Lessons from 10 Years in Cultural Real Estate

A report commissioned by the Kenneth Rainin Foundation and prepared by WolfBrown on the Community Arts Stabilization Trust.

Executive Summary

The Community Arts Stabilization Trust (CAST) was founded in 2013 as a solution to create stable spaces for arts and cultural organizations in the San Francisco Bay Area. Through real estate expertise and access to innovative financial tools, CAST prevents the displacement of community-based arts and cultural organizations from rapidly increasing rents in the San Francisco Bay Area and ensures their long-term stability. With the success of the CAST model, which was proof-tested during COVID, and on the occasion of their 10-year anniversary, the Kenneth Rainin Foundation commissioned WolfBrown to interview CAST's senior staff members about the evolution of their work over the past decade. This report outlines five key takeaways to benefit the wider arts and cultural field.

1. Identifying and Cultivating Partnerships

CAST partners with nonprofit arts and cultural organizations, prioritizing those rooted in historically disenfranchised communities. To support these small and mid-sized organizations, CAST applies alternative measures of creditworthiness, emphasizing community impact over conventional financial metrics. It also adapted its model to include a wider range of partners beyond traditional community-based nonprofits.

2. Covering the Costs

Lease-to-own agreements need to balance affordability with actual cost assessments. CAST now requires professional property and asset management from tenants, which will sustain long-term asset viability.

3. Accessing Low Interest Financing and Other Market Incentives

Helping arts organizations access low interest loans and tax credits incentivizes private investment in distressed communities. There is a need for market incentives that support smaller development projects and ones focused specifically on community-based cultural assets, so that incentives are readily accessible without the expertise of specialized consultants.

4. Maintaining an Ownership Stake

Retaining a 1% ownership stake in the building ensures that CAST has an ongoing role in managing the asset and helping it remain a community-based cultural asset in perpetuity.

5. Supporting Individual Artists

Community-based arts organizations struggle to thrive without local artists, yet they often lack the resources to adequately support them. A broader view of the arts ecosystem is essential, which has led CAST to consider serving individual artists more directly.

Cover photo: Stewarded as a cultural community hub by the Community Arts Stabilization Trust, the 447 Minna building in San Francisco offers affordable work and performance space to arts and culture groups. Photo credit: Cesar Rubio.

Lessons from 10 Years in Cultural Real Estate

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Introduction

The Community Arts Stabilization Trust (CAST) was formed in 2013 to "create stable physical spaces for arts and cultural organizations" and facilitate equitable urban transformation." CAST works with community-based arts organizations, providing real estate expertise and access to innovative financial vehicles to prevent them from being driven out by the rapidly increasing rents in the San Francisco Bay Area.

When CAST was founded, there was no precedent for a nonprofit community development organization working with arts organizations to create sustainable solutions for their space needs. It was a living laboratory that pioneered new ways of securing permanent, affordable space for artists, creative entrepreneurs, and arts and culture organizations. While the broad tenets of its approach have proved remarkably successful over the organization's first ten years, in many ways surpassing its original goals, several important lessons have been learned along the way.

On the sidelines of the ten-year anniversary, senior staff members, including Moy Eng, CEO; Carolyn Choy, Director of Real Estate Development and Partnerships; Joshua Simon, Senior Advisor; Owen Levin, Chief Operating Officer; and Tyese Wortham, Director of Community Engagement, took time to reflect on what's been learned and distill some key takeaways. The purpose of this report is to share that learning, both for the sake of transparency and for the benefit of the wider arts and cultural field.

The value that CAST creates for local arts organizations is stability and predictability, which was on full display during the COVID-19 pandemic, when arts venues were closed, thus suppressing, if not eliminating revenue from the sale of tickets and artworks. All of CAST's long-term tenants were able to withstand the extended closures, which would almost certainly not have been the case if they had been renting from commercial landlords or holding conventional mortgage loans. In many ways, the pandemic was an extreme and unexpected proof of concept for the CAST model in that it successfully shielded its tenants from the vagaries of the market and ensured their long-term stability.

What have we learned?

1. Identifying and Cultivating Partners

At the very core of CAST's work lie its partnerships with nonprofit arts and cultural organizations. CAST supports small and mid-sized arts organizations that are at the forefront of social change, movements, innovation, and public health and safety, but that face uncertain futures. It prioritizes organizations that are rooted in communities that have historically suffered from disenfranchisement, racial injustices, and underinvestment, and that continue to experience turmoil and trauma. Most of these organizations are so preoccupied with their day-to-day survival that they don't have the psychic bandwidth, operational capacity, or financial resources to be able to plan for long-term sustainability. This is where CAST comes into the picture.

Identifying and cultivating partners are the crux of CAST's operational model, with its Real Estate and Community Engagement departments working closely in sync to best understand and respond to the needs of the arts community. Most small and mid-sized organizations operate with financial margins so thin that they could never qualify for a loan, if evaluated on conventional financial metrics. In working with such organizations, CAST has had to become comfortable with alternative measures of their track records and creditworthiness in evaluating their potential as partners. As one staff member puts it,

> *[A bank] would look at their operating income and their reserves and say, "You're gonna go out of business!" And we look at them and say, "You've been about to go out of business for thirty years*

> *– so clearly you're <u>not</u> about to go out of business." You have a community around you, where if you do hit a crisis point, you can go to that community and they'll support you and get you through the crisis. That's different than having six months of operating income in the bank, but what you have is thirty years of goodwill in the community. A bank won't underwrite that, but we might.*

The criteria CAST pays attention to in identifying potential partners focus on community impact. In particular, the degree to which an organization is rooted in its surrounding community has emerged as a primary criterion in determining which organizations to work with.

As part of this trajectory, CAST has invested heavily in building its relationships with community-based organizations over the years as a means of establishing trust and building their capacity to address real estate challenges. CAST has also come to realize that some of the community-based organizations that it's interested in partnering with aren't traditional nonprofits. Many are individual artists, creative enterprises, artist collaboratives, or other organizational forms. Consequently, CAST has had to adapt its model to serve a wider range of entities.

2. **Covering the Costs**

There is an inherent tension in CAST's mission between the desire to give partner organizations access to space at the lowest rates possible with the need to establish a sustainable operational model in which rental income from tenants covers the costs of property and asset management, building maintenance, taxes, insurance, and other expenses related to holding and operating the real estate.

Because of CAST's desire to negotiate rents that its prospective tenants could truly afford, those rents were lower than the costs actually incurred by CAST to maintain the property, necessitating philanthropic subsidization through grants and general operating support.

CAST's operating model relies on economies of scale: when you're dealing with large amounts of real estate, the costs of purchasing, maintaining, insuring, and managing each square foot decreases. The discounts CAST receives by operating at scale allow it to make properties available to tenants at below market rates.

However, CAST currently operates at a point where it is just beginning to see those efficiencies materialize.

Efforts to be responsive to the needs of tenants at times also led CAST to waive a provision in its rental contracts that requires tenants to pay for professional third-party maintenance services. The rationale for this requirement was that building maintenance generally isn't a priority for arts organizations, which often leads them to underinvest in their properties (one of the reasons that the rare small and mid-sized arts organizations that have owned their own properties often haven't fared well in the long run). By mandating that tenants engage the services of professional property managers, CAST sought to protect its assets (which ultimately become the tenants' assets in the lease-to-own model) and establish good practices among its tenants as future building owners.

When CAST allowed tenants to handle the building maintenance themselves so as to avoid the costs of a third-party property management, they encountered precisely the type of deferred maintenance issues they had sought to avoid.

In its current lease-to-own agreements, CAST has returned to the requirement of professional property and asset management, and stands firm on that policy. As one team member noted,

> *There are certain expenses that come along with building ownership that are not negotiable. If you can't prioritize them, you shouldn't be a building owner.*

3. Accessing Low Interest Financing and Other Market Incentives

A critical service that CAST provides is helping arts and cultural organizations access low interest loans and tax credits such as the US Treasury's New Markets Tax Credits (NMTC) that incentivize private investment in distressed communities. Such incentives are often designed with larger community development projects in mind, which can make them difficult for cultural organizations to access.

CAST has the expertise to assemble complex financing agreements for cultural organizations, but the technical details of some of the financing tools are so nuanced that CAST relies on specialized consultants to manage those processes.

Typically, real estate developers are able to retain a development fee when putting together projects such as these. In the case of NMTC's, that fee comes directly out of the federal tax credit. In theory, such development fees would allow CAST to cover a portion of its operating costs, without creating any direct costs for the organization that will occupy the newly developed property.

Two takeaways result from CAST's experience with low interest loans and other market incentives: 1. CAST's ability to secure such financing for cultural organizations greatly benefits the organizations, but at its current level of operation the available developer fees don't fully compensate CAST's efforts for securing the financing; 2. There is a need for market incentives that support smaller development projects and ones focused specifically on community-based cultural assets, so that the incentives are more readily accessible without the expertise of specialized consultants.

4. Maintaining an ownership stake

The idea that properties acquired by CAST will serve as community-based cultural assets in perpetuity is a basic premise of CAST's operating model. In CAST's lease-to-own agreements, a tenant who leases a building from CAST may eventually buy the property; however, if the tenant later decides to sell the building, it is required to sell to another cultural organization or reinvest the proceeds in another property that serves the community's cultural needs.

Initially, it was envisioned that this provision would be created through a restriction on the property's deed, permanently barring the owner from using the property for any purposes other than arts and culture. However, in practical terms, such a deed restriction could be difficult to enforce.

CAST has therefore switched approaches and now instead retains 1% ownership in the buildings even after they have been acquired by a lease-to-own tenant. This ensures that CAST can continue to play a role in managing the asset even after the tenant has taken ownership, and also gives CAST a say in any future sale.

5. Supporting Individual Artists

One of the core assumptions that was made at the inception of CAST was that securing arts and cultural organizations in communities would indirectly also support local artists. That may be true in a macroeconomic sense, but in practical terms the extent to which individual artists are served varies greatly by organization. One staff member notes,

> *There was an assumption that by serving small to mid-sized organizations we were serving individuals, ... but serving organizations with facility issues doesn't address chronic housing issues or studio space issues.*

Many artists in the Bay Area can't afford to live near the organizations for which they work. Instead, they commute from across the Bay Area. Community-based arts organizations can't flourish without local artists, but the organizations may not have the means to provide the level of support that those artists need. This has led CAST to consider serving the needs of individual artists more directly.

More generally, it has become apparent that a broader view of the arts ecosystem is necessary to effectively support anchor arts and culture in local communities. Assisting arts organizations with their facility needs is one piece of the puzzle, but that must be seen in the context of the available support for arts (which varies widely across the municipalities in the Bay Area), as well as the availability of affordable housing and studio spaces. For that reason, CAST is currently considering a real estate project that includes low-cost housing for artists.

Conclusion

The 2023 acquisition of a CAST-owned property by its tenant, CounterPulse, proves that the CAST's original lease-to-own model works. In addition, the financing terms and other economies of scale that CAST is able to secure will continue to improve as the organization grows, allowing additional savings to be passed on to tenants. However, CAST's ability to learn and adapt, particularly in working with diverse communities and arts organizations around the Bay Area, may be even more significant for the organization's long-term success.

There is no cookie-cutter solution to the Bay Area's cultural real estate challenges that can easily be replicated and scaled. While no two arts organizations are alike and each partnership requires tailoring to each individual situation, CAST ultimately seeks to create models that can serve as templates for other organizations to replicate in other neighborhoods, cities, and even countries. Building the capacity to broaden the portfolio of relationships and maintain a pipeline of development projects at various stages of completion will take sustained investment over decades.