Strengthening the Philadelphia Economy through Targeted Local Pension Investment

A Proposal from the Philadelphia Public Banking Coalition, December 2023

The Philadelphia Public Banking Coalition (PPBC) proposes that the Philadelphia Board of Pensions and Retirement (City Pension Fund) recognize an asset class for local Economically Targeted Investments (ETIs) and direct its investment managers to target $160 million (2%) of its portfolio to this asset class. This goal can be accomplished by redirecting investments from "global" asset classes to the "local" ETIs, including low-income housing, cooperative and environmental protection projects.

This proposal contains the following sections:

I. Overview

The Philadelphia Pension Fund exists to promote the welfare of retired City workers. That is and must always be, paramount. However, employee welfare depends not only on the size and security of their pension benefit, but the safety and security of the city in which they live. At its most basic level, failure of the City to maintain and increase its tax base of viable housing resources, to invest in environmental sustainability, and to support a vibrant and cooperative economy, threatens the health and viability of the entire Pension Fund.

Accordingly, we propose that the Pension Board set aside 2% of its resources – about $160 million - to fund a Targeted Investment Program that would invest in Philadelphia projects that are economically sound, can grow the local economy, but are challenged in attracting conventional credit.

The overall Fund is valued at around $7.6 billion, and though it has an Investment Management Office, most of its specific investment decisions are made by a wide range of private investment managers. These managers' investment discretion is confined solely by the designated category of investment targets that they are hired to pursue. Check out the Fund's most recently selected investment priorities in the latest Investment Report.

Critics voice concern about risk and return with funding social concerns. Yet Economically Targeted Investments (ETIs) provide opportunities for the Pension Fund to address social policy goals while managing a portfolio that is as safe and provides returns as strong or stronger than many of the Fund's current asset classes.

The Fund is not particularly risk-averse, demonstrated clearly by the following descriptions and observations made in its 2021 Audit Report:

> The Fund enters into a variety of financial contracts, which include options, futures, forwards and swap agreements to gain exposure to certain sectors of the equity and fixed income markets; collateralized mortgage obligations (CMOs); other forward contracts, and U.S. treasury strips. . . The Fund is exposed to credit risk in the event of non-performance by counterparties to financial instruments.

Another big chunk goes to private equity investments, targeted for 12% of the entire Fund. In the Report, the Controller said this about private equity investing, noting its riskiness and also, its failure to compensate for the risk with high returns:

> Taking into consideration current and historical capital market assumptions, private equity remains one of the riskiest financial asset classes. The Pension's private equity investments have failed to meet the public market equivalent (PME) benchmark, inclusive of a typical 300 basis-point risk premium, for the lifetime of the Pension.

The Funds' 2021 Audit Report also described a variety of risks the Fund takes by investing in derivatives, Futures Contracts, Interest Rate Swaps, and a variety of other non-conventional investments.

Given this context, it's important to acknowledge that the Fund *has*, from time to time, considered public policy concerns in making investment choices. For instance, the Fund has taken steps to bar all of its advisors from investing in Russian companies, private prisons and arms manufacturers that don't agree to adhere to certain principles. So, it clearly has precedent for considering social and political concerns in making investment decisions. Strangely though, while many of its advisors seem to focus on real estate projects and developments, there's no indication that they give any preference to Philadelphia projects.

To be appropriate vehicles for pension fund investment, opportunities must be packaged in amounts and with securitization appropriate for fund portfolios. A public bank would be an ideal structure to serve this function, by packaging aggregations of loans from local lenders, and issuing bonds designed specifically for acquisition by pension fund portfolios. Until we have such a public bank, the Philadelphia Pension Fund can still invest prudently in opportunities that support the overall well-being of City workers, such as those described below.

II. Investment Opportunities in Housing

A .The New York City Program

According to the Controller's 2019 Report, the Philadelphia Pension Fund at that time was seeking to increase its allocation for housing investments up from 9% to a staggering 19%. That means almost $1.5 billion in shelter-related investments, *with little or none of it targeted toward meeting Philadelphia's needs*. But there is ample precedent for that lack of attention to local housing shortages to be reversed.

New York City has had a Targeted Investment Program in place since the 1980s, placing investments valued at $4.3 billion in affordable housing. According to the City Controller's office, which runs the program:

> In an effort to generate risk-adjusted market rates-of-returns and to promote economic development within New York City, the Teachers' Retirement System of the City of New York, the New York City Employees' Retirement System, the New York City Police Pension Fund, the New York City Fire Pension Fund and the Board of Education Retirement System of the City of New York (collectively, NYCRS) allocate 2% of pension assets towards Economically Targeted Investments (ETI). The ETI program is designed to address market inefficiencies by providing capital or liquidity to underserved communities and populations citywide.
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> The ETI program's investments have historically been targeted towards affordable or workforce housing for low, moderate and middle income neighborhoods and populations in the five boroughs. These ETIs have helped to revitalize neighborhoods by returning distressed properties to the City's tax rolls and by developing new housing that is affordable to working people.

This program, and its components, have produced well over 100,000 units of affordable housing, including both single family homes and apartments (although the program's definition of "affordable" might not be what Philadelphia adopts). It often packages its loan products with subsidies from a variety of other programs to reduce their ultimate cost to beneficiaries. Presumably we would do the same, and perhaps spur the development of new programs that would serve this purpose.

B. Other U.S. Programs

In 1992, the General Accounting Office issued a report at the request of Congressmember John Conyers detailing how various public pension funds around the country found ways to invest in affordable housing. It found 15 investments that met that criterion, most of which involved a packaging of different programs. This is how the report summarized common characteristics of these investments:

> The nature and extent of pension fund involvement in financing affordable housing varied widely among the investments we reviewed; however, three principal characteristics were common: First, in investing in affordable housing, pension funds funneled their assets primarily into fixed-rate securities that could be easily sold to other investors in a national market. Second, each investment had some type of government assistance, which pension fund managers recognized as important to the success of affordable housing ventures and critical to protecting their fiduciary interests. Finally, pension fund investments were set up by intermediaries, such as banks, state housing authorities, and nonprofit developers, who identified affordable housing investment opportunities and arranged financing. These intermediaries provided the staff and expertise that the pension funds lacked.
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> . . . Typically, about one-third of the financing comes from market-rate loans and another third from the property owner. Federal, state, or local government-subsidized funds provide the rest. Generally, this government assistance reduces the interest rate that investors pay to finance housing and provides against losses.

These are criteria that our Pension Fund should be able to meet with little difficulty, and the need is demonstrable. According to the news website Generosity " . . . 88% of Philly renters are cost-burdened; of that number, 68% are *severely* cost-burdened—meaning 50% or more of their monthly income covers housing only." And although the Pension Fund's prime mission is to confer lifetime income to retired workers, the unions representing them have long invested funds that they control into affordable housing.

C. Social Housing

Around the world there is a growing movement to create a housing supply that is permanently affordable to those in need and can anchor economically diverse neighborhoods. It's called social housing and is directly owned by local government.

It is important to note that social housing is different from conventional public housing in one important respect. It is open to people of different incomes, although some percentage is reserved for very low-income people. Also, the housing remains available to whomever acquires it, regardless of changes in their income over the years. Thus, this is public housing with security, housing that builds community, public housing that builds thriving neighborhoods.

Direct government control over housing eliminates the profit motive and ensures residents are receiving the most affordable rent, thus reducing the burden on families and allowing tenants to build wealth. Since the passage of the Fair Housing Act, disparity in housing and wealth generation has barely changed, reinforcing the need for different, creative solutions that reduce costs of housing and work toward guaranteeing every person a home. Direct provision of such homes is a key aspect of this work.

Seattle has such a program. Other cities, like Vienna and Singapore have had such programs for decades.

Social housing would be a perfect investment for our Pension Fund. It could take equity positions or purchase debt securities issued by developers. It could justify a lesser financial return than normal credit sources because it could count indirect benefits that flow from reducing the homeless population. And, if deemed appropriate, it could set aside some units for workers or retirees.

III. Investment Opportunities in Environmental Improvement

Even without a financial intermediary to package investments suitable for the Pension Fund (see section V, on the Philadelphia Public Financial Authority), other entities can aggregate debt and/or equity investments aligned with their missions to provide local investment opportunities for pension fund investment in both housing and environmental sustainability. For example, the Accelerator Fund could assemble financing for affordable housing projects and the Philadelphia Green Capital Corporation (PGCC) could leverage financing for programs promoting renewable energy and energy efficiency. The New York State Energy Research and Development Authority (NYSERDA) provides examples of such financial structures.

The Philadelphia Green Capital Corporation needs a Working Capital Fund to provide liquidity for renewable energy and energy efficiency projects that receive grants, reimbursements and/or tax credits following completion. The Pension Fund could finance such a Working Capital Fund through a long-term loan or a standby line of credit, or some other means. In effect, the Fund would support PGCC bridge loan financing that expedites public and private projects of benefit to the community, at minimum risk and with fair return.

The Pension Fund could also help the PGCC leverage grants and capital investment from private sources. For example, the PGCC is applying for a $10 million grant under the Inflation Reduction Act (IRA) to implement a Clean Communities Investment Accelerator program. Such a grant could collateralize a loan from the Fund, thereby further expanding PGCC capacities.

The declining cost of renewable energy technologies (PV solar and batteries in particular, but also geothermal and wind) makes conversion from reliance on fossil fuels financially compelling. Even without incentives, the controlled fixed costs of renewable/efficiency systems are lower and not as risky as the uncontrolled variable costs of fossil fuel systems. Furthermore, financial incentives provided by the Inflation Reduction Act (IRA) and other recent legislation now remit 30% to 50% of project costs in the form of tax credits or direct payments. The transition process is retarded, however, by reluctance to replace fossil fuel infrastructure before the end of its useful life as well as non-financial considerations such as permitting and other obstacles to adoption. Because renewable energy and energy efficiency systems require upfront capital outlays, the availability of Pension Fund financing will expedite transition and facilitate efficient deal flow, workforce training, and program implementation.

IV. Investment Opportunities in Cooperative Development Projects

The capital components assembled to finance specific cooperative development projects can be of sufficient size to be a stand-alone investment for a pension fund. Weavers Way Cooperative expansion to stores in Ambler and Germantown, for example, have been in the range of $2 million to $5 million. The availability of financing from the Pension Fund would encourage new cooperative ventures and expansion of established coops.

Though the community of cooperatives in Philadelphia, supported by the Philadelphia Area Cooperative Alliance (PACA), have access to some financing, such as the Twin Pines Cooperative Community Fund Program, the average small scale in this sector currently limits its capacity to create investment vehicles appropriate for Pension Fund investment. Credit unions, which are a form of cooperative organization for financial purposes, have created such investment vehicles in other countries. This could provide a model for the local credit unions and the Philadelphia Pension Fund.

Community land trusts (CLTs) provide a form of cooperative ownership designed to stabilize development of open space, housing and/or commercial real estate. CLTs could hold property of a size and for ETI purposes suitable for investment by the Pension Fund. Long-term investments in CLTs could support the refinancing of properties where affordable housing is threatened by the expiration of rental subsidies or tax credit deals. In one model, LISC Bay Area has made loans to the San Francisco Community Land Trust and the Oakland Community Land Trust to finance the conversion of such “expiring” properties to permanently affordable land-trusted housing. Such projects could be backed by federal housing subsidies as well.

V. Prospective Role for the Philadelphia Public Financial Authority (PPFA)

To be appropriate for inclusion in the City Pension Fund portfolio, investment opportunities such as those described above must be of sufficient size, present an acceptable risk profile and provide an adequate return, among other criteria. Yet parties with whom the City Pension Fund currently does business may be unwilling to take on an investment banking function for the ETIs most in need of financing. There is also a need for an entity that can advise on the larger context in which these investments are made and buffer against political favoritism in choosing projects.

One entity that could address both these gaps and serve as the financial intermediary to package Philadelphia ETIs for the City Pension Fund is the Philadelphia Public Financial Authority (PPFA). Enacted by the City of Philadelphia in March of 2022 (Ordinance #210956), it was specifically designed to facilitate Philadelphia ETI financing. With this democratic governance and stakeholder direction, the identification and development of ETIs can be responsive to the needs felt by the people most affected. Tasked with creating, tracking, and reporting metrics for nonfinancial as well as financial impacts, the PPFA can not only report the direct return on investment, but can also measure the financial and social benefits to the City Pension Fund, the employees it serves, and the regional economy in which they are embedded.

VI. Conclusion

These are not the only opportunities for local pension fund investment. Employer-Assisted Housing programs for city employees, guaranteeing some or all of the mortgage in return for more flexible underwriting, could help with employee recruitment and retention. Creation of new geriatric-focused Federally Qualified Health Centers could be backed by Medicare and Medicaid. The state is currently looking for partners to develop senior housing that specifically diverts people from nursing homes; with Medicare and Medicaid guaranteeing much of the financing, this would both support construction work and free up public housing units. PGW, which is currently spending rate payer funds for energy conservation activities, could more efficiently use pension fund investment and repay with PGW loans. Neighborhood Improvement Districts could create lines of credit to undertake new activities such as capital improvement, energy conservation, or storm water management, with loans backed by the District rather than individual property owners—linking to TIF overlays to capture the value of the pension-backed improvements.

The bottom line is clear: There is no reason why the City Pension Fund can't invest some small portion of its portfolio – 2% would amount to approximately $160 million - in socially useful local ventures. While the opportunities in housing are most fully developed here, there are many socially useful projects in Philadelphia that a Targeted Investment Fund could support. Investment in such projects can provide market rate returns at normal, or lesser, risk for the Fund while further encouraging Environmental, Social and Governance values (ESG) and those of Equity, Diversity, Inclusion (EDI). At the same time, these investments can stimulate the local economy, and expand jobs and economic opportunities, thereby improving the City's tax base and supporting the beneficiaries of the Fund, in the present as well as upon retirement.