LAWYERS' COMMITTEE FOR CIVIL RIGHTS OF THE SAN FRANCISCO BAY AREA

March 15, 2019

The Honorable Jose Cisneros, Treasurer
City Hall, Room 140
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Via Email

Re: Comments on February 2019 Municipal Bank Feasibility Task Force Report

Dear Treasurer Cisneros:

We write to thank you for including us as members of the Municipal Bank Feasibility Task Force which has led to the 2019 Municipal Bank Feasibility Task Force Report (the "Report"). We admire and appreciate the effort your office put into producing this Report, especially the hard work of Molly Cohen, Katherine Chen, Amanda Fried, and Tajel Shah. While the Report has not considered enough factors to rise to the level of a feasibility study, it gathers critical data, provides initial analysis and is the beginning of the conversation about how the City can create a safe, accountable and transformative banking solution that will benefit all of its residents. We think that the next steps are to develop additional models which consider more factors, convene all internal City actors tasked with lending, and hire a consultant to develop a business plan for San Francisco's Public Bank. As community development advocates who strongly believe in the potential that such a bank could offer the City and people of San Francisco, we offer the below comments in the spirit of providing feedback on the Report and endorsing the next steps it has laid out.

A. The Report considers financial models that overcomplicate the formation of the public bank.

We agree with the conclusions of Task Force member, Lauren Leimbach, who stated in her March 7th, 2019 response letter that, "The models over-estimate start-up and operational costs and under-estimate revenue generation." The Report assumes that Models Two and Three would cost a total of \$1.6 billion and \$3.9 billion, respectively, including start-up costs, operational subsidy and capital investment. We believe these numbers are overstated. We agree with Ms. Leimbach's assessment that, "due to time limitations and lack of experience in bank and payment operations, it was difficult for Task Force staff to identify existing and more cost-effective options to optimize operating costs." We believe a critical next step would be to rigorously test the Report's cost assumptions, hiring external consultants who could advise on technology solutions to handle the City's banking needs, or exploring correspondent banking relationships with larger mission-aligned banks, such as Amalgamated Bank.

B. The Report does not model a phased approach.

The Report mentions starting with a phased approach "where the City implements interim opportunities while a municipal bank is in development, and then allows the bank itself to develop over time" (page 41), and we agree that this should be one specific phased-approach model. As a next step, we recommend modeling a phased approach that would build towards taking on all of the City's banking needs.

The Report provides three models for a public bank—Models 2 and 3 are depository institutions that serve as the City's primary banker, providing its cash management and payment services. Model 1 is a non-depository loan fund. The Report projects very high costs for Models 2 and 3, ranging from $95 million to $143 million *annually*. Part of the reason that the costs are projected so high is because the Models are performing the City's cash management and payments systems work, which is much more expensive than just holding deposits. The information technology development for cash management *is the highest fixed cost, projected at $40 million annually*.

Performing the City's cash management is not the central, nor most pressing need, for a public bank. The most pressing needs are community re-investment—especially affordable housing, small business lending, student loans and renewable energy investment. Cash management can be phased in over time, and there are many more technology options available beyond what the Treasurer's Staff could investigate given time and other constraints.

We think the City should model a depository institution that grows, over time, to become the City's primary banker. This "Model 1.5" as we have termed it, would be a bank that holds City funds that are not required for daily operations or that are currently invested in the Treasurer's Pooled Funds. Its primary function would be lending for community re-investment.

This Model 1.5 would not serve as the City's primary banker, as considered in Models 2 and 3. While Model 1.5 would be a depository institution, it would not initially take on cash management or payment processing. As a depository institution, it would have access to a deposit base—primarily City deposits, but also from other depositors—which would be a lower-cost base for lending. This Model could therefore overcome some of the cost concerns in Models 2 and 3, while still providing access to a deposit base, which is not available in the current Model 1. More importantly, Model 1.5 would start building core competency in lending, which would allow it to eventually become the City's primary banker.

C. The Report leaves out critical factors which would otherwise be required in a feasibility study.

The Report models interest rates for direct loans below-market. Instead, it should have recognized that the mix of interest rates in the proposed loan portfolio will be fluid and not all loans will be below-market. It also models static loan growth at 5 percent per year with no consideration of business cycles, especially those affecting the supply and demand of housing. There should be more discussion of risk modeling, such as potential downturns in the business cycle or a collapse of the real estate market.

In addition, the Report makes passing mention of the disruptive effect that fintech developments will have on the banking industry. Banking experts agree that fintech will severely disrupt the banking industry in the coming years, potentially reducing current technology costs dramatically. The Report fails to model this likely disruption; indeed, technology costs are modeled as the highest annual cost, with no alternative scenarios presenting the likelihood of lower costs in the future. This oversight underlies our concern that the Report may be overstating technology and other operational costs.

The Report mentions housing lending activities for mezzanine debt targeted at for-profit developers, ADUs and small sites acquisitions, to the exclusion of other products. We wish that the Report had gone bigger, for example modeling large scale acquisitions for the development of affordable housing or direct lending to nonprofit affordable housing developers.

D. The Report is not clear about the source of deposits and assumes away a major source of funding.

The Report contradicts itself with regard to the source of deposits. In Assumption 9 (page 31) the Report states that the depositors are not defined and that “the models do not depend on deposits coming from any source.” Earlier, the Report states that in Models 2 and 3, the bank will hold $100 million of the City’s short-term deposits (page 22). We can only conclude that Models 2 and 3 depend on the City being the primary deposit source. The Report should have been more clear about this crucial point because advocates are clear that they want to build towards a bank that will hold the City’s deposits. The question is whether, in the initial phase, this bank needs to be the City’s *primary banker*.

The Report also assumes away the use of the Treasurer’s Pooled Investment Fund, a major source of potential funding. It is imperative to examine the legal or policy changes that would be required in order to use the $11 billion of Treasurer's Pooled Funds, either in the bank’s deposit base or as a non-deposit funding source. We appreciate that there are legal barriers to moving this money—some of which may be addressed in pending legislation in Sacramento (AB 857-Chiu), and the Report could specifically call for state legislation to address those issues.

In discussing why the Pooled Investment fund is off the table, the Report states,

> *The money in the pool comes from tax revenues, fees, federal and state government, and bond proceeds. All of these funds have already been allocated through the budgetary process and through voter-initiated bond approvals and as part of the capital plan. State law and the City's investment policy sharply limit how the Treasurer can invest the Pool, and in general these investments must be of the highest quality and most secure and short-term in duration. For example, almost 60 percent of the Pool is currently invested in treasuries and federal agencies, and over 50 percent held in securities under 1 year in duration* (page 22).

It is important to note here that over 50 percent of the Pooled Fund is held in securities under one year in duration—but not all of it is invested in federal treasuries. This means that those funds are presumably being invested with other banks. The Report should analyze the potential to use this source of funds for the public bank, such as by using them as short-term notes or through some other non-depository funding mechanism. To dismiss the Pooled Fund strips the City of a potentially critical source of its own funding.

E. The City should convene all agencies performing lending work with a mission of consolidating lending activities into one entity.

The Report recommends convening a working group of internal City actors to lead the next phase of the work, which should be tasked with finalizing objectives for the bank and building a realistic roadmap (page 43). We endorse this as a next step. In addition, we think the Board of Supervisors should provide more direction about what a potential working group should explore. We recommend two areas of exploration: 1) consolidation of all existing lending activities into one entity; and 2) exploration of the Model 1.5 described above.

1. <u>Consolidation of all lending activities with the mission of forming a single lending entity</u>

As the Report describes, the Mayor's Office of Housing and Community Development (MOHCD) and the City spends and invests $400 million per year on affordable housing on subsidies to develop and preserve affordable housing units and on down payment assistance programs which help individual homeowners purchase their first homes (page 16). Four hundred million dollars annually is half of the operational subsidy that the Report projects for Model 2, notwithstanding the high costs of that model. We believe there are potential cost savings to redirecting this subsidy to the operations of the future bank. The purpose of convening the working group could be to make recommendations to this effect.

2. <u>Hire a consultant to model the creation of a depository institution that could grow, over time, into the City's banker.</u>

As we discuss above, we believe the City should explore a Model 1.5, which would be a depository institution that could grow to become the City's primary banker. We wholeheartedly endorse the Report's recommendation to hire a consultant to develop a business plan that would explore such a model.

We look forward to continuing to engage with you and with the Board of Supervisors on this critical endeavor, one with the potential to establish San Francisco as both a thriving global center and an equitable home for all of its residents.

Sincerely,

Sushil C. Jacob, Senior Economic Justice Attorney, Lawyers' Committee for Civil Rights

Paulina Gonzalez-Brito, Executive Director, California Reinvestment Coalition

Ky-Nam Miller, Task Force Member

John Avalos, Coordinator, National Union of Healthcare Workers