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Berkeley's Plan to Make Its Own Cryptocurrency Raises Eyebrows.

Facing a homelessness crisis and funding gaps from recent tax cuts, the city of Berkeley is considering something revolutionary: making its own bitcoin-like cryptocurrency.

"Acts of resistance require creating resources," said Councilman Ben Bartlett, one of the people behind the plan. He's working with Mayor Jesse Arreguín, and teaming up with the startup Neighborly and UC Berkeley's Blockchain Lab on proposals to turn municipal bonds into digital currency, with the goal of raising additional funds for specific projects.

Bartlett and Arreguín came up with the idea over dinner when they were brainstorming about the affordable housing crisis with constituents, some of whom work with digital currencies.

"This is largely driven by Berkeley residents," Bartlett said. "Their nickname for Berkeley is Crypto City."

Some of cryptocurrency's harshest critics have characterized them as Ponzi schemes, even as others anticipate that they will revolutionize payment systems. A few early backers of cryptocurrencies are now billionaires on paper, thanks to the run-up in prices. Startups have sought to use the issuance of new digital currencies, called inital coin offerings, to fund development of software tools and marketplaces instead of raising venture capital.

Berkeley has no plan to buy bitcoin, ether or other similar currencies with city funds. Instead, the idea is to break up municipal bonds, allowing people to buy them in smaller quantities as digital tokens, similar to how other cryptocurrencies are traded. The currency will use blockchain technology, as most cryptocurrencies do, that creates a decentralized ledger of transactions designed to increase people's trust in cyber money. But the micro-bonds recorded on the blockchain will be tied to an asset — the underlying bond. Bartlett argues that this makes it less risky than other cryptocurrencies, which have seen wide price swings in the past year.

The councilman said he expects the plan to be embraced by residents and regulators. But John Reed Stark, a lawyer and professor who was formerly head of the Securities and Exchange Commission's Office of Internet Enforcement, is dubious.

"I truly cannot believe this," he said of Berkeley's plan. He says cryptocurrency offerings resemble "the drivers-ed film of securities violations. They trigger every single kind of security violation."

"The notion that a municipality is somehow encouraging the use of pseudo-anonymous currency strikes me as incredibly irresponsible," Stark said. "There are tremendous security ramifications, and they should expect an unbelievable amount of regulatory scrutiny. Whatever they do will be under the microscope of the SEC."

More than a dozen companies have shelved plans to raise money from investors after SEC officials called them up, Robert Cohen, head of the SEC's cyber enforcement unit, said Friday. The SEC scrutiny prompted firms to realize that their offerings may have violated federal securities laws, he said at a conference in Washington.

Lynnette Kelly, president and executive director of the Municipal Securities Rulemaking Board said it’s too early to say whether there would be concerns about security or stability in Berkeley’s case.

“There are rules in place and all of those rules need to be followed,” she said. “I think having a currency backed by a municipal bond is different, and I know the SEC and the (Commodity Futures Trading Commission) have talked at length about cryptocurrencies and issues surrounding these coins.”

“We’ll continue to investigate and monitor, and get smarter about this and any other new technique in the market, but that doesn’t mean it necessarily raises red flags,” Kelly said.

A spokesman for the SEC declined to comment.

Marc Lifsher, a spokesman for the State Treasurer’s Office, said the office has no position and views it as a local issue.

“The State Treasurer’s Office has not talked to Neighborly or Berkeley about cryptocurrency,” he said.

Jase Wilson, CEO of San Francisco’s Neighborly, shrugged off questions about instability.

“The volatility looks more like a municipal bond,” Wilson said. “Berkeley is an extremely strong and fiscally disciplined borrower.”

The downside of a relatively stable security is that it’s unlikely to attract the get-rich-quick speculators and arbitrageurs who have caused gyrations in the prices of cryptocurrencies but also created relatively liquid markets in them.

The Berkeley project’s goal is to streamline the process for buying and selling municipal bonds, cut transaction costs and allow people to invest in projects of their choosing at low levels.

“For a normal person to invest in a bond is like $5,000, but under a micro-bond enabled by the blockchain it could be like $25 or $50,” Bartlett said. Someone could theoretically invest in the creation of a new park — or even just the purchase of a swing set.

While Bartlett’s long-term goal is to fund big projects like affordable housing, he wants to start small. Some ideas so far, which Bartlett said came from residents: planting a row of trees, buying another ambulance for a fire station and engaging a group of artists to create a series of rotating public art pieces.

The city and its partners are planning what backers like to call “an initial community offering” for May.

Bartlett said that either the City Council would have to approve the plan, or its backers could pursue it with a private company without the council’s OK.

They want to move quickly, he said: The technology promises “direct community engagement, and the need is more pressing than ever.”

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Bloomberg News contributed to this report.