The Rainin Arts Real Estate Strategy

A collaborative strategy connecting resources in the community to the real estate needs of arts and cultural organizations.

Kenneth Rainin FOUNDATION

A MESSAGE TO OUR READERS

In 2012, the Kenneth Rainin Foundation embarked on an unusual journey in response to the escalating displacement crisis facing the San Francisco Bay Area arts community. The problem was particularly acute in San Francisco, where the already high cost of real estate and rents combined with an enormous influx of workers to fuel the region's booming high-tech industry. A growing exodus of arts groups and individual artists threatened the city's vibrant cultural identity and its diverse arts communities.

Together with other community leaders—including some of our most progressive thinkers on creative finance and nonprofits—we set out to address an issue that was impacting a field we believe is vital to our quality of life. Driven by the spirit of collaboration and innovation that is at the heart of the Rainin Foundation's programs, we came together with partners who were willing to challenge the status quo, test creative ideas, and share knowledge.

We did not start out to establish a new organization, let alone one that is arguably a new category of nonprofit. But our work together led to the creation of the Rainin Arts Real Estate Strategy and, with a "big bet" grant, the founding of the Community Arts Stabilization Trust (CAST).

The path we've taken has not been straight or smooth. There are still many unknowns and, as a rising real estate market continues to displace Bay Area nonprofits, the dynamic environment challenges past assumptions in the arts, community development, and nonprofit finance. So, as part of the Rainin Arts Real Estate Strategy, we thought that it would be instructive to tell the story of how the first five years of our work evolved.

We hope this brief history of our journey so far is useful in advancing work on nonprofit real estate issues in the Bay Area and responding to similar pressures in communities across the country. We look forward to working together with you—our fellow funders, city governments, arts organizations, and many others—to mitigate the impact of displacement on the nonprofit sector and support the essential role of the arts and culture in our society.

Shelley Trott
Director, Arts Strategy & Ventures
Kenneth Rainin Foundation
Oakland, CA
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Impetus for the Model

The Kenneth Rainin Foundation is committed to the belief that the arts must be integrated into the fabric of civic life—we believe they are essential to positive community development and vital to our region's culture of innovation and diverse cultural traditions. This commitment led staff from the Kenneth Rainin Foundation's Arts Program to meet with the Northern California Community Loan Fund (NCCLF) in 2012, when the growing displacement of San Francisco Bay Area nonprofit organizations was already evident.

Between 2011-2014, approximately 1,860 nonprofit organizations left San Francisco. By 2014, there was concern that the remaining 6,000 were in danger of being driven out due to the high demand and escalating cost of commercial real estate. Among those displaced or facing significant financial disruption were a multitude of arts organizations.

All conditions pointed to a displacement cycle reminiscent of the 1998 crisis triggered by the dot com boom. It was clear that a significant segment of San Francisco's cultural identity and economy was at risk. Here, in one of the top three US cities for artists (after Los Angeles and New York City), rent increases averaging 30 percent and higher were becoming a major challenge for both artists and arts organizations.

The often staggering statistics attracted both national and local media attention. A November 24, 2013 *New York Times* article captured the tension around affordability: "…city officials must grapple with the arithmetic of squeezing more people into… San Francisco's 49 square miles," noting that San Francisco's "median rent is the highest in the country."

In their January 3, 2014 article, the *San Francisco Business Times* reported that rents in San Francisco had increased 69.4% since the market bottomed out in 2010. In the Central Market and South of Market neighborhoods—home to a vast number of tech companies—rents had grown 95%. These are areas that historically have been more affordable and heavily populated with arts and other nonprofits.

Another factor contributing to San Francisco's affordability issue for nonprofit organizations: from 2011-2013, more than 41,300 new jobs—largely for the tech sector—were added, fueling demand for commercial real estate in the city.

More recently, the TODCO Group, an affordable housing and community development nonprofit, conducted a 2015 survey of 644 artists and arts entities in the South of Market neighborhood on the question of displacement and affordable space. Among their key findings, "at least 60% of the spaces rented—over 95,000 square feet in total—are leased from private owners and vulnerable to future displacement due to market-driven rent increases." The average rent was $1.80/sq. ft. per month, far below current market levels. Even now, data continue to illustrate an ongoing problem of unprecedented rental price increases and lack of affordability for nonprofit organizations.

To mitigate an impending displacement crisis that threatened San Francisco's arts and cultural infrastructure, the Rainin Foundation partnered with NCCLF in 2012. Our collaboration led to the development of the Rainin Arts Real Estate Strategy and a commitment of $5 million from the Foundation in seed funding to create the Community Arts Stabilization Trust (CAST), a real estate development and holding company.

The Rainin Arts Real Estate Strategy is rooted in a multi-sector collaboration that revolves around an innovative financing approach to securing permanent space in urban areas for arts and cultural organizations. The real estate holding company is a critical intermediary organization, working exclusively on behalf of the arts and cultural sector to provide an entrée into property ownership. Operating in concert with NCCLF to facilitate the financing, utilizing the New Market Tax Credits program when possible, CAST helps arts nonprofits gain permanent affordable space and the financial acumen they need to purchase and maintain a property.

In making this investment, the Rainin Foundation aimed to eliminate the prevailing pattern of key arts organizations getting pushed out of cities due to rising property values. Our strategy is designed to ensure that they can sustain the creativity and capacity necessary to promote lively and stable neighborhoods.

Overall, our work was founded on two core beliefs: first, that the arts drive strong, vibrant, diverse communities; second, that sustaining a mix of arts organizations, artists, and a community of people diverse in age, race, gender, economic status, and cultural background in urban centers, will lead to improved neighborhood health and well-being. We anticipate that the financing mechanisms we employ are applicable in a myriad of creative placemaking scenarios, to alleviate displacement due to a rising real estate market as well as address other urban development challenges that put the sustainability of the cultural sector at risk.

The Rainin Arts Real Estate Strategy

Inherent to our strategy was the driving ambition to develop permanent affordable spaces for highly valued but threatened critical arts and cultural organizations, and to provide the time and space they needed to gain financial stability and the capacity to ultimately purchase their own space. It is critical to acknowledge that property ownership is not our aspiration—nor is it even advisable—for all arts nonprofits. We see it instead as a path to stabilization for a core group of anchor, yet undercapitalized, arts organizations that cannot compete in a volatile real estate market.

In early meetings on the issue, Rainin Foundation Arts program staff, Foundation leadership, and NCCLF senior staff jointly brainstormed solutions to a historical pattern of displacement. An innovative funding mechanism emerged that adapted a model used for affordable housing to the particular constraints faced by small to medium sized arts organizations. Several components were required to set up and operate the mechanism, including bringing funding and the right partners to the table.

Project Participants

The financing mechanism is dependent on the successful collaboration among several key participants, with the interests of threatened arts organizations at the core of our purpose.

These participants work closely together on the organization's path to facility ownership. Participants would typically include one or more foundations, banks, a Community Development Financial Institution (CDFI), the local government, and a real estate holding company. Over time, additional funding sources may participate, augmenting the financial and other resources available.

The key players and their roles are as follows:

Arts & Cultural Organizations

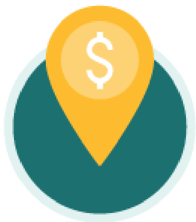
Facing displacement and lacking key capital, assets, and real estate expertise.

Private Foundations

Philanthropic entities like the Rainin Foundation provide capital in the form of a grant or program related investment to supply the pool of funds drawn or variously leveraged by other players.

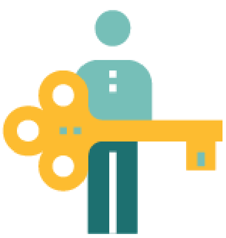
Banks

Using the equity provided by the foundation, a bank offers a line of credit to make more liquid capital available on a timely basis, which is required for the purchase of real estate.



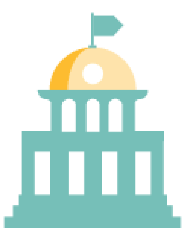
Community Development Financial Institution (CDFI)

A Community Development Financial Institution, such as the Northern California Community Loan Fund (NCCLF), uses the bank capital to establish an initial pool of funds for the property purchase and increases it by aggregating other funding streams. The CDFI structures both the sources and uses of funds, including foundation support, additional funds borrowed from the bank, and equity leveraged through the Federal New Markets Tax Credits Program or other sources. The CDFI may work jointly with the real estate holding company or another entity to provide real estate expertise to identify appropriate properties and match them to the needs of each arts nonprofit.



Real Estate Holding Company

The Real Estate Holding Company is a stand-alone entity that works with the participants to ensure that the focus remains on a shared vision and goals. In partnership with the local CDFI, a holding company, such as the Community Arts Stabilization Trust, purchases real estate on behalf of several organizations. It also helps organizations decide whether to purchase a facility, conducts organizational due diligence, and assists with financial planning and capacity building. In many cases, the Real Estate Holding Company or another entity maintains the pipeline of nonprofits that need help with facilities.



City Government

Municipalities play a variety of possible roles, including providing zoning designation, intervening in public policy to encourage access, or identifying properties or neighborhoods that are eligible for additional assistance programs. The city can also bolster the case for mitigating displacement, provide supplemental funding for nonprofits to remain in communities, and contribute to the conversation on maintaining diverse neighborhoods, among many other roles.

Other Funders

As the need arises for an expanded pool of capital, other foundation, corporate or government funders can augment the resources available to individual organizations and add legitimacy to their case. They can also bolster the process through supporting an individual organization’s capital campaign or operating costs. As the capital pool is developed, various financial instruments are employed including foundation program related investments funds.

Forming an Intermediary Organization

For this financing mechanism to work, the Rainin Foundation needed to find or develop an intermediary organization. The real estate holding company was initially envisioned as a vehicle that both aggregated funds for the project and disbursed them to arts organizations that needed a permanent facility solution. This intermediary would also serve as a fiscally sponsored vehicle that would be overseen by a steering committee made up of representatives from the Rainin Foundation, NCCLF, and other experts in related real estate and nonprofit fields.

As the demand for this work grew, the number of projects in the portfolio of this holding company expanded, along with the services it was providing from pipeline to due diligence. Additionally, interest from public and private funders increased. It became apparent that, to manage all of these activities, the real estate holding company needed to evolve as its own nonprofit organization with a staffing infrastructure that corresponded to its objectives. Early in 2014, the Rainin Foundation and the CAST advisory committee incorporated CAST as an independent nonprofit.

The mission of CAST is to create affordable, permanent workspaces for artists and arts entities in the Bay Area. It implements the real estate strategy for the arts by recycling financial resources and forging unprecedented public-private partnerships. CAST's working thesis is that intervening in the real estate market on behalf of and with arts nonprofits will facilitate smart decisions about securing a permanent home best suited to carrying out an organization's mission. Its efforts will increase the sustainability, limit the displacement, and ensure the vital role of the arts in thriving urban communities.

CAST now serves multiple roles, beginning with serving as a clearinghouse for arts organizations in facility distress. It also ensures that participants maintain focus on a shared vision and goals.

Overall, CAST does five things:

- Stabilize rent for nonprofit arts and cultural organizations by freezing real estate prices in an escalating market.
- Increase the financial and technical acumen of these organizations.
- Use a variety of financing, including New Market and Historic Tax Credits, to bring new capital to arts and cultural facility projects.
- Involve multiple partners, such as CDFIs, banks, government agencies, and other funders.
- Assist arts organizations with their capitalization by helping them gain a permanent asset without jeopardizing their operations and programs.

CAST focuses on small and mid-sized organizations (annual operating budgets under $5 million), which are noted for their artistic quality and programs, benefit from their "home" neighborhood, and/or community, and are well managed.

CAST matches such groups with the right space and acts as an aggregator to bring together the financing, real estate expertise, and individualized technical assistance to secure long-term, below market rate space.

The Path for an Arts Organization

The diagram below shows the path that an arts organization—in this case, the fictional Westside Dance Company—might follow to acquire permanent affordable space.

1

Westside Dance, an organization that presents live modern dance performances and offers arts education, is faced with an untenable rent increase.

2

Westside Dance contacts the **Real Estate Holding Company** and is considered as a possible partner.

Westside Dance undergoes a capacity assessment.

3

Deemed a solid candidate, Westside Dance works with the Real Estate Holding Company to identify an **appropriate facility to buy**.

4

Once a facility is identified, the **Community Development Financial Institution (CDFI)** and the Real Estate Holding Company work with Westside Dance to collect build-out or renovation estimates, and arrive at a final cost.

The CDFI packages the project along with other projects, and submits it for the **Federal New Market Tax Credits** program as part of the financing package it can offer the arts organization.

5

The City may become involved in issues such as: negotiating easements, considering properties for enterprise zones; applying economic development funds to the project; or facilitating the sale of air rights.

6

When the entire financing package is approved, the Real Estate Holding Company works with Westside Dance on the **details of its financial package**.

7

Westside Dance Company has an affordable, permanent home, and activates the neighborhood through community engagement.

1-7 YEARS

Over the course of seven years, Westside Dance implements a **capital campaign** and pays below market monthly payments to the Real Estate Holding Company while establishing equity.

7-10 YEARS

At the end of seven to ten years, Westside Dance will have **purchased the property at the original sale price and own a permanent home**. The Real Estate Holding Company then recycles previously encumbered funds to buy the next property for an arts organization.

Benefits & Challenges

Numerous benefits for nonprofit arts organizations arise from the design of this strategy:

- Rent increases at a below-market rate. Costs are essentially frozen at the time the facility is purchased by the real estate holding company. This insulates the organization from an escalating real estate market.

- Participating organizations gain equity without ever carrying debt. The below-market lease with option-to-buy model of the real estate purchase limits the risk for the nonprofit while helping the organization acquire an asset. By shifting the risk to the real estate holding company, the nonprofit does not jeopardize its sustainability. The end result is a permanent asset that will always have an arts purpose.

- Working with a CDFI. CDFI's are able to aggregate projects in a large pool of real estate purchases. This makes the individual property purchases—which are relatively small—eligible for additional investment opportunities. These include the desirable New Market Tax Credits Program, which attracts private capital by providing investors a federal tax credit.

- Depending on the municipality in which the project takes place, nonprofit organizations can benefit from the augmentation of city government tools such as transfer development rights; economic development funds; empowerment zones; redevelopment funding, etc.

Our experience implementing this strategy has also revealed a number of challenging considerations:

- The mechanisms to support the nonprofit arts organizations and each entity's role can become complicated. There is a potential overlap of services offered in the nonprofit community, including pipeline, technical assistance, and capacity building services, in addition to financing/lending services.

- Although different partners can play different roles, responsibilities should be clearly defined. The Real Estate Holding Company plays an important role, supporting the process by centralizing communication and facilitating decision-making in a timely manner. It also ensures that participants maintain focus on a shared mission and goals, and have a clear understanding of their respective roles.

- There are pros and cons of using a Community Development Financial Institution to hold real estate versus a separate real estate holding company (whether forming a new organization or using a fiscally sponsored entity). There are complexities to each approach, but it is a critical choice to make when determining how to implement the funding and real estate strategy.

- Lack of capitalization of arts organizations impedes their ability not only to purchase, but also to manage facilities. Long-term funding and management plans are vital, along with sufficient maintenance reserves to protect their real estate investment.

- Most cultural organizations, no matter how savvy, need financial capacity building assistance to take on a project of this size and complexity, as well as to manage a capital campaign.

- Many of the findings from the Nonprofit Finance Fund's benchmark National Cultural Facilities Study (1994) still hold true, and are important to take into account when working with cultural organizations on their facilities needs:

    - Cultural organizations are market sensitive. Planning should be broad based—the artistic mission, institutional capacity, and the market should all be considered in major financial and organizational decisions.
    - Time and leadership sophistication are both required to undertake multi-year facility projects that frequently amount to several times the annual revenue of an organization.
    - The make-up and capacity of organizational staffing is frequently insufficient to manage the overlay of a facility project and requires additional short-term and project management personnel.

Recommendations for the Field

Lessons and recommendations for potential funders and partners:

- Be aware of and inform participating arts and cultural organizations about the vastly different timelines and operating procedures present in the real estate world, lending community, among architects and construction contractors, government agencies, and grantmakers.

- Clearly define and communicate the specific roles and responsibilities among the partner organizations. Be particularly transparent with the nonprofits about decision-making authority and who is in charge of what aspects of the process: determining organizational capacity; conducting financial due diligence; vetting real estate options; putting together the financing deal; and weighing in on purchase; architecture and construction budgets; etc.

- Set up a board or steering committee with diverse expertise (including real estate and development, nonprofit lending, nonprofit administration, public policy, etc.) to guide this multi-party strategy.

- Consider multiple ways to use the real estate strategy, and be opportunistic. An owner may want to donate a building; a developer may want nonprofit co-owners or to condominiumize; a group of nonprofits may want to come together on a purchase. All implementation strategies are worth considering.

Conclusion

The Rainin Arts Real Estate Strategy has given us an exciting path forward for strengthening the long-term effectiveness of our arts grantmaking and ensuring a vibrant, sustainable arts ecosystem in the San Francisco Bay Area.

We're encouraged by the success of our initial projects, where CAST partnered with two vital community arts organizations to acquire buildings that these nonprofits have leased with the intent to purchase.

We celebrated the grand re-opening of the renovated Luggage Store Gallery in 2015. This gallery and multidisciplinary community space amplifies the voices of the region's diverse artists and residents, and occupies three stories in a 6,000 sq. ft. property in Central Market. We also watched the transformation of a former adult theater into a new home for CounterPulse, a performing arts incubator supporting risk-taking art that shatters assumptions and builds community, which moved into its beautifully renovated building in the Tenderloin in March 2016.

Momentum continues to build for CAST, as it attracts additional public and private partners, while gaining national recognition for its innovative approach to funding and its promising role in securing permanent, affordable space for the arts.

The Rainin Foundation anticipates more success stories as CAST grows and develops as an organization. We look forward to expanding the impacts of the Rainin Arts Real Estate Strategy with our Bay Area partners, and working to support the critical role of the arts in our urban communities with colleagues and potential partners like you.

Kenneth Rainin FOUNDATION

Learn more at krfoundation.org/artsrealestate