

AFFORDABLE HOUSING OVERSIGHT IN OAKLAND

EXECUTIVE SUMMARY

Last August, a concerned Oakland resident called the Grand Jury’s attention to a particular sentence in a recent newspaper article. It stated that “Oakland has loaned a total of \$4.1 million to the E.C. Reems Apartments owners and received no repayments. . . .” The Grand Jury was also intrigued by the statement – how do you avoid repaying a loan? The article also described the deplorable conditions of the complex and management’s apparent abandonment of the project. The Grand Jury decided to investigate.

The city of Oakland plays an integral role in fostering local affordable housing projects by administering state and federal loans or grants. Developers receive soft loans that in effect

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become grants in exchange for covenants that keep rents affordable for low-income residents. Currently, the city is a party to regulatory agreements and loans related to over 100 housing projects in Oakland. When the projects

are managed appropriately by the owners of the property, low-income residents benefit greatly. But when management and oversight goes wrong, in situations like the E.C. Reems Apartments, residents live in substandard conditions for years.

The Grand Jury learned through its investigation why affordable housing financing is structured as a loan, even when there is no realistic expectation that the “loan” will ever be repaid. This mechanism gives the city the authority and the obligation to exercise legal and financial oversight and governance over the housing projects.

While the city has legal authority to take some action when property owners in effect abandon management of the projects, the regulatory agreements that supposedly empower the city with oversight authority actually can discourage city intervention because of the complicated web of state and federal financial participation. On top of this, shrinking local resources have resulted in inadequate staffing, poor training, and outdated technology systems that have prevented

effective local oversight of these public investments. This makes it even more important that the city use best practices in selecting qualified affordable housing developers.

Oakland, like most other communities in California, faces a severe affordable housing crisis. It is not enough simply to finance projects. Oakland needs to improve its selection process for developers and its oversight practices for managing properties.

BACKGROUND

The city of Oakland coordinates efforts to support local affordable housing through its Housing and Community Development Department. While the projects and support for the programs were more robust during the era of redevelopment agencies, the city still invests millions of dollars a year in helping developers, mostly non-profit, rehabilitate and, in some circumstances, construct affordable housing projects. Some of that money has been replaced by a \$100-million bond the city floated to support such programs. Since 1988, the city boasts that it has helped build over 6,000 units of affordable housing. In return for loaning these developers money, the city puts deed restrictions on the properties for the term of the loans.

Loans for rental projects are typically provided at a low interest rate for up to 55 years. In exchange for the city's loan, the property's rents are restricted to remain affordable to lower income households. The agreement is legally described as a loan, but it is more practically treated as a grant. Loan payments are received by the city if the project has sufficient cash flow, although that rarely happens. The city is really providing the funds for restricted rents in return for these "soft loans." Although the property's deed of trust may be designated as security, these soft loans usually are subordinate to other lenders' loans, most often state or federal.

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The regulatory agreements become the city's most significant enforcement tool to ensure that the properties are livable and that the specified percentage of housing units is deemed affordable. To guarantee compliance, best practices require that, at a minimum, each property be inspected annually.

A decade ago, Oakland Community Housing, a major manager of public housing projects, ceased operations and abandoned 25 affordable housing projects with 638 units spread throughout the city. The city had invested \$24 million in those projects, many of which had fallen into severe disrepair with residents living in deplorable conditions. The city was left trying to find new property owners. (*See Grand Jury report of 2011-2012, p. 135.*) In many of the projects, the California Housing Finance Agency, which provided additional funding to Oakland Community Housing, refused to foreclose because it did not want the liabilities associated with receivership – violence, lack of security, lack of maintenance, and responsibility to relocate renters during building repairs. That year, the Grand Jury criticized the city for failing to protect its \$24 million investment by not adequately monitoring the various properties and failing to take action when the properties fell into disrepair.

At the time, the city promised to take steps to train staff and improve the oversight process. In 2012, the city claimed that its employees visited each property in the city’s inventory, and did onsite audits of 15% of the individual housing units at those facilities to ensure the units were in livable condition and that income levels of renters were consistent with regulatory agreements. That commitment has now disappeared.

INVESTIGATION

The Grand Jury reviewed city staff reports and loan documents concerning E.C. Reems Apartments and other affordable housing projects, and heard testimony from current and former Oakland employees involved with affordable housing.

Originally built in 1948 as market-rate housing, a privately-owned apartment complex near Golf Links Road and MacArthur Boulevard in Oakland had devolved by the 1980s and 1990s into a haven for drug traffic and violence. In 1995, the bank that held the mortgage on the property foreclosed on the owners. The city helped a Southern California non-profit, Corporation for Better Housing (CBH), acquire the property and convert it into 126 units of affordable apartments, where it became known as E.C. Reems Apartments (named after a well-known Oakland pastor, whose family acquired a 1% interest in the project).

Oakland loaned CBH \$2 million in 1996 to acquire and renovate the buildings with funds it received from three federal and state affordable housing programs. The Grand Jury learned that the terms of this loan are typical of those made to finance the development of affordable housing

throughout the country. Unless there is an annual positive cash flow (which as a practical matter, is very unlikely), payments of principal and interest are deferred until the earliest of (1) 30 years, (2) the date the property is sold or refinanced, or (3) in the event of a default by CBH that has not been cured.

The loan agreement set forth a variety of requirements specifying what CBH would accomplish during the renovations and what it was required to do regarding occupancy by income-qualified families and management of the property after construction was completed. This financing arrangement is a typical way for public agencies to support this sort of housing.

If a grant was made directly, then the public agency would lose its ongoing ownership position in the lien and thereby lose any power to correct for mismanagement or failure by the developer to be in compliance with its contractual obligation. By maintaining a lender position, the public agency can exercise its right to foreclose and reassign ownership to a more responsible party.

Over the next five years Oakland increased the loan amount three times, resulting in a principal balance of \$2,939,500 as of March 20, 2001. Oakland's loan, however, was subordinate to a multi-million dollar acquisition loan to CBH insured by the Department of Housing and Urban Development (HUD), which complicated and diluted Oakland's ability to enforce the covenants set forth in its loan agreement.

Building conditions quickly deteriorated and crime resumed. There were frequent turnovers in on-site property management. CBH claimed that cash flow problems prevented it from doing both routine and extraordinary maintenance, resulting in multiple complaints by tenants regarding mold, broken stairs, poor lighting, damaged mailboxes, and more. At one point a city crew had to make emergency repairs to the complex in order to stop raw sewage from contaminating a nearby creek. Despite a well-publicized affordable housing crisis in Oakland, a substantial number of the units remained unoccupied. Over the years, Oakland tried to make CBH comply with its obligations by sending many default letters and meeting with CBH and HUD officials multiple times, all with little result.

Eventually, by the spring of 2017, HUD was threatening to foreclose on its senior loan and put the complex on the open market. In order to prevent its secondary lien from being erased and to preserve the property, bad as it was, for occupancy by low-income tenants, Oakland's city council

voted in July 2017 to purchase HUD's mortgage for approximately \$3.6 million. By that time, principal plus accrued interest on the city's loan had reached approximately \$4.2 million.

Thereafter, the city issued a Request for Proposals (RFP) for a new owner/developer/property manager to take over the project from CBH, and to assume the outstanding loans. The city received two responses. The proposals were evaluated by Oakland's Housing and Community Development staff and by a three-person panel consisting of two former employees plus an industry expert. The outside panelists asked the city for financial information regarding the two companies submitting proposals, but it was not provided to them, although it apparently was available for at least one of the two proposers. The panel accordingly made its recommendation without sufficiently evaluating the finances of the two competing bidders.

One of the two proposals was to tear down the existing structures and rebuild; the other was to rehab the apartments within 12 months and operate the complex with new management. According to the staff report presented to city council, the evaluators selected the developer that proposed rehab rather than tear-down. The evaluators touted the developer's willingness to self-finance (although without knowing whether the developer had the financial wherewithal to do so), and its successful renovation of two failed Oakland Community Housing projects in East Oakland (77 units) after obtaining them from the state for \$10,000. The city council approved the loan assignment to the developer on November 21, 2017.

Although the Grand Jury shares the city's hope that the new developer will turn the E.C. Reems Apartments around, we remain concerned that adequate policies, structures and staff are not in place to ensure that the new company complies with its contractual obligations. We learned that, for the last several years, the city had only one employee with an inadequate housing inspection background to oversee approximately 100 affordable housing projects on a part-time basis. While the Grand Jury learned that the city recently hired a staff member with building inspection experience, it has been years since the city has been able to complete annual inspections and audits of all of its properties.

Housing and Community Development records are maintained on spreadsheets that only contain a limited amount of information rather than on project-tracking software that allows for complete reporting and monitoring.

Moreover the city has not invested in an appropriate database system for managing its affordable housing inventory. The Grand Jury heard that the department's records are maintained on

spreadsheets that only contain a limited amount of information rather than on project-tracking software that allows for complete reporting and monitoring. If one coordinator leaves, the next may not have an accurate record of the project status if the first was not a good record-keeper.

CONCLUSION

Cities and counties play an essential role in helping to administer and oversee significant public investments in affordable housing. In Oakland, both the voters and city leaders have been committed to providing such investments for decades. Most recently, voters approved \$100 million in bonds for affordable housing construction. The city of Oakland is distributing the funds in the form of loans but it is important for voters to understand that these are loans that most likely will never be repaid. Over the past 25 years, the city has provided private developers, including non-profit organizations, with these soft loans to build or refurbish thousands of rental units in over 100 affordable housing projects. In exchange, the developers were contractually obligated to keep the projects both habitable and available to low-income residents for decades.

Despite some success stories related to building such projects, the city has a poor history of ensuring that failing housing project owners and managers are held accountable when residents are living in substandard conditions. Decades of mismanagement at the E.C. Reems Apartments have exposed the city's failure to invest in proper oversight and enforcement of developer covenants. Lack of proper staffing, failure to inspect and audit each project annually, antiquated record-keeping systems and insufficient vetting of developers can only invite more failures like those that occurred at E.C. Reems and Oakland Community Housing before it. At a time when affordable housing is so essential, the city must make a more serious commitment to both protect this significant public investment and the vulnerable residents that these programs are supposed to support.

FINDINGS

- Finding 18-22:* Loans from the city of Oakland for affordable housing rental projects are typically provided for a term of up to fifty-five years and, in exchange, rents are restricted for that same period, making the rents affordable to lower-income households. No repayment is expected until the end of the loan period or upon transfer of the property, giving the public the perception that these transactions are grants of public money rather than traditional loans.
- Finding 18-23:* Oakland's Housing and Community Development Department has failed to inspect and audit all of its affordable housing stock annually, putting lower-income households renting at projects like E.C. Reems at risk of living in substandard conditions.
- Finding 18-24:* The Housing and Community Development Department's failure either to provide building inspection training for staff or partner with Oakland's Building Services Department to inspect its affordable-housing stock inhibits the agency's ability to respond to tenant complaints and protect the residents properly.
- Finding 18-25:* The Housing and Community Development Department's use of outdated technology to catalogue and manage data regarding the city of Oakland's affordable-housing stock prevents consistent oversight of those projects, putting public funds at risk.
- Finding 18-26:* Failure to maintain consistent policies related to the selection process for affordable housing developers, especially in the area of financial strength of applicants, invites project management failures like the one that took place at the E.C. Reems Apartments.

RECOMMENDATIONS

- Recommendation 18-18:* The Oakland Housing and Community Development Department must hire and train staff capable of properly inspecting and auditing all of Oakland's affordable-housing stock annually.
- Recommendation 18-19:* The Oakland Housing and Community Development Department must acquire a technology solution to help staff catalogue inspection, audit and other affordable-housing oversight data.

Recommendation 18-20: The Oakland Housing and Community Development Department must update policies surrounding the process for selecting affordable-housing developers to ensure that developer applicants provide sufficient information to city decision-makers about their financial capacity to build and manage these projects over the long-term.

RESPONSES REQUIRED

Oakland City Council

Findings 18-22 through 18-26

Recommendations 18-18 through 18-20

Mayor, City of Oakland

Findings 18-22 through 18-26

Recommendations 18-18 through 18-20