth noting that, for some tenants, this may be a very desirable outcome. While it offers no long-term benefit for future tenants, the policy treats current tenants as if they were, in some sense, owners already, allowing them to reap some of the immediate profits from development.

Ownership Structures

B. Limited Equity Cooperative

Tenants form a democratically controlled cooperative corporation which owns the building.

Advantages:	Disadvantages/challenges:
• Homeownership opportunities to families and individuals with incomes far below the cut off for other homeownership programs • Does not require owners to qualify for individual mortgages • Security of housing and housing costs over the long term • Resident control over housing quality and conditions • Opportunity to build equity through mortgage paydown and (limited) appreciation	• Incorporation and resident leadership development take months or years • Requires new local capacity for leadership development and ongoing oversight of coops • Coops have sometimes struggled with long term asset management and capital needs planning • No access to Low-income Housing Tax Credit Financing

A Limited Equity Housing Cooperative (LEHC) provides a legal mechanism through which tenants can share ownership of a multi-family apartment building without each resident individually obtaining a mortgage. Instead, the tenants buy shares in a cooperative corporation and the corporation buys and finances the building. Resident owners can sell their co-op shares when they move and earn limited appreciation. In addition, co-op residents who itemize their tax returns can deduct their share of property taxes and insurance.

Perhaps the primary financial benefit for co-op residents comes in the form of control over rents. Co-op residents are often able to benefit from fixed mortgage costs to ensure that rents don't rise with inflation and sometimes actually decline. For example, Dos Pinos is a 60-unit co-op built in 1985 in Davis. The co-op was developed without affordable housing subsidies and, when it opened, monthly costs in the co-op were similar to and even higher than comparable rents for nearby apartments. The Dos Pinos Board of Directors (all residents) has prioritized keeping the monthly carrying charges as low as practical while still maintaining the property. As a result, Dos Pinos residents today pay less than half of what nearby apartments cost. Shares in Dos Pinos cost around $33,000 but because the monthly costs are so low, the co-op manages to provide housing for many Very Low-Income residents.

How would a building be financed?

Limited Equity Housing Co-ops are generally able to obtain bank loans like other owners of apartment buildings. However, a co-op targeting low-income tenants would have limited monthly cash flow which would limit the size of any mortgage. LEHCs can generally access most sources of public affordable housing subsidy, however, because a Co-op is owned by its residents and not investors, it is not able to benefit from Low-income Housing Tax Credit financing. This means that a LEHC will generally require more subsidy from local sources in order to serve lower income residents.

HUD offers a mortgage guarantee program specifically for cooperatives (Section 213) but in the current environment the program may not be cost effective.

Washington DC has supported the creation of more than 4,400 LEHC units in 99 buildings[1] but coop advocates point out that the TOPA legislation alone could not have generated this result. It was not until DC established its Housing Production Trust Fund about 10 years after adoption of TOPA that coop development became practical. DC's trust fund has provided the level of local subsidy necessary to make co-ops feasible without access to federal Low-income Housing Tax Credits. DC has been investing roughly $10 to 25 million per year in Trust Fund resources for TOPA projects. In recent years, however, as housing costs have risen and competition for scarce trust fund resources has increased, the city has been financing fewer coop projects in part because they can serve more low-income residents by investing in LIHTC funded projects. And in fact, as prior TOPA Cooperatives have been undergoing refinancing, quite a few have converted to nonprofit rentals specifically in order to access Low-income Housing Tax Credits to fund renovations without increasing tenant rents[2]

How would a building be managed?

Most co-ops are professionally managed by a private property management company like any other apartment building. If the City were to provide public subsidy, they could require professional management as a loan condition.

How would the co-op be governed?

[1] https://dhcd.dc.gov/sites/default/files/dc/sites/dhcd/page_content/attachments/Final%20LEC%20Recommendations_10.21.19.pdf

[2] https://www.dcfpi.org/wp-content/uploads/2013/09/9-24-13-First_Right_Purchase_Paper-Final.pdf

Cooperatives are democratically governed by a Board of Directors directly elected by residents. Having final say over the key decisions that affect your housing is clearly a benefit of cooperative ownership and every cooperative must invest in building and sustaining resident leadership in order to support governance of the co-op. Some co-ops put a lot of energy into this effort in hopes that residents will participate in all day-to-day decisions or even self-management. But not all tenants have a strong interest in spending time participating in the details of operations – particularly when things are going well. For larger buildings with professional property management companies, co-op properties end up operating very much like other rental properties. A 2002 study by the California Coalition for Rural Housing found that residents in California farmworker housing placed a high value on co-op ownership even though many reported that they did not feel that they had direct control over decisions. Participation in management is important, but shouldn't be seen as the primary benefit of cooperative ownership.

Who would provide start up support and long-term oversight?
To ensure long-term success in resident governance, it is critical that the Co-op have access to initial and ongoing training and board support. There have been a number of co-ops that have run into serious ongoing management or governance problems. Some co-ops have failed to undertake necessary long term building maintenance. Others have struggled with internal conflict between residents. Some degree of ongoing support can help avoid these challenges. Some property management companies can provide governance support to co-op boards. Other communities have contracted with affordable housing nonprofits or Community Land Trusts to support local cooperatives.

Washington D.C. funds the equivalent of 8 FTE staff to provide direct outreach and resident organizing support under TOPA. This level of staffing support provides assistance for 30 transactions per year.[3] In addition, DC provides operating support grants to several nonprofit organizations that provide tenant support and legal assistance for both start up and ongoing operations of co-ops.

Across the country, many Communities Land Trusts (CLTs) have taken on support and oversight of Limited Equity Cooperatives. The CLTs are generally nonprofit organizations operating multiple housing programs with a neighborhood, citywide or even regional footprint. The CLT retains ownership of the land under the cooperative as a means to protecting the long-term community interest and securing long term affordability but sells or leases the building to the cooperative. The co-op manages the building independently, but the CLT plays a long-term support and oversight role so that co-op residents are not entirely on their own.

What about tenants that don't want to buy?
If share prices are set too high, some tenants may be unable to afford their share purchase. State law requires that the majority of tenants in a building purchase shares in the coop at the

[3] Staff report for Berkeley TOPA Proposal. https://www.berkeleyside.org/wp-content/uploads/2020/03/2020-03-05-Agenda-Packet-Land-Use.pdf

time of conversion but allows for some units to be occupied by renters who are not members of the cooperative.

How much equity could residents earn?

California's Limited Equity Housing Cooperative law limits the rate of share price appreciation to no more than 10% annually and initial share prices cannot exceed 3% of the value of a unit. This limitation means that if share prices are set at very low rates initially, then the equity building that is available to residents will also be fairly low.

Some older cooperatives were organized with resale prices tied to the gradual repayment of the cooperatives mortgage. The resale prices in these projects escalated very rapidly especially during the later years of mortgage repayment and often rose beyond the means of low-income residents.

How would share purchases be financed?

Low-income tenants will find it difficult to come up with the funds to purchase a share in the co-op. Many co-ops have addressed this by offering loans to help members buy their shares. But these loans increase the monthly costs that those tenants face.

For example, if share prices were set at $20,000 and buyers were expected to invest $500 and borrow the rest from a credit union or similar institution at 5% interest over 5 years, the monthly share loan payment would be almost $370. Lowering the initial share price can make the co-op more accessible. At $3,000 per share the payment would be $47 per month. However, it may be difficult to find a lender willing to manage loans this small. And, importantly, the lower the initial share, the less share price appreciation will accrue to owners. If shares increase at 2% annually, a $3,000 share would increase to only $3,650 after 10 years.

One strategy for partially overcoming this barrier is a 'matched savings' grant program. For example, the Federal Home Loan Bank's WISH and IDEA programs provide 4 to 1 matching grants to low-income first-time homebuyers who save money for homeownership. Generally, the owners save money and receive the match before they buy a house. But the programs can also be used to underwrite the purchase of LEHC shares by tenants who have already moved into a co-op. Grants can be up to $22,000 per family and, at that level, would require $5,500 in savings from the tenant. A co-op could require a low initial investment (say $500) and then a monthly contribution to a share account (say $40 per month) over and above the co-op carrying charges (rent). At this rate, the tenant would pay off their portion of the share price over 10 years and would receive the matching grant. **If the share price were to appreciate at a rate of 2%, then at the end of 10 years, the tenant would own an asset valued at $33,500.** This kind of program could be developed with more flexible rules with grant support from a corporate or philanthropic sponsor. However, the program requires ongoing access to this grant funding for each new buyer or else the share prices will be prohibitively expensive for lower income buyers.

Is it possible to transition later to co-op ownership?

It is possible for buildings to be purchased initially by a nonprofit partner and held for the benefit of the tenants with the option for a later transition to legal tenant ownership. Vermont enacted a Tenant Right to Purchase law for Mobile Home Parks in the 1980s and a number of parks were purchased by nonprofits and held for several years while residents organized cooperatives and arranged financing needed to purchase the parks directly. Several Community Land Trusts in the Bay Area have pursued this approach to cooperative development with the CLT buying the building and allowing the residents to play a role in management as if they were owners while working toward the possibility of eventual sale to a Limited Equity Housing Cooperative. However, very few of these properties have ultimately converted to LEHC. The challenges of conversion are significant and the incentives to convert after the immediate threat of displacement has been removed are limited. One could see this lack of conversion as a failure, but it could also be seen as a success. As long as the CLTs provide adequate management and limit rent increases, tenants may lack motivation to convert to full ownership and lenders and public partners may be reluctant to prioritize these projects. The potential for future conversion provides a measure of resident accountability to the CLTs as nonprofit landlords without all of the expense and risk associated with a full conversion.

It would be possible to structure a COPA program to rely on immediate purchase by nonprofits that are prepared to hold the properties for the long term while providing tenants with an additional measure of power and control by enabling them to vote to convert to co-op at some point in the future. It would be common for a co-op conversion to take 2-5 years for residents to complete with adequate support. This would require some degree of additional oversight from the City but would require far less infrastructure than would be necessary if the buildings were set up as co-ops initially.

C. Below Market Rate (BMR) Condo

Tenants each buy their own unit individually.

Advantages:	Disadvantages/challenges:
• Provides a familiar form of homeownership • Security of housing and housing costs over the long term • Resident control over housing quality and conditions • Opportunity to build equity through mortgage paydown and appreciation • City can restrict equity/preserve affordability through deed restrictions if appropriate	• Requires lengthy regulatory approval through CA Dept. of Real Estate • Creation of Home Owners Association can take months • Each resident must qualify for an individual mortgage • Required building inspection can trigger unexpected costly repairs • Condos have sometimes struggled with long term asset management and capital needs planning • No access to Low-income Housing Tax Credit Financing • Few other affordable housing programs will fund condos

Condominiums are the most common form of shared ownership for multi-family housing. When an apartment building is converted to condominium ownership, the owner must file a subdivision map and associated legal documents with the California Department of Real estate. Once approved, the individual apartments in the building become separate pieces of real estate which can be bought and sold and financed individually. In a condo conversion, each tenant would find their own lender. If one tenant failed to pay their mortgage, their lender could foreclose on just their unit without impacting the financing of other tenants.

As with LEHC, forming a condominium can take months (or longer). Forming a condo to purchase a building under COPA will require considerable patience on the part of the seller. Nonetheless, this has happened several times in DC. Some sellers may be willing to wait for condo formation in exchange for a potentially higher price.

What about building conditions/Fire standards?
San Jose's Condo conversion regulations require potential upgrades to sound proofing and compliance with the building code and fire regulations that were in effect at the time the building was constructed (not at the time of conversion). State law also requires that buildings comply with fire codes but doesn't require buildings to be upgraded the most recent code. However, it is not uncommon for major renovations conducted at the time of conversion to trigger a need for fire code updates which can sometimes be prohibitively expensive. The City does require sound insulation and separate electrical meters at the time of conversion for most buildings.

And even compliance with the building code in effect at the time a building was erected can pose a significant barrier to condo conversion for some buildings. Section 20.170.310 of the city's condo conversion ordinance requires a building inspection and correction of any identified deficiencies prior to proceeding with conversion. It is not uncommon for this kind of inspection to identify significant life safety concerns due to maintenance issues or work that has been performed without a building permit over the years. A key issue relates to the timing of this building inspection. It is often possible to sell a rental property that suffers from significant building code compliance issues. Ideally potential purchasers would conduct their own inspection and identify potential deficiencies, but, in practice, many times these buyer inspections result in reductions to the price but not in work being performed to correct the deficiencies. Since there is no city inspection, there is no mechanism for enforcing code compliance. Because inspection is required for a condo conversion, the inspection creates a public record which generally creates a need to make repairs whether or not the condo conversion moves forward. This makes pursuing conversion risky for property owners. One response is to conduct a private inspection in order to evaluate potential compliance issues before deciding whether to pursue condo conversion and only initiating the City inspection once a clear path to conversion (including financing for any likely repairs) has been identified. But this results in a much slower sale process.

What about tenants who can't or won't buy?

It is likely that many small buildings would include some tenants who could qualify for mortgages and others who could not. In a market rate conversion, tenants with less strong credit might end up being evicted or relocated but that is not a positive outcome for a TOPA conversion. Even if the city provides subsidy to bring the loan amounts down to an affordable level, each tenant must have a relatively strong credit history, personal savings and have only a limited amount of other debt including credit cards and car loans. The lower the tenant's income the greater the likelihood that they would face financing challenges.

Condo conversion will work best if all existing tenants want to buy their units and are able to qualify for financing. California law allows creation of a condo unit with a tenant in place who continues to rent but, in the context of a COPA conversion, some third party would need to own and finance any unit that was not sold to the tenant. Theoretically, a local nonprofit could step into this role and, particularly with public subsidy, they might be able to finance a condo that was rented, but managing scattered individual rental condos would be challenging and there may be no local nonprofit willing to take this on. The presence of more than a very small number of rented condo units can also make it difficult or impossible to finance other units in a building due to lender rules. FHA, for example requires that at least 50% of units in any converted building be owner-occupied at the time of conversion.

This financing limitation may mean that condo conversion would only be feasible for a small subset of potential COPA properties. Smaller buildings and buildings occupied by higher income tenants would be more likely to qualify. If a local nonprofit was willing to manage scattered individual rental units, it would likely be possible to finance mixed ownership/rental buildings provided that the majority of units were owner-occupied. This strategy would greatly expand the number of possible condo conversion properties.

Allowing some residents to buy their units while others continue to rent could be beneficial (particularly if the tenants retained the option to purchase their units later). Mixed tenure would require a nonstandard (and presumably more costly) loan product for the nonprofit to finance the rented units. The City might be able to help build an organization's capacity to play this role and could help ensure access to an appropriate loan product.

How would buildings be managed?
Every condominium must have a Home Owners Association (HOA) which is governed by a board elected by owners. Most HOAs contract with property management firms to oversee building maintenance and other tasks. Some HOAs, particularly in small buildings, elect to self manage in order to save money. If the City were to provide public subsidy, they could require professional management as a loan condition.

Could long term affordability be preserved?
In DC, the TOPA program does not require any long-term affordability restrictions and several buildings have converted to market rate condominiums. However, when residents have required city subsidy to afford condo purchases, the city has recorded long term deed restrictions which require that units remain owner occupied and that they resell at a below

market price only to an income eligible buyer. While less effective in preserving long-term affordability, some cities use shared equity second mortgages to preserve affordability. One advantage of shared equity loans in this context would be that loans could be 'sized' based on each resident's financial need. In this way some residents in a building may be able to purchase with little or no public subsidy and retain most of the equity in their unit while others, who receive very deep levels of subsidy would be required to pass that public investment along to other lower income buyers when the sell – while still earning significant equity.

Who would provide start up support and long term oversight?
If San Jose were to provide subsidy to support below market rate (BMR) condos under COPA, the City could contract with a local nonprofit or legal services organization to provide assistance with the subdivision process. The City would need to develop educational material and possibly a training program for homeowners to ensure that they understand the process and any affordability restrictions. City staff would need to perform some level of ongoing monitoring to ensure ongoing affordability. As with the LEHC model, a Community Land Trust could be used as an intermediary to provide an additional level of ongoing support and oversight to 'steward' the long term affordability of BMR condos.

D. Tenants in Common

Residents share ownership of the whole building and share responsibility for joint mortgage

Advantages:	Disadvantages/challenges:
• Can be set up quickly. No new corporation or subdivision map • Security of housing and housing costs over the long term • Resident control over housing quality and conditions • Opportunity to build equity through mortgage paydown and appreciation • City can restrict equity/preserve affordability through deed restrictions if appropriate	• Difficult for residents to qualify for TIC mortgage • Residents responsible for each other's mortgage payments • Won't work with LIHTC or most other affordable housing funding programs

Tenants in Common (TIC) offers a different legal structure for groups of residents to co-own a building. TIC residents share full ownership of their building just like a couple might share ownership of a house. They each own part of the whole and neither can sell without the other's consent. TIC residents generally sign an agreement giving each resident exclusive access to one unit or another but, in fact, they each own a part of every unit. For very small properties (2-4 units?) TICs may offer an alternative to Condo conversion. They avoid many of the bureaucratic issues associated with Condo formation and don't require an ongoing Homeowners Association (HOA). TICs have been popular in San Francisco and Berkeley where local regulations limit the number of buildings that can convert to condominium ownership.

However, condominium laws and regulations exist for good reason and TICs lack some of the features that provide protection to residents and to their lenders. The CA Department of Real Estate carefully regulates Condos to, among other things, ensure that HOAs set aside reserves for future maintenance expense. TIC owners are on their own and can find it difficult to force their co-owners to pay for needed capital improvements. Lenders treat TIC owners just like they would treat a couple sharing ownership of a single-family home. Each resident is fully liable for the whole loan which can create serious problems. When one resident is unable to pay their share of the mortgage, all residents face foreclosure. The key advantage of a condo structure is that each unit is legally separated, and each owner can pledge their individual unit as collateral for their individual mortgage. This makes the loans safer both for the bank and for the residents. As a result, TICs typically sell for 10-20% less than comparable condos and buyers pay higher mortgage rates. It can also be difficult for homebuyers to find banks willing to provide TIC mortgages for unrelated individuals sharing ownership of a multi-family building. The larger the number of unrelated co-owners, the greater these risks which has generally limited TICs to duplexes or triplexes.

There appears to be no experience with TIC conversions under a TOPA/COPA policy but it seems possible that, for very small buildings it would be possible to structure TIC purchases with the expectation that the building would convert to Condo ownership within a relatively short timeframe. In particular, if building financing were provided by a public agency or if a public agency were to provide a loan guarantee, temporary TIC ownership might make some conversions possible where condo conversion would be impractical given the timeframe for purchase and where nonprofit ownership could be impractical due to the property management challenges for very small buildings.

E. Hybrid Models: Ownership Like Experience

Community Land Trust Rental

Nonprofit CLT owns and finances building but develops structure for tenant governance

Advantages:	Disadvantages/challenges:
• Can be set up quickly. No new corporation or subdivision map • Security of housing and housing costs over the long term • Some degree of resident control over housing quality and conditions • Resident participation in governance of CLT provides additional 'sense of ownership'	• No resident opportunity to build equity • Requires ongoing support for resident governance • Challenging for CLT to staff property management of small buildings

A Community Land Trust (CLT) is a community-based nonprofit formed specifically for the purpose of holding land for long term community use including affordable housing. CLTs often own land under single family homes, selling the home to lower income residents and entering into 99-year ground leases which restrict the home resale price to maintain affordability. But CLTs also commonly play a similar stewardship role in multi-family buildings. In some cases, CLT hold land and then sell the buildings to their residents either as co-ops or BMR condos. In other cases, CLTs own and manage rental properties. CLT rentals can look and feel like any other nonprofit rental or they can be set up to provide some of the feel of ownership.

The San Francisco Community Land Trust is one of the 8 community organizations that have been certified by the City of San Francisco to participate in COPA purchases but to date they have not purchased any COPA properties. Prior to COPA, they did purchase several buildings through the City's Small Sites program. The Land Trust refers to these small properties as "co-ops" though none have formally been incorporated as cooperatives. The Land Trust owns the buildings as any other nonprofit owner would and enters into traditional leases with individual building tenants. The CLT is a membership organization with reserved seats on its board of directors for tenants. This direct democratic governance provides some power to tenants who otherwise have no formal legal ownership rights. Residents in these buildings earn no equity. However, the program is designed to feel like ownership by giving the informal association of tenants broad discretion to make the key decisions that impact their building and relying on them to perform limited self-management. Some of these properties are engaged in a process of preparing for eventual LEHC conversion while others have no plans for conversion. The new South Bay Community Land Trust may be able to play a similar role in San Jose.

Permanent Real Estate Cooperative

Multi-building corporation formed to provide homeownership like experience but with access to Direct Public Offering financing.

Advantages:	Disadvantages/challenges:
• Can be set up quickly. No new corporation or subdivision map • Security of housing and housing costs over the long term • Some equity gain over time • Possibly declining rents over time • Some degree of resident control over housing quality and conditions • Resident participation in governance of PREC provides additional 'sense of ownership'	• Very new model, relatively untested • Requires creation of new PREC corporation, new board, etc. • Complex securities regulation for Direct Public Offering to investors • Requires ongoing support for resident governance • Challenging for PREC to staff property management of small buildings

The Permanent Real Estate Cooperative (PREC) model was created by the Sustainable Economies Law Center and pioneered in practice by the East Bay Permanent Real Estate Cooperative in West Oakland to provide an alternative to the Limited Equity Housing Cooperative. The model was designed to "simulate homeownership as closely as possible" while still offering a more centralized and easily financeable organizational structure. A PREC is incorporated as a consumer cooperative (like REI) but not as a LEHC under California law. This difference allows a PREC to include investor members who are not residents. EB PREC sells shares for $1,000 to individual investors through a Direct Public Offering (DPO) and provides very limited annual returns (less than 5%) to investors.

They use the money raised in this way to finance the purchase of housing and community real estate. Their first project was a 4 unit apartment building purchased with $100,000 of investor funds (along with other traditional public and private financing). The residents in PREC property are just members of the coop in the same way as other investor/members but they have special rights over management of their building. And just like purchases at REI qualify members for a patronage refund each year, PREC tenants earn a refund each year based on their rent payments (assuming that the building is profitable). These refunds are held in an account for residents and can be paid out when a resident moves out – providing a form of limited asset building – possibly comparable to the returns from a LEHC.

But possibly more importantly for tenants, the PREC model proposes a new kind of lease which they call a “diminishing rent lease” which, they claim, will reduce rents over time as a building’s mortgage is paid off. This declining rent is one of the biggest financial differences between LEHC and nonprofit rental properties. In most nonprofit buildings, rents generally rise with inflation, even when mortgages are paid down. Any extra income is generally used to fund building reserves, or to fund organizational sustainability for the sponsoring nonprofit – which ultimately helps provide affordable housing to other tenants. But in most co-ops resident boards do everything in their power to keep monthly charges low so that initially below market rents often get much lower over time. It remains to be seen whether the PREC model will deliver on this promise. The board of a PREC that owns multiple buildings may be reluctant to lower already low rents in one building even as they face unexpected expenses in another. But, the model shows that the elements of homeownership can be pulled apart and it is possible to offer many of the benefits without all of the organizational overhead of a LEHC.

Recommendations:

Larger buildings:

For buildings with 20 or more units, conversion to LEHC seems like the best way to offer homeownership. These buildings will also be the most attractive to non-profit rental operators. The city should plan for two potential paths:

> **Direct to Coop:** Because of the uncertainties and challenges with later conversion, it would be simpler to create cooperatives at the time of initial purchase. However, it typically takes many months to a year or more for residents to organize an effective association, negotiate purchase, arrange financing and form a legal cooperative corporation. Most sellers would presumably not be willing to wait for a co-op conversion process but there are likely some sellers who would agree to a longer time frame either because they are socially motivated to support resident ownership or because they believe that they will be able to get a better price for their building from a cooperative purchase. In these special cases, a nonprofit sponsor might negotiate a

longer purchase timeline with the seller in order to complete the co-op conversion process directly.

Nonprofit rental with option to convert: More commonly, the sponsor would purchase the building and manage it as an affordable rental while the conversion to co-op was explored. The City could develop a standard attachment to its Affordability Restrictions which provides tenants with an enforceable option to purchase a building as a cooperative. This document would spell out conditions including the level of tenant participation and necessary steps tenants would need to take before any sale but would ensure that tenants could form a co-op at any time and purchase the building at a fixed price based on the nonprofit owner's costs.

Smaller buildings:

Because of the challenging governance and financing issues, it is less likely that buildings with fewer than 20 units could successfully convert to formal LEHC ownership.

For the (somewhat rare) small properties where the current tenants are all able to qualify for (and afford) a mortgage, condo conversion could offer an appropriate option. However, the time required to complete condo conversion may create a need for a temporary ownership strategy. For very small properties (2-3 units) where tenants are able to qualify for loans, Tenants in Common (TIC) ownership may be the best interim ownership option while condo conversion is completed. For buildings with more than 2-3 units, TIC ownership seems impractical. If sellers of these buildings are not willing to wait many months for condo conversion, a nonprofit could serve as the interim owner. However, the nonprofits most likely to be willing to undertake small sites development may be less interested in investing their limited staff capacity in buildings with tenants that have the financial resources necessary to complete condo purchases.

Mixed ownership/rental provides another option which should be explored. If it were possible it could expand the number of potential buildings and allow the program to meet the needs for more vulnerable tenants, while still offering ownership to some residents.

Even if mixed ownership is possible, most small properties would likely not be appropriate for condo ownership. These properties would need to be financed as affordable rentals. While traditional nonprofit rental should meet most tenant's needs, in cases where tenants strongly prefer ownership and are willing to play a more active role, the two hybrid models (Community Land Trust and Permanent Real Estate Cooperative) can offer a 'sense of ownership' to residents in buildings that are more traditionally financed. The City could engage with a nonprofit sponsor to adopt one or the other of these models to the San Jose context.

The current COPA proposal would exempt single family properties but, if the ordinance is applied to **single family** properties, fee-simple ownership would be the only appropriate ownership model. It might be possible for a nonprofit to own single family units, rent them temporarily and eventually sell them to homeowners (either the current tenants or others whenever tenants vacate). However, because of the strong demand for single family homes, it may be difficult for nonprofits to finance market rate purchases without increasing rents on current tenants which may make nonprofit ownership impractical.

Summary:
Table 3: Recommended approach for different building types

Building Type	Tenant Mix	Recommended Approach
20+ Unit Buildings	Most tenants Low-income (<80% AM)	Nonprofit rental with resident option to purchase.
20+ Unit Buildings	Most tenants low to moderate income (60-120% of AMI)	Limited Equity Housing Cooperative
4-19 Unit buildings	Low-income (<60% AMI)	Hybrid rental
4-19 unit buildings in relatively good condition	Most tenants middle income (80-120% of AMI) with strong credit	Condo Conversion
1-3 unit buildings –	All tenants middle income (80-120% of AMI) with strong credit	Tenants-in-common with plan to convert to Condo.

Building capacity for TOPA conversions:

1. **Preservation Project Capacity Building Funding**

The city could issue an RFP and select one or more local nonprofits to receive multi-year contracts staff the conversion process. Two roles are key and they could be performed by the same organization or two different nonprofits:

Preservation Sites Pre-development: The city will need one or more experienced real estate developers to undertake the time consuming task of evaluating the feasibility of purchasing many small properties. While some of this pre-development cost can be recovered through a developer fee at the time of purchase, the timelines and complexity of TOPA are likely to mean that a potential nonprofit sponsor will evaluate many buildings for each one that they successfully purchase and it is unlikely that developer fees will be large enough to compensate for the level of upfront work. San Francisco set aside $3.5 million to fund 3 year direct operating grants to qualifying nonprofits pursuing Small Sites acquisitions. These grants enabled the selected organizations to hire permanent staff dedicated to small sites acquisitions and to pay for other soft costs.

Tenant Support and Organizing: In addition to the usual real estate development tasks, a TOPA conversion also requires some level of tenant outreach, education and organizing support. While purchases for permanent nonprofit rental ownership may require less staffing in this area, any of the ownership models will require significant time engaging with tenants individually and in groups prior to purchase, even if the plan calls for a period of nonprofit ownership before conversion to resident ownership. As above, the organization leading this work will invest in many buildings that are not successfully purchased for each one that is acquired.

2. Preservation Project Stewardship Support

Regardless of the model that is implemented, TOPA conversions for smaller buildings will require extra expenses for property and asset management, tenant support and ongoing monitoring – over and above the typical per unit share of rents allocated for management expenses. The lack of economies of scale have been the major barrier to non-profit or tenant ownership of the kind of smaller buildings which make up much of San Jose's housing stock. To address this barrier, the City could develop alternative mechanisms to provide supplemental funding for this work including:

Budgeting for Stewardship: Operating budgets for COPA properties should be designed to incorporate an additional line item for COPA stewardship. This annual cost would initially compensate nonprofit sponsors for higher than average staffing needs of COPA buildings (including supporting leadership development and tenant involvement in management and preparing for possible later conversion). Once a building converts to tenant ownership, this line item would be used to compensate the nonprofit sponsor (or third party) for ongoing support and monitoring of the Cooperative or HOA. Including these expenses in annual operating budgets will generally require a larger initial investment of subsidy per unit than would otherwise be needed.

Conversion Costs: If the city pursues a policy which relies on initial nonprofit ownership with possible future conversion to tenant ownership, it would make sense to put in place a mechanism to compensate and even incentivize the nonprofit sponsors to complete conversions. One way to do this would be to set aside funding to provide a fixed per unit conversion fee for each unit that is successfully converted to resident ownership. This fee would function like a developer fee, compensating the nonprofit sponsors for the costs of supporting a conversion. The fee can be capitalized into the development budget at the time of initial purchase and held in a reserve until conversion expenses are incurred. Some portion of the funds should be accessible in advance of conversion to pay for costs like legal assistance and some withheld until successful conversion.