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Municipal Bank of LA: Housing Solutions and Portfolio Options

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Introduction & Relevant Mandates

This memo addresses one of the most cited reasons for a public bank in Los Angeles: its ability to support the city's broader infrastructure, housing, and sustainability goals. More specifically, this brief speaks to the capacity of our proposed Municipal Bank of Los Angeles, or MBLA, to increase affordable housing, while also pursuing parallel mandates to build community wealth and repair historical harms to underserved communities. Our proposals are meant to achieve cost savings for the city and long-term financial sustainability for the bank, which will not be run on a profit-seeking model.

The bank must comply with the partner-bank model envisioned in AB 857, the California Public Banking Act (discussed below). This law ensures that most of the bank's interventions in affordable housing will work alongside—and amplify—the efforts of many financial institutions and community development organizations that tackle housing insecurity. Below we account for the existing roles of government, private, and non-profit players in defining what the public bank might do. We focus on programs that address gaps in the affordable housing finance landscape and point out functions that are better served by existing institutions. The bank's democratic governance structure (described in a separate brief) could enable the public to give their input on the fraction of the portfolio dedicated to housing relative to other public investments. The overall structure and sequence of the bank, as well as proposed lending portfolios to support the clean energy transition and financial justice, are described in our Introductory Working Paper.

This brief is structured as follows: First, we provide a picture of the present crisis of housing affordability in Los Angeles, addressing the challenges faced by organizations working to increase housing affordability and financing gaps that prevent more rapid production or preservation of housing. We then speak to the opportunities within the city's existing financing environment and funds for affordable housing, the scale of available land for production, and the amount of naturally-occurring affordable housing (or "NOAH") that may need preservation. We then outline how a public bank might take up these challenges and financing opportunities, describing specific financial products which could be offered. We end by reflecting on some projected outcomes of those products. Legal and financial questions are addressed throughout, including recently passed legislation relevant to upzoning or reforms for infill development (SB 9).

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Section 1: Present Context of Affordable Housing - Challenges & Opportunities

The Landscape of Affordable Housing in LA

Los Angeles is at the center of the housing crisis that is spreading across the country. Almost half (47%) of households in Los Angeles county pay more than the recommended 30% of their income on housing costs.[1] That ranks Los Angeles as the most cost-burdened county in California, and among the top five most cost-burdened nationwide. It is also the least affordable metropolitan area with a population above 500,000.[2]

The typical Los Angeles home is totally unaffordable for most renters. The median home price in the county is $862,333, which makes the estimated median monthly housing cost (including mortgage, taxes, and insurance) over $5000 a month. The median household income in Los Angeles County is $75,000 per year, which means the typical Los Angeles household would have to spend 80% of their income on buying an average house. One survey of renters in Los Angeles Promise zones found that a majority of households cut back on consumption of basic needs like food in the last two years to afford rent. The high-cost burdens of the LA area are closely linked to LA's high levels of homelessness, which (at last count) increased 16 percent in 2020 (relative to 2019) to 41,290 individuals.

According to Los Angeles's Housing Needs Assessment, the county must add over 250,000 affordable homes by 2029 to meet its housing needs. The same assessment projects that only 51,000 affordable homes are on track to be added during that time period, less than 20% of the goal. To meet the new standard, the city has to radically increase its pace of housing production. Some advocates claim that even the goals of the Housing Needs Assessment are woefully inadequate.

[1] Statistics on Los Angeles county are substituted when statistics for Los Angeles city are not available.
[2] For the Los-Angeles-Long Beach-Anaheim metro area.

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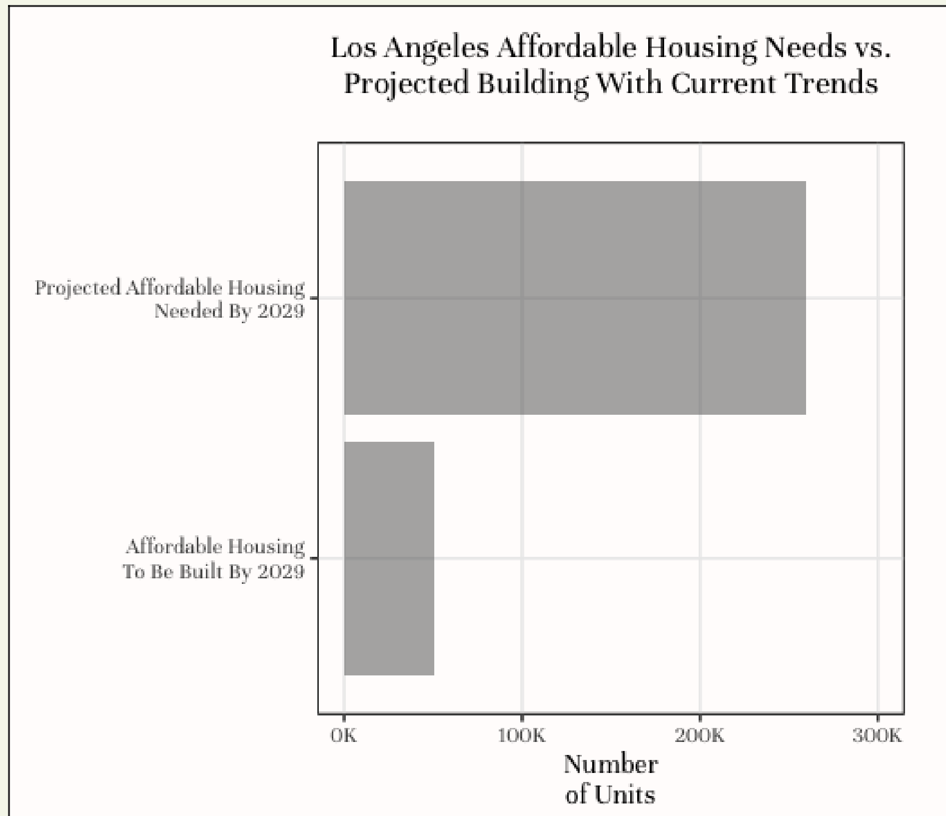

Challenges in Financing Affordable Housing Production & Preservation

As in many cities, affordable housing in the City of Los Angeles is funded through multiple sources, which are often layered together. The typical affordable housing project has over 15 sources in its capital stack. A vast majority of affordable housing includes some capital from government agencies. Often these funds flow directly from local government agencies. Their originating sources include local taxes and bonds, often housed in Affordable Housing Trust Funds, as well as federal programs, including Community Development Block Grants (CDBG) and HOME Investment Partnership loans or grants administered locally. Funds for some projects also may come directly from state or federal programs.

These subsidies are called “soft debt” or permanent financing because they come with low or no interest, are often repaid through residual receipts (a portion of cash flow leftover once all other operating expenses are paid), and are forgivable or commonly renewed at

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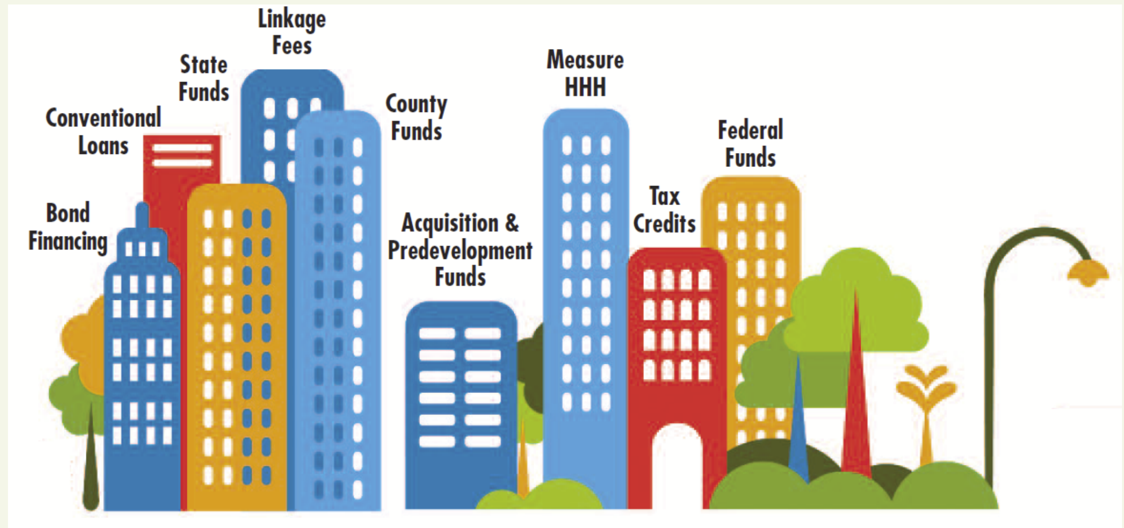
the end of their lengthy (30 to 55-year +) terms. These sources are vital for most, but not all, affordable housing projects, which would not be affordable without them. Other funds are contributed by post-stabilization subsidies like Project-Based Section 8, sourced from the federal government's Department of Housing and Urban Development (HUD) and administered through local housing agencies.

A second important source of funding for affordable housing projects is equity investment, which traditionally takes the form of proceeds from the sale of Low-Income Housing Tax Credits (LIHTC) to outside investors. LIHTC is a longstanding federal program wherein credits are awarded to developers through a lengthy and semi-competitive application process. The LIHTC program provides needed capital for projects to achieve affordable rent levels, which are restricted for 55 years.

The final source of funding is the senior debt obtained through federal programs administered by the California Housing Finance Agency (CalHFA), from community development financial institutions (CDFIs), or through private, conventional lenders like banks. Often referred to as hard debt, these loans may cover gaps like bridge acquisition financing or construction financing, depending on the project type. They typically require all subsidy and equity be committed before a loan is made, which is a major bureaucratic hurdle in assembling all the required financing for a project.

Figure 1: "Typical Housing Development Funding Sources" from the LA Housing & Community Investment Department (HCIDLA) 2018-21 Strategic Plan



Because the additional funding sources, like tax credits and local subsidies, are complex and difficult to navigate, development timelines for affordable housing projects are much

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longer than comparable private developments. There is an urgent need to innovate financing in order to compete with speculative investment—especially in the case of acquisition-preservation projects that expand affordable housing in the City to include currently unsubsidized sites. Investors often are able to purchase rapidly with cash on hand, outcompeting community-based organizations like community land trusts.

In general, senior debt lenders today offer loan products at standard market rates for new construction projects. However, for preservation and rehabilitation projects many conventional lenders do not offer loan products to affordable housing developers, in the absence of additional federal subsidies. Affordable housing projects may also have unique recapitalization needs that arise prior to the fifteen-year mark, which is when LIHTC projects have an opportunity to apply for public funds for repairs.

Together, these challenges in acquisition, production, and preservation lead to many gaps in the lending environment that a public bank would be uniquely well-positioned to fill.

Opportunities: Available Finance and Land for Affordable Housing

Housing Dollars Across the City

The city appropriates a complex array of revenue sources for its housing agenda An equally complex landscape of private capital and philanthropic dollars are invested in affordable housing. In this section, we identify some of the public and private funds the public bank may amplify. Yet this is not a complete picture of revenues or city deposits for housing that may be reinvested (particularly if the initial bank charter was that of an investment bank and not a deposit-taking entity). The public Bank of Los Angeles could seek to delineate which funds would be best managed in-house, including lending activity conducted by agencies with special status as non-bank financial institutions.

The City of Los Angeles budget for 2021-22 includes wide-ranging allocations for housing-related initiatives, drawing on general Fund revenues as well as d several established funds for housing initiatives from federal, state, and local sources. The total housing budget is upwards of $77 million, with further housing revenue sources also cross-appropriated in the city's economic and workforce development or related community development personnel costs (upwards of $5 million more than the city's overall $11.8 billion budget).

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Several of the city's revenue sources for housing programs are federal prograns. For example, the federal Department of Housing and Urban Development (HUD) provides the Community Development Block Grants (CDBGs), the HOME Program, the Housing Opportunities for Persons With AIDS (HOPWA) Program, and Emergency Solutions Grant (ESG) funds. Some trust funds and revolving funds in the city's budget represent consistent revenues from fees, loan repayments, and ballot measures previously passed at the state or local level.

Funds toward affordable housing development in Los Angeles also comes from HACLA, the Housing Authority of Los Angeles, which has a budget of over $1.84 billion; the Los Angeles Housing Department (LAHD), which oversees investments of Prop HHH funds ($1 billion)' and the Affordable Housing Managed Pipeline (AHMP), which leverages millions of dollars of the Affordable Housing Trust Fund, Affordable Housing Linkage Fee, and matched funds of the nine percent Low-Income Housing Tax Credit (LIHTC) program. Most recently, in the 2022 elections, voters approved a new tax on home sales above $5 million, which is expected to raise between $600 million to $1.1 billion per year. This revenue is earmarked for spending on housing and preventing homelessness, but is currently being challenged in court.

The County of Los Angeles has a much larger budget, with a $533 million spending plan for housing in 2022-23. Most of the county budget comes from Measure H, a sales tax passed in 2017 with the funds dedicated to preventing homelessness, and the rest of the fund comes from state revenues. That budget primarily goes to permanent supportive housing services, rental assistance, and interim housing.

We envision that MBLA will lend at an anticipated capital ratio of at most 15%, with more flexible terms than existing capital sources, and—if modeled after the Bank of North Dakota—with the backing of the city's full faith and credit (its capacity to tax and subsidize projects undertaken by the bank as a public mandate). As such the bank will serve multiple functions within the landscape of existing housing finance nonprofits, CDFIs, and governmental agencies. First, it will be a first mover and market maker for new forms of affordable housing finance. Second, it can engage in secondary markets for its lending programs in order to continually grow its portfolio and spread risk across a diverse range of lending programs. Third, it can serve as a convener and coordinator with informal monitoring functions across the wide range of players in the housing finance ecosystem in Los Angeles. Experts from several CDFIs and developers have indicated that this is a need met largely through informal networks at present. While there will be some overlap between the bank's affordable housing aims in this portfolio and those of other financial institutions, the bank—by mandate—will support and amplify those goals.

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Scale of Unsubsidized Housing Available for Preservation

Unsubsidized affordable housing (at times referred to as naturally occurring affordable housing or "NOAH") refers to units whose rental cost is affordable but is not subject to a deed restriction or affordability covenant. These units are often found in disinvested neighborhoods, have intensive repair needs, and are rent controlled with long-time tenants. When longtime tenants move or are displaced, often through renovation loopholes that allow for the pass-through of construction costs that they cannot afford, rents on these units can rise to unaffordable levels through vacancy decontrol.

Unsubsidized units make up an estimated 80% of all affordable housing in Los Angeles County. As such, the acquisition and preservation of unsubsidized affordable housing is vital to the expansion and protection of affordable housing. Until acquired and preserved by a mission-driven organization, these units lack deed restrictions to keep them affordable into the future. An estimated 14,000 units of subsidized affordable housing are at risk of expiring by 2031.

The Scale of Land Available for Development

A public bank cannot take on all aspects of LA's housing crisis. For instance, restrictive zoning laws often prohibit development and make development on the land that is available more expensive. However, existing zoning laws are not so restrictive as to make development impossible altogether. The McKinsey Global Institute analysis of LA's zoning code found that the city has the potential to add 1.5 million to 1.9 million housing units under current legislation. While some of that excess capacity is in transit deserts or would involve marginal increases in the capacity of existing buildings, there remains significant unused capacity near mass transit. Specifically, the institute found that 40,000 parcels of land near transit are utilizing less than 25 percent of their zoning allowance. Another 14,800 parcels utilize less than half their allowance. Analysis by the Terner Center found that new multi-family developments often do not take advantage of their full zoned capacity. There are also ample opportunities outside of existing residential areas. According to the ACCE institute, there are over 20 square miles of corporate-owned vacant lots in Los Angeles that could be developed into affordable housing.

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Section 2: The Role of MBLA - Solutions & Recommendations

Many advocates of public banks envision these institutions as low-cost ways to protect public revenues from financialization. By contrast, private, for-profit institutions extract large fees for their services (skimming off of public revenues) and also make investment decisions outside the purview of public input. Without additional data from the City of Los Angeles and City Controller, we are unable to estimate the savings they would accrue from moving financial operations and deposits from privately-managed coffers and the various agencies that presently hold portions of the city's revenues (housing or otherwise) to a public bank. Estimates from the San Francisco Municipal Bank Feasibility Task Force are inconclusive; there was considerable disagreement among experts of that committee on the scale of startup subsidies projected in their final brief, which ultimately suggested little to no cost savings.

Efforts to establish MBLA should approach lending products as a menu of options that may be operationalized at different points in the first ten to twenty years, with more revenue-generating loan products prioritized at startup to ensure breakeven in three to five -years, similar to other new banks. A fluid loan portfolio could spread net losses from operational startup costs.[3] Likewise, it is possible to move housing and community development trust funds over to MBLA, as they function similarly to some of the proposed lending programs outlined below. While we do not discuss this possibility within the brief, we also expect the city could, with careful implementation and sequencing, generate cost-savings over the long term, if funds were kept within a not-for-profit, public-serving institution—the municipal bank—with lower associated fees and greater democratic oversight. Forthcoming data from the City Controller's office could substantiate this analysis.

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[3] In the case of the City of San Francisco, the Municipal Bank Feasibility Task Force estimated that moving all public revenues over to the public bank would require charging the city an equal amount ($600,000 to Bank of America annually, in the case of San Francisco) for the cash management, while also seeking significant additional subsidy to develop the bank's technical capacity to mimic the functions served presently by a large private bank, Bank of America. Based on those estimates, moving all city deposits over to the public bank would not result in immediate cost savings, and may extend out the bank's break-even point after initial capitalization and subsidy for startup. However, some members of that feasibility task force disagreed with the large start-up cost estimates of such bank functions, noting in the appendix that experts with significant experience in commercial banking might rightfully disagree with the expected costs, and that loan-fee revenues and a fluid loan portfolio could "spread net losses to cover operational expenses and generate growth to meet future mission oriented demand."

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Instead, in this brief, we focus on a lending program that relies on new funds provided through the bank's initial capitalization. Further detail on existing city programs (or unappropriated revenues) that may be subsumed under MBLA may emerge from the city's ongoing efforts to build out a business plan and viability study with a chosen consultant.

Proposed Products and Programs

There are several ways that a public lender could facilitate the production and preservation of additional affordable housing—. A sufficiently large public bank could simply take over existing mortgage lending. This would certainly bring some benefits to the affordable housing development community: more favorable loan terms, more leniency/less aggressiveness, and more willingness to take on certain kinds of risk. But a public lender could reach more households and support more affordable homes if it expanded production beyond today's subsidy constraints.

Developer Pre-Underwriting & Construction Contractor Prequalification

A recurrent obstacle in the creation and preservation of affordable housing is the time and labor involved in underwriting for each project. Underwriting involves an assessment of the qualities and risks of the individual project, as well as the qualities, risks, experience, and track record of the individual developer. The complexity of the capital stacks assembled from multiple sources makes this process even more time-intensive. Individual projects must be underwritten as they coalesce and move to the financing stage. However, timelines can be reduced by pre-underwriting individual developer organizations. Developers and lenders alike have called for this process innovation. With projects passing more quickly through underwriting, labor is freed up on both the developer and lender end to pursue more projects overall.

As a public financial institution deploying funds locally, the Municipal Bank of Los Angeles (MBLA) will be well-positioned to establish organization-level underwriting. This will occur ahead of individual project underwriting with a trusted set of local developers. This organizational underwriting can be periodically updated and the pool can be expanded over time, as newer developers. This emergent network of pre-underwritten developers adds a layer of transparency that offers strength, reduced risk, and greater affordability to the product recommendations that follow. This can in turn prompt mainstream financial institutions to offer lower-cost debt while mitigating the risk assumed by the bank.

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In addition to developer pre-underwriting, California Public Works already has a model for contractor prequalification, which the bank can mimic and expand upon, to mitigate some of the risk involved in construction lending. As outlined further in the "new construction loans" program below, construction finance comes with well-known risks: unpredictable environmental factors that can disrupt build timelines; completion issues with building mistakes or equipment issues and missing or incorrect data; compliance risks with regulatory requirements; the likelihood that borrowers will not pay premiums until a few years after a project begins due to varying costs, reliability, and availability of contracted labor; and finally, fluctuations in market trends that change the expected value of projects as they are being built.

Some of the compliance risks can be attenuated by the use of construction finance software like Built Technologies, Rabbet, and Land Gorilla. The bank could also mimic these software solutions through its own process of prequalification, which would also involve assessing a contractors' record of completion, insurance, use of contingency budgets, and related factors that can mitigate risk in construction. MBLA's contractor prequalification would help borrowers secure take-out loans as the bank has preempted construction with its risk-mitigating approach.

Following are several examples of capacity-expanding loan products and deal structures that MBLA could offer to build on existing lending to accelerate the preservation, production, and purchase of affordable housing. The municipal bank should carefully weigh the administrative burden and timelines associated with each, and develop a plan for sequencing implementation accordingly.

I. Rapid Acquisition Fund

Some public land is available for development and should be prioritized for transit-linked, affordable housing wherever possible. However, the acquisition of land and housing by developers and community organizations is necessary for both new construction and preservation of currently unsubsidized housing. The pace of real estate transfers is rapid, with a majority of homes sold in under a month from the time of listing. Investors—including enormous multinational firms—are often able to close with cash, requiring no time to align financing. As of 2020, investment entities owned two-thirds of all residential units in the city.They currently account for one in five new sales. By contrast, affordable housing developers must line up complex capital stacks in order to finance acquisitions.

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While some larger developers have sufficient equity for competitively rapid acquisition, many do not. In particular, community land trusts play an important role in the preservation of smaller sites and are unlikely to have the needed acquisition capital on hand. Given access to appropriate acquisition capital, many community land trusts in Los Angeles are well-positioned with internal expertise and community grounding to do the vital work of preserving unsubsidized units within the city.[4]

These dynamics point to the opportunity for MBLA to establish a rapid acquisition fund. With loan terms of one to five years, a rapid acquisition fund deploys capital for the timely acquisition and preservation of sites for affordable housing. In that period, affordable housing organizations work to replace the acquisition capital with a mix of longer-term loans, including construction loans where necessary, and permanent government subsidies. Once returned to the revolving fund, the rapid acquisition capital is deployed again for the acquisition and preservation of new sites.

This fund could be paired with the suggested program of organizational pre-underwriting by the bank, as well as new funds available through Measure ULA Together, they help the city make large strides toward closing the gap between the pace and capacity of the private market and that of affordable housing actors. At present, many acquisitions are financed with a combination of developer equity and bridge loans, with the bridge loans slated to be replaced with longer-term financing and permanent subsidy within one to five years. As bridge loans often carry higher interest rates, it can be challenging to finance more unconventional projects with them. Stitched into the fabric of affordable housing creation and preservation in the City of Los Angeles, and paired with a mandate to stem displacement through its activities, MBLA's local and strategic risk analysis[5] can allow it to offer more competitive terms to a wider set of projects.

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[4] Community housing organizations or developers may also recognize opportunities for use of the acquisition fund in the case of housing incompletes, when private developers may have incomplete developments or acquisitions, in order to transfer incomplete housing projects to nonprofits or the bank itself.

[5] As mentioned in the Democracy Collaborative report "Constructing the Democratic Public Bank," and drawing from an ISLR report in 2020, community banks generally lend more to under-resourced individuals and community-based institutions due to a more holistic assessment of their borrowers, rooted in local knowledge and relationships. We do not define what this alternative risk analysis would be, but we posit that the bank's KYC and other assessments will be more vested in neighborhood and local outcomes. Likewise, HCILDA has proposed a rating system for neighborhood improvement projects (in keeping with CDBG guidelines), and the public bank could similarly opt for such projects thereby "vouched for" by mission-aligned development agencies of the city.

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Scale of Investment

1. Conventional lenders are often able to lend on up to 80 percent of loan to value for acquisition-rehabilitation projects.
2. The gap to be addressed through acquisition financing is the remaining 20 percent of value plus predevelopment, rehabilitation, and soft costs. These can vary widely by project.
3. Assuming the cost of preservation is on average two-thirds that of new construction, the average cost of affordable housing preservation may be $450,000 per unit.
4. With an initial rapid acquisition fund of $13.5 million, this loan product can fund $129 million[6] in acquisition-rehabilitation projects, or 471 preserved affordable units.
5. Terms will be made flexible in accordance with uncertain funding timelines, with a range of 1-5 years. Interest rates under 3% are likely to be affordable relative to the market.

II. New Construction Loans

At construction, the simplest new multifamily housing development has three primary items in its capital stack: senior debt, construction equity, and developer cash equity. While debt products reflect the interest rate environment, construction equity from private partners is a typically expensive source of capital. Replacing private equity investments with construction period loans from MBLA would significantly reduce construction costs for mixed-income housing developments and expand total affordable housing production beyond the subsidy constraints that exist today.

Construction loans are considered risky investments, which is why they come with higher interest rates than mortgage or permanent financing loans, for example. Because construction loans must be repaid in a relatively short term (compared to a 30-year mortgage, for example), and construction is a uniquely complicated process, the chances of failure are higher than in the standard long-term operations of a property. There are many things that can go wrong in the course of a construction project (as discussed above). Further, complications during the construction period can lead to defaults due to the short construction period window.

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[6] See the Capitalization section under “Capitalization, Paths to Incorporation, and Democratic Governance” in the introductory working paper for an explanation of how leverage can be used to loan a much larger sum than the initial capital allocation.

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For this reason, government housing finance agencies and local housing departments very rarely make construction loans. In general, gap financing for affordable housing development comes from a mix of local grants and equity proceeds from the sale of Low-Income Housing Tax Credits. However, the availability of such subsidies is limited by both federal and local fiscal constraints, making public construction bridge financing a strong candidate for unlocking additional affordable housing production.

The local public housing authority in Montgomery County, Maryland has found a way to reduce interest rates in this type of lending with a new program they call the Housing Production Fund. The public housing authority takes out conventional debt for the majority of its project costs. In addition, it has a $100 million revolving fund that is used to loan into projects for the construction period at a lower interest rate. Transparency between the lender and developer, who in this case are the same entity, reduces risk to the former r.

MBLA can achieve a similar effect in the City of Los Angeles ecosystem, through developer pre-underwriting or contractor and subcontractor prequalification, as described above. This approach would similarly ensure transparency into a contractor's performance history and financial solvency. For developers, prequalification would assess previous project timelines, completion rates, and other key indicators. The risk of construction lending would not be wholly mitigated. But coupled with a diverse lending portfolio and loan-loss reserve expectations that are backed by the City, the product would play a key role in increasing housing production and closing a stop-gap for some developers.

As a way to hedge against risks associated with construction finance, commercial lenders often require that a developer identify a take-out source prior to offering them a short-term, high-interest construction loan. Take-out lenders are often large financial institutions that, after a given stage of development or period of time, buy out the loan, allowing developers to refinance with permanent debt that comes with a lower interest rate and a longer repayment period. MBLA may additionally mitigate risk in construction lending by supporting pre-qualified developers in seeking a take-out source when a project is 80 percent complete. Bundling construction finance loans on successful projects for a secondary market (e.g. the secondary mortgage market) can also mitigate risk. Finally, as mentioned in the contractor prequalification section above, the bank would mitigate some of its risk by giving preference to developers that incorporate contingency funds in their overall construction budgets, particularly within industry benchmarks of 10% and 15%.

In the case study of Montgomery Country, projects that draw on the Housing Production Fund are majority financed with conventional debt, with the HPF construction bridge loan covering 15-25 percent of total project costs with a four-year loan, which is taken out at

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stabilization when the project acquires permanent financing. Those funds then revolve back into the HPF and can support a new project the very next day. The low-interest construction investment allows the public housing authority to make rents more affordable, supporting a significant proportion of Very Low-Income and Low-Income apartments in mixed-income projects. These mixed-income projects achieve subsidization of rents by cross-subsidizing moderate-income and market-rate rents. However, projects financed in this way can also be stacked with additional sources of subsidy should they become available, such as tax credits, vouchers, or local and state grants.

MBLA could achieve significant increases in total affordable housing production by offering construction period lending products to housing developers, or to partner public agencies developing new public housing. Legislation in the California legislature this year proposed the establishment of a new state-level agency, called the California Housing Authority, tasked with developing mixed-income public housing projects. MBLA could be a strong investment partner in such projects, should the legislation pass in the future.

Scale of Investment

1. Bridge construction loans make up around 20 percent of the overall cost of new construction.
2. New affordable housing in Los Angeles can be assumed to cost around $700,000 per unit, although costs per unit can vary widely by project.
3. With an initial fund of $18 million, this loan product can fund over $170 million in new construction projects, or 404 new affordable units every year assuming three-year loan terms.
4. The fund will grow year-on-year at the scale of the interest rate. Interest rates under 10 percent are likely to be affordable relative to the market.

III. Recapitalization of Existing Subsidized Multifamily Housing

By year ten to fifteen of a typical multifamily housing development, there are often recapitalization needs, such as roofing repairs, HVAC repairs, plumbing repairs, and so on. Funding reserves are required to be set up to fund repairs. Yet, according to a 2012 report from the Department of Housing and Urban Development on LIHTC properties, these reserves are “usually insufficient after 15 years to cover current needs for renovation and upgrading.”

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For LIHTC-funded projects, the 15-year tax credit renewal can help facilitate these investments. However, the renewal process takes time, and putting together subsidies is complicated, much like in the predevelopment phase. In high-rent areas such as Los Angeles, if further subsidies are not available, developers may convert the property to market rate after 15 years—there is a process to exit affordability requirements and the tax credits cannot be recaptured. California LIHTC projects are also especially likely to need more funding for capital improvements because they often exceed the affordability requirements set out by the Federal government, meaning they have less income from rents to fund repairs than projects that simply meet the minimum standards.

Most conventional banks do not offer recapitalization loans for affordable housing projects. This is, in part, because the regulatory environment is difficult to navigate. Subordinate mortgage loans for developers would allow for more rapid recapitalization of projects near or in the process of acquiring longer-term stability, aided by tax credit renewal. Even small loans could help owners make needed upgrades more quickly, which helps prevent maintenance problems from worsening and becoming more expensive. Moreover, many recapitalization projects can double as green energy retrofits, electrifying heating, improving insulation, or adding solar power (see our brief on the bank's climate portfolio for more information on this subject).

A public bank could offer recapitalization loans to affordable housing developers. These serve an important social goal that public lenders can facilitate when private banks will not.

Scale of Investment

1. There are 9,086 low-income units in LIHTC buildings in the city of Los Angeles that came into service between 2010 and 2015 and are thus up for 15-year renewals.
2. To give all LIHTC projects loans of $10,000 per unit at the fifteen-year mark would cost approximately $15 million dollars per year, providing repair funds to 1,000 units every year.
3. Assuming an average of three-year loan terms (terms should be made flexible in accordance with uncertain funding timelines) and a three percent interest rate, profits from interest can be allocated to the administrative costs of running the loan program.
4. With an initial capital allocation of $2.25 million dollars, the fund could support total loans of $61 million dollars and give loans to approximately 700 units per year, assuming funds revolve after an average of three years. This fund would be able to give loans to roughly half of all LIHTC projects in Los Angeles hitting the

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fifteen-year renewal mark every year. Profits from other bank projects could also be reallocated to expand LIHTC recapitalization.

IV. Low and Moderate-Income Homebuyer Mortgage Assistance

Currently, the city of Los Angeles runs a low and moderate-income home purchase assistance program that could be relocated to MBLA and expanded. The program is aimed at residents who can afford the monthly payments on a mortgage but are not able to save for a large down payment. Homebuyers contribute at least one percent of a house's cost to a down payment. The city contributes up to $140,000 for a down payment, closing costs, and acquisition fees. Household size income restrictions apply. Smaller amounts of assistance are available for households with higher incomes.

The program enables low-income home buyers to buy a house without an onerous down payment, which many would-be first-time home buyers cannot save up for, t due to the high cost of renting. Moreover, for moderately priced houses, the program enables renters to qualify for a traditional mortgage at favorable rates, thus avoiding the mortgage insurance costs associated with a smaller down payment. This further pushes monthly costs down.

The money given by the city is not a grant. Homebuyers who enroll in the program have to both pay back the initial loan and give the city a share of the home's appreciation over time. The share of appreciation due to the city is equal to the share of the purchase price it initially supported. Homeowners can deduct their initial downpayment, transaction costs, and eligible capital improvements from the appreciation share due to the city. Importantly, the money due to the city operates as a deferred loan. It is due only at the time of sale, or after 30 years. There are no monthly payments to the city.

Currently, the policy operates on a small scale. Between the fiscal years 2013 and 2017 (the only data available), an average of 116 homebuyers were enrolled in the program per year. Administratively, the program is run via for-profit private bank partners. Both of these things (the scale and program administration) could change under MBLA.

First, the program could be massively scaled up. Since the funds are eventually paid back, there would be no net fiscal cost to the city. (We assume average repayment in ten years and appreciation of ten percent per year, as outlined below. In addition, MBLA may engage in the secondary mortgage market as needed). The losses from the occasional homeowner that fails to repay funds would be more than offset by the profits from shared appreciation.

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Second, the program could be administered by MBLA. At the current small scale, it may make sense to let private banks with home-mortgage expertise administer the program, rather than developing in-house expertise. However, at a large scale, these functions should not be outsourced to extractive, for-profit institutions. Moreover, under MBLA's jurisdiction, it would be easier to provide further aid once residents are making payments on their mortgage, rather than stopping assistance once a mortgage has been procured. Differing mortgage payments due to temporary income loss (without changing mortgage holders' long-term obligations) can effectively prevent foreclosure at only a small fiscal cost.

Third, the program could be expanded to offer deepened support. Jurisdictions across the country offer mortgage rate subsidies alongside downpayment assistance. Should appropriate funds become available through bank capitalization or City of Los Angeles subsidy set-asides, MBLA will be well-positioned to add lower, blended mortgage interest rates to its homebuyer mortgage assistance program. This will further reduce the monthly housing cost burden for homebuyers.

Fourth, the program could expand to allow the purchase of owner-occupied two-four unit buildings, where the new owner occupies one unit while renting out the others.[7] Currently, the Los Angeles program is limited to purchases of single-family homes or a single unit in an apartment complex or condo. However, the growing cost of housing is putting these properties increasingly out of reach for lower-income Angelenos. Small multi-family buildings, while having a higher purchase price, can be more affordable on a monthly basis, once rental income is factored in. Importantly, buildings that have four or fewer units still qualify for mortgages backed by the Federal Housing Administration. Non-resident investor owners would not be extended this subsidized financing, which puts resident owners at an advantage.

By allowing the purchase of owner-occupied two-four unit buildings, the program will also benefit incumbent renters. Currently, small multi-family properties that go up for sale in Los Angeles are often bought by large investors, who often displace tenants, conduct luxury renovations, and then rent out to new tenants at a significantly higher price. This is unlikely to happen with lower-income owner-occupants supported by an MBLA deferred loan program.

For one, they are less likely to be able to afford a luxury conversion. More to the point, their structural financial advantage will disincentivize them from seeking a large return on investment. If they purchase a unit in a building that has four or fewer units, owners

[7] We thank Ruby Harris for this idea.

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can still qualify for mortgages backed by the Federal Housing Administration, which gives them better financing terms than non-resident investor-owners. As live-in landlords, owner-occupiers will also face less overhead costs than an offsite company. They should thus be comfortably able to make monthly payments without enforcing large rent increases. On-site landlords also tend to establish personal relationships with their tenants, making them more flexible with those struggling with rent. Large investor owners are more likely to resort to foreclosure immediately after a missed payment. Lacking a personal relationship with the tenant, these corporate conglomerates cannot distinguish between tenants unlikely to ever catch up on rent and those experiencing a temporary setback.

Scale of Investment

1. We assume an average loan amount of $400,000 to support a mix of single-family and multi-family properties, with an average purchase price of $2 million dollars.
2. We assume an average loan term of 10 years and an average home value appreciation of seven percent per year.
3. With an initial capital allocation of $4.5 million, this program would initially support over $40 million in total lending for over 100 households to buy a single family home or multi-family property.
4. To scale the program more quickly, loans that are showing strong signs of success (i.e. property value appreciation and good payment history on the underlying mortgage) could be packaged and sold on the secondary mortgage market based on expected profits before the loans actually come due.

V. Homeowner Accessory Dwelling Unit (ADU) Creation Assistance

While it is critical to help lower-income Angelos move from renting to owning, homebuyer assistance programs do not address the lack of housing supply, which is the underlying issue that makes housing increasingly unaffordable in Los Angeles. While several of the bank's proposed lending programs increase supply, the bank can also increase available housing in Los Angeles by helping low and moderate-income homeowners add housing units to their property.

Over the last five years, California has passed several laws liberalizing zoning rules to allow the construction of additional units on parcels zoned for single-family homes. More recently, the city of Los Angeles has rolled out a series of programs supporting ADU development. These laws are a tremendous opportunity to construct new housing units,

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but significant barriers remain. Chief among these barriers is financial: the costs of planning, permitting, and constructing new dwelling units are very high. MBLA can help ameliorate this problem with shared appreciation loans, which ease the homeowner's path to qualifying for financing by sharing the financial return of adding new housing with the homeowner.

According to one 2021 survey, ADUs can cost upwards of $150,000 to build. As such, only the wealthiest homeowners can afford to build a substantial number of homes. Most incumbent owners will require financing, which current financial products are ill-suited for. Two common status-quo ADU financing options are home equity loans and renovation loans. Generally, home equity loans are only accessible to homeowners with significant equity and excellent credit. Similarly, large renovation loans tend to be accessible to higher-income borrowers. While there are some more economically accessible renovation loans backed by the federal government (via Fannie and Freddie and the FHA), they tend to be too small and bureaucratically cumbersome to be workable. Most lenders (including those unbacked by any government guarantee that would allow for higher lending amounts) do not consider the income generation potential of ADUs when evaluating an applicant's creditworthiness. Financing such a large project is thus impossible for all but the wealthiest homeowners. Moreover, many of the wealthy homeowners who would qualify for financing would not be interested in constructing an ADU to rent out because they do not need additional rental income.

The construction of ADUs offers two new income sources for homeowners: they can rent out a part of the property or split the lot and sell the property with an ADU. Accounting for this potential income increase, MBLA can unlock a vast market for ADU construction excluded by the present financing system. Of course, construction is an inherently risky process. Some approved loans may not convert to actual rental units. MBLA will guard against such large-scale losses or onerous interest rates by sharing in the increase in home value from the construction of the additional dwelling unit, similar to the terms outlined in the homebuyer assistance program.

To qualify for the program, existing homeowners would need to cover ten percent of the estimated construction costs as a down payment. MBLA would cover the remaining costs in the form of a conditional loan. All existing homeowners would need to agree to either rent out the additional unit(s) created or to split their existing lot and sell the new lot (with the new housing unit(s)) on the open market. This ensures the funds create new housing supply and makes loan repayment more likely.

The specific loan terms would depend on whether the homeowner wishes to sell or rent the ADU. If the homeowner decides to split their lot and sell the property, MBLA would recoup all loaned construction costs plus 15 percent at the time of sale, taking the deed to

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the split lot as collateral before construction begins. If the homeowners want to rent the property and preserve their right to ownership, MBLA would structure the loan like a traditional second mortgage using market rate interest rates. However, unlike a traditional second mortgage, payments on the additional mortgage would only come due after ADU construction. This monthly mortgage payment structure would differentiate MBLA's offering from private shared appreciation loans, for which the entire loan amount plus value appreciation is due as an onerous lump sum after roughly ten years, with no monthly payments.

These terms would help maximize the program's appeal, both to homeowners who want a significant payout from a short-term sale and to those who want a continuous stream of rental income. Options would be extended to homeowners depending on the projected value of the ADU for rent or sale. Only homeowners projected to make a significant profit given the loan terms would access these MBLA funds, to facilitate reinvestment and increase the likelihood of project completion.

MBLA could also work with the city housing authority to direct low-income families with housing vouchers to the newly created ADUs. Currently, many residents who receive housing vouchers struggle to find landlords willing to lease to them. ADUs financed by the bank could be leased to voucher holders, with homeowners receiving financing options from MBLA in return. Beyond meeting the bank's affordable housing mandate, this also makes financial sense. Voucher holders' rent payments are subsidized by the government, providing homeowners an assured source of income to repay their loan.

Scale of Investment

1. We assume average construction costs of $200,000 per deal, creating an average of 1.5 units of housing.
2. We assume a 50:50 division of homeowners opting to lot-split and sell vs. preserve and rent.
3. With an initial capital allocation of $6.75 million, this program could initially produce almost 500 units of new housing and over a 7% profit.

Non-Bank Legislative Measures for Affordable Housing

The City of LA Department of Housing and Community Investment (HCIDLA) strategic plan for 2018-2021 addressed some of the legislative changes that might enable more affordable housing development and preservation. HCIDLA's proposals overlap somewhat with the programs envisioned for MBLA in this memo. Expanding those recommendations may serve to increase the impact of the bank. For example, the

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Managed Pipeline process of the HCIDLA provides gap financing that leverages public and private resources in the high-cost and planning-intensive period of pre-development, as would MBLA. Likewise, the HCIDLA has suggested creating a universal online funding application with the County Community Development Commission (LACDC) and HACLA, the Housing Authority of the City of Los Angeles, which is similar to our recommendation for a developer prequalification tool. In addition, HCIDLA emphasizes the need to recapitalize housing development programs like the Affordable Housing Managed Pipeline (AHMP) and use a part of these funds to both pilot new affordable housing programs and augment existing efforts for development and preservation. Advocates have highlighted important new potential sources of capitalization, such as a Vacancy Tax, a Flipping Tax, a Real Estate Transfer Tax, an Out-of-State Transaction Tax, and an increased Gross Receipts Tax. At the same time, they have called to disincentivize practices that stem housing affordability and access in the city.

HCIDLA also supported the founding of a housing finance agency to enable affordable housing developers and city departments to access public finance markets, in ways similar to those envisioned in this memo for MBLA. Another overlapping proposal was pushed this year by San Jose Assembly Member Alex Lee, in his Social Housing Act (AB 2053), which would have created a publicly-owned housing agency that acts to leverage public dollars statewide in housing production and preservation. The bill passed the CA State Assembly but was blocked in the Senate. Successful recent legislation includes SB 8, which expanded the Housing Crisis Act of 2019; SB 9, the California HOME Act, which allows duplex and two-lot subdivision approvals without CEQA (California Environmental Quality Act) review; and SB 10, which enables cities and counties to upzone qualifying properties, likewise without environmental review holdups. Still, further legislation may be needed, as the obstacles to affordable housing extend beyond financing gaps. These include historic patterns of housing segregation and exclusion, NIMBYism or opposition to neighborhood change, regulatory hurdles for developers, insufficient zoning at the local level, and greater federal dollars toward affordable housing finance (subsidy and LIHTC/lending alike).

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Section 3: Outcomes and Balance Sheet Allocation Options

The suite of product and program recommendations outlined here aims to intervene at each stage in the life cycle of affordable housing production and preservation, leveraging the unique positionality of a public bank in the City of Los Angeles. The affordable housing need is immense: Los Angeles County estimates a nearly 500,000-unit shortfall and is not on track to meet its Regional Housing Needs Allocation targets to close that gap. Los Angeles residents are the most cost-burdened in California; housing in the city is the second most unaffordable in the country. Speculators outcompete both local homebuyers seeking to remain in their communities as well as mission-driven organizations poised to apply deed restrictions and preserve affordability. The fiscal and social costs of maintaining investments in affordable housing at their current, inadequate levels are likewise immense: growing rates of houselessness, increasing shelter and social service provision, and related well-being impacts of overcrowded living, health and social fallout of housing insecurity, worsening labor market participation or recidivism.[8]

A rapid acquisition fund would provide needed capital to aid in the preservation of existing unsubsidized affordable housing, which makes up the vast majority of all affordable housing in Los Angeles, and the acquisition of vacant land for new construction. A robust ecosystem of new and emergent community land trusts would be well-poised to take advantage of additional investment into acquisition-preservation in particular. Community land trusts operate with local resident oversight and governance to remove land and housing from the speculative market, making those units permanently affordable with a one-time influx of subsidy at the time of acquisition.[9] This important tool is broadly supported among housing advocates in Los Angeles, as it gives residents voice and agency in local development. With an initial investment of $15 million, MBLA's Rapid Acquisition Fund could facilitate the acquisition and preservation of an estimated 166 units in its first round of lending.

This would not be a groundbreaking intervention. All it involves is taking existing products and amping up their use. Since 2010, the City of Los Angeles has provided an average of

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[8] Not to mention the well-known impacts of housing on social mobility, particularly for young children who have housing security in mixed-income neighborhoods. The Joint Economic Committee, a bicameral committee of the US Congress, also published a brief pointing to the impacts of affordable housing.
[9] Community control through land trusts is also aligned with aims for democratic control of development.

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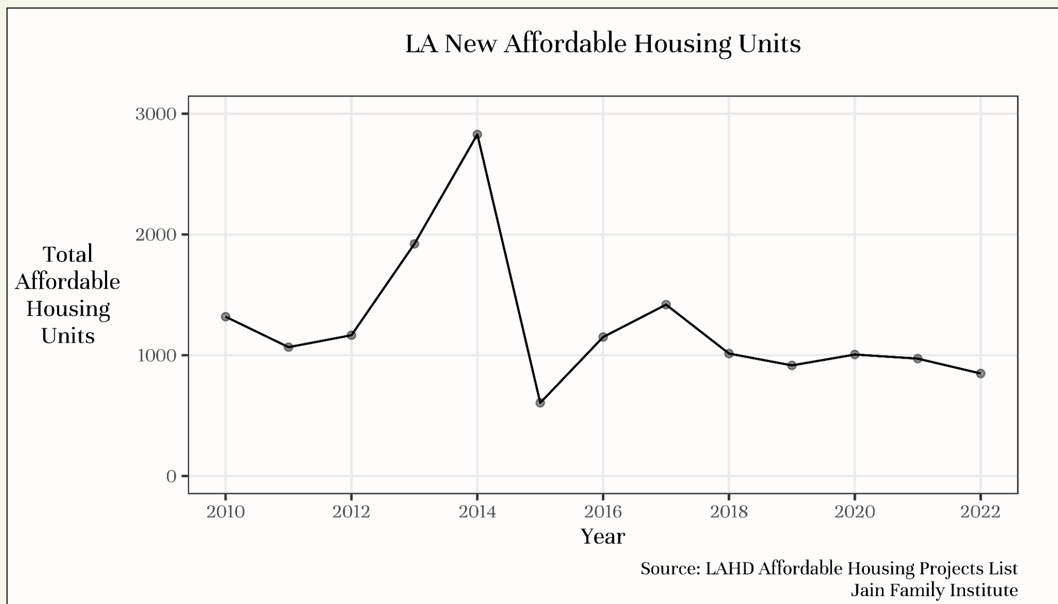
1,118 units of affordable housing every year (including both new construction and rehabilitation/preservation projects). The products offered by MBLA would add or preserve approximately over 1,700 units per year (not counting loans for recapitalizing existing subsidized housing). Most of the proposed projects only cover a part of the financing needed in the life cycle of affordable housing projects. Nevertheless, these innovations can help reverse the recent trend of declining affordable housing production since 2017 (see Figure 2 below).

Figure 2: New Affordable Housing Units Produced in LA



Together, the proposed products and initial capitalization level can facilitate projects at more than double the level that the City currently funds annually. Better terms and capital with lower interest rates will reduce the overall cost of housing projects, helping to close the financing gap and allowing city dollars to go farther. However, for most of the proposed products, the financing innovations are only part of a project's overall financing–they also require direct subsidy. In order to fully realize the preservation and production potential of the municipal bank's products and programs, the City of LA may also need to dedicate additional subsidies.

To estimate some of the impacts of these proposed housing-related lending products, we assume 45 percent of the overall public bank portfolio is dedicated to its affordable housing mandate. With an initial startup capitalization of $100 million overall (with $45 million toward housing), this would allow for a loan portfolio over $400 million, if we assume a 10.5 percent capital ratio. Of course, the municipal bank's mandate and priorities may differ from the allocation we describe here, as it will be democratically

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governed. This will require adjusting targets and capital allocations. In keeping with the spirit of AB 857, these programs should be constructed in dialogue with existing institutions in the affordable housing landscape, which may support MBLA in dramatically amplifying efforts to protect and produce affordable housing throughout the city.

The table below summarizes a sample portfolio with projected profits and housing units created. Importantly, we do not rigorously model how the bank could grow its portfolio over time. While we forecast a substantial profit for many products, the length of loan terms can be substantial, which limits the growth of the housing portfolio over time. However, it's possible that products with long loan terms could be sold on the secondary market before they come due if they have a history of on-time payments. The proceeds from the sale could be reinvested into the bank, quickly growing its portfolio rather than waiting for funds to be completely repaid over long timeframes.

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Example Balance Sheet

Product	Portfolio Share	Balance Sheet Share	Initial Capital Share	Loaned Amount	Loan Loss Rate	Loan Loss Adjusted Amount	Interest Rate	Net Margin (Yearly)	Equity Appreciation (Yearly)	Net Profit (Yearly)	Project Capital Stack Share	Unit Cost	Loan Term (Years)	Total Unit Output	Yearly Unit Output
Rapid Acquisition Fund (3-4% APR)	30.0%	14%	$13,500,000	$128,571,429	1%	$127,285,714	3%	3%	0%	3%	20%	$450,000	3	1414	471
New Construction Loans (~10% APR)	40.0%	18%	$18,000,000	$171,428,571	1%	$169,714,286	10%	10%	0%	10%	20%	$700,000	3	1212	404
Recapitalization of Existing Subsidized Multifamily Housing	5.0%	2%	$2,250,000	$21,428,571	1%	$21,214,286	3%	3%	0%	3%	100%	$10,000	3	2121	707
LMI Mortgage Subsidy (0% APR, 70% share of appreciation)	10.0%	5%	$4,500,000	$42,857,143	3%	$41,571,429	0%	0%	7%	7%	20%	$2,000,000	10	104	10
ADU Rentals	7.50%	3%	$3,375,000	$32,142,857	1%	$31,821,429	7%	7%	0%	7%	90%	$150,000	15	236	16
ADU Sales	7.50%	3%	$3,375,000	$32,142,857	1%	$31,821,429	0%	0%	7.5%	7.5%	90%	$150,000	2	236	118

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A Note on Legal Constraints

The California state legislation that enables the chartering of public banks presents certain constraints on the scope of the bank's business. It enables governments to deposit funds with public banks, which may be chartered by the Commissioner of Business Oversight, after a viability study and voter approval of a motion to establish said bank by application to the Commissioner. A city or county could lend funds to, deposit funds in, and invest in a public bank. The bank could make distributions (of revenues or deposits) to its members. However, the bank could likely only conduct retail services (such as individual bank account offerings) with or through local financial institutions. These retail banking restrictions are discussed further in our memo on Financial Justice.

Importantly, with regard to MBLA lending for affordable housing measures, the public bank would likely be prohibited from competing with small and local banks (with assets less than $1.32 billion) and with Community Development Financial Institutions (CDFIs). The statute thus pushes toward partnerships with existing CDFIs and local financial institutions.

While the noncompete provision unambiguously applies to the consumer/retail services; wholesale lending, or lending between the public bank and existing institutions, is permitted. It is our understanding that transferring or receiving cash reserves from the city would not result in prohibited competition, and that typical lending practices that are the core functions of a bank are not restricted by the legislation.

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