Banking On
NEW JERSEY

Public Banking to Grow Our Common Wealth

Benefits
For Cities and Municipalities
Of a Public Bank

Key Questions and Answers for
Elected Officials and Policy Makers
Treasury Staff, Bankers,
Taxpayers and Voters

www.PublicBankingInstitute.org
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***The American people in cities and communities throughout our nation need a strong local banking industry**, free of the destructive practices of Wall Street**.** Local Banks distribute the sustainable and affordable credit our local economies need. Local banks working in partnership with public banks are able to lend additional funds and, in contrast to Wall Street, their profits do not depend on reckless risk taking. The result: a more democratic and prosperous local economy in which the benefits are shared by all.*

And it is within reach.

Across the nation, in more than twenty states and a growing list of municipalities, support is growing for the creation of public, "partnership" banks, based, in part, on the model of the hugely effective Bank of North Dakota.

From the capitols of New England, to New York and Pennsylvania, to Texas, Arizona and New Mexico, to Colorado, Oregon, Washington State and California – treasurers, state lawmakers and others are advancing public banking.

In cites large and small – Boston, Philadelphia, Allentown, Pittsburgh, New Brunswick, Chattanooga, Houston, Chicago, Santa Fe, Seattle, San Francisco and Los Angeles – mayors, council members, candidates and community leaders are stepping up to free their communities from the ruinous banking of the Too-Big-To-Fail banks –that failed and will in all likelihood fail once again.

Public banks partner with our existing community banks, credit unions, financial institutions and development agencies to provide affordable and sustainable credit for locally-directed economic development and jobs creation. The partnership supports sound municipal finance, lowers public debt, contributes substantial non-tax revenue to the general funds of our local governments and creates solid economic opportunity.

We invite you to learn about Public "Partnership" Banking and join the campaign to create the urgently needed alternative to a dangerously concentrated and failed banking industry.

Benefits for Cities and Municipalities of a Public Bank

How Does a Public Bank Generate Non-tax Municipal Revenue?

A public bank makes a sizeable profit through its partnership lending for economic development. Because public banks partner with community banks in making loans that extend credit into their communities and do not compete as retail banks, public banks need no branches, tellers, ATMs or broad and expensive marketing. Public banks are chartered to serve the public not exploit it. Hence, there are no mega salaries, bonuses or commissions to provide incentives for imprudent risk taking. The business model of public banks, so very different from Wall Street "banking," means that its profits are returned annually to the municipal general fund and reinvested in growing the partnership loan portfolio.[i] This helps balance the operating budget without raising taxes, cutting vital programs, taking on more debt, asking for givebacks from employees or raiding pension funds.

What Role Do Public Banks Play in Sound Municipal Economic and Fiscal Policy?

Not only do public banks return profits to the municipality as non-tax revenue, but by providing reliable and affordable credit, they facilitate economic development, create jobs, and grow the tax base. Further, as explained below, public banks can reduce public debt and the debt service costs loaded onto annual municipal budgets. A public bank allows a municipality to direct local lending, offer below market-rate loans,[ii] and leverage other capital for specific public purposes such as affordable housing, neighborhood development, infrastructure, small business development, education, and job creation. Dedicated loan funds can be set up in the bank's charter and it can modify its loan portfolio priorities from year to year with input from board members, local government and the public.[iii] Credit becomes local and supports longer-term investments. Partner banks facilitate hiring local contractors rather than large out of state companies often favored by directors of major, private banks.[iv] This "virtuous circle" increases local prosperity and the local tax base.[v]

How Does a Public Bank Reduce Public Debt and Debt Service Costs?

A public bank finances capital projects and bond issues at lower interest rates than the traditional bond market.[vi]It can also refinance current public debt, lowering debt service costs without the use of swaps and deceptive public/private partnership agreements that give away public assets to private companies with no accountability.[vii] It is also a stable buyer of municipal bonds as investments. Paying non-escalating, fee-free payments without the need to provide additional profits for commercial bank shareholders can mean cost savings of 35% to 50%[viii] for municipal projects. And whatever interest the public bank collects is retained and returned, in part, in profits deposited in the municipal general fund, rather than extracted and exported from the community.

How Do Public Banks Maintain Local Prosperity in Economic Downturns?

Research on public banks worldwide, whether municipal, regional, or state, shows that they function counter-cyclically, increasing credit flows and support for local businesses, especially small- and medium-sized businesses, in times of economic downturn. This stems business losses and failures and maintains robust local employment. In contrast, the last economic downturn saw the largest banks severely cut their loans to local businesses.[ix]

Can Public Banks Reduce Municipal Banking Costs and Maximize Returns on Deposits?

Many municipalities across the United States deposit receipts and fees with large banks that are seen as providing security with collateral, something smaller community banks cannot do. These deposits often earn negligible interest, sometimes .49% interest or less,[x]With a public bank, a municipality can deposit its funds in its own bank and obtain far greater yields; in part by making loans, but also owing to the low overhead business model of public banks. The profit margin can support increased interest on some government accounts[xi] or on special savings accounts, such as those for seniors or pension-related accounts. Deposits in a municipal public bank are managed with direct accountability, flexibility, and full public transparency.

*How Do Public Banks Eliminate Non-Productive Rainy Day Fund*s?

Whereas commercial banks hold rainy-day funds but pay little or no interest, a public bank pays higher interest. Further, a public bank can eliminate the need for a set aside by extending an affordable, "internal" line of credit in the event of a budget shortfall or emergency. This can be in the form of an interest-free loan or very low-cost Fed funds. Rather than sitting as cash, themoney in a rainy day fund can go to work. Because the public bank makes loans for disaster preparedness and for quick relief in cases of floods or climate-related disasters, the local tax base is preserved.[xii] Hence annual budgets can be balanced without raising expensive, high-interest capital on the open market.[xiii]

In What Ways Do Public Banks Strengthen the Local Banking Industry?

Because a municipal public bank makes loans in partnership with community banks, credit unions, and financial institutions, the local finance industry is strengthened. This partnership enables local lenders to increase loan amounts[xiv] without modifying existing underwriting standards, thus broadening their market. Public banks often buy down interest rates or guarantee loans thereby helping more borrowers to qualify. As the "front office," local banks and credit unions perform due diligence on each loan and keep all loan origination and service fees. Public banks also increase community bank capital by buying their loans on the secondary market and purchasing community bank stock[xv] In contrast to commercial banks that purchase loans and mortgages on the secondary market, a public bank never cross sells retail banking services or tries to lure community bank customers away. The financial health of its partner or "lead" banks is paramount for a public bank.[xvi]

Is a Public Bank More Secure Than Banking With Wall Street?

A public bank provides a safe and secure vehicle for the deposit and investment of funds from the general budget, agency budgets, and sometimes municipal pension funds.[xvii]Many city or state CAFRs (Consolidated Annual Financial Reports) reveal investments in far riskier vehicles such as hedge or equity funds.[xviii]Because the Global-Systemically Important Financial Institutions (G-SIFIs) that hold many of the sizeable municipal deposits also invest heavily in derivatives, municipal treasurers have cause to be concerned about the possible confiscation, or "bail in" of their deposits in the event of another Wall Street crash. Legally, derivatives have "super-priority" in the case of bankruptcy and the FDIC (where applicable) only has enough to pay pennies on the dollar.[xix]The next mega bank failure could exhaust the FDIC[xx].

FOR MORE FAQ GO TO:

www.publicbankingpa.org
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Endnotes:

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[i]The public Bank of North Dakota (BND), our nation's oldest public bank, earned $94 million last year in profits for North Dakota's 670,000 residents. BND deposits roughly half its profits into the State's general budget and uses the other half to increase its capitalization in order to make more loans. In the past decade, BND has returned over $300M to the general fund. In addition to lending based on a formula that includes both its public deposits and its capitalization, BND also has access to low-cost Federal Home Loan Bank capital. BND isnot required to contribute to FDIC insurance because it is not a retail bank and it is backed instead by the full faith and credit of the State of North Dakota. This and its partnership arrangements with local banks lower its operating costs considerably.BNDhas averaged more than 25% return on equity over the past 16 years. Since 2008, BND's annual return on investment has been between 17 and 26%. Financials are at: http://banknd.nd.gov/financials_and_compliance/annual_reports.html. Founded in 1919, BND is a mature public bank.It is estimated that the startup phase of a new public bank during which time it attains profitability is from two to three years; less than the three to five year range for commercial *de novo* banks. This is because of the regularity of its deposits and outflows combined with its unique partnership business model.

[ii]Though most of the loans made by BND are "average market-rate," it cooperates with State agencies such as the state economic development agency with which it shares its headquarters, to allow it to make below market-rate interest loans.On job creating business or agricultural loans, the BND uses the PACE fund to buy down interest rates by from 1% to 5%. Loans for qualifying entrepreneurs are offered at a 1% interest rate. See http://ilsr.org/rule/bank-of-north-dakota-2/, p. 3.

[iii]A process like the participatory budgeting already used in cities such as New York and Chicago, can allow for public input as to the relative loan portfolio priority of areas and needs to be invested in without designating specific investments, something done by professional bankers and lending officers.

[iv]Because quarterly profits for stockholders are not paramount, the public bank and community bank working in partnership can invest for the longer term. Some profits, such as that from a highway improvement that brings in new business may not be measureable in quarterly increments. Because local banks in North Dakota are supported by a public bank, they are able to make a greater proportion of small business loans than banks in other states. Ellen Brown writes:

> Over the last ten years, the amount of lending per capita by small community banks (those under $1 billion in assets) in North Dakota has averaged about $12,000, compared to $9,000 in South Dakota and $3,000 nationally. The gap is even greater for small business lending. North Dakota community banks averaged 49 percent more lending for small businesses over the last decade than those in South Dakota and 434 percent more than the national average. In other states, increased regulatory compliance costs are putting small banks out of business. The number of small banks in the US has shrunkby 9.5% just since the Dodd-Frank Act was passed in 2010, and their share of US banking assets has shrunk by 18.6%. But that is not the case in North Dakota, which has 35 percent more banks per capita than its nearest neighbor South Dakota, and four times as many as the national average. The resilience of North Dakota's local banks is largely due to their amicable partnership with the innovative state-owned Bank of North Dakota. See: "*Why Do Banks Want Our Deposits? Hint: It's Not to Make Loans*", Oct. 26, 2014 at: http://www.globalresearch.ca/why-do-banks-want-our-deposits-hint-its-not-to-make-loans/5410125.d

[v]In 2010, the Center for State Innovation, published a study analyzing the effects of moving Massachusetts State Funds from large banks (assets greater than 100B) to medium banks (assets 1-10B) and small banks(assets less than 1B). This complex study included bank limits to absorb deposits and the willingness of different sized banks to lend. Tellingly, the study found that for each 10M moved, small banks created between 4.50 and 7.23 jobs and medium banks created between 4.67 and 5.75 jobs. This was simply the result of moving deposits. With a partnership public bank, the entire lending system is refocused to create local jobs with likely far more jobs created. Community banks tend to make loans to local businesses that create the bulk of new jobs. By contrast, large banks tend to rely on computerized FICO models that eliminate most businesses requiring less profitable loans of below $5 million. Apparently these banks have not only exclude "relationship" criteria, but they are eliminating loan officers. See: "Why Getting Rid of Loan Officers Hurt Banks and the Economy," Yves Smith, Naked Capitalism Blog, December, 30, 2014.

[vi]An established public bank such as BND, can also borrow at the Federal Reserve's discount window and lend directly to local governments at lower rates than the municipal bond market provides. See http://ilsr.org/rule/bank-of-north-dakota-2/, p. 3.

[vii]Darwin Bondgraham, "Highway Robbery; How 'public-private partnerships' extract private profit," Dollars and Sense, November/December 2012 at http://www.dollarsandsense.org/archives/2012/1112bondgraham.html
See also: Ellen Dannin, "Innovations or Hucksterism?: Three Little-Known Infrastructure Privatization Problems," Truthout News Analysis , December 22, 2014 at http://truth-out.org/news/item/28142-innovations-or-hucksterism-three-little-known-infrastructure-privatization-problems
And Drew Reed, "US cities could turn to "community mini bonds" to fund infrastructure projects" at http://www.citymetric.com/politics/us-cities-turn-could-turn-community-mini-bonds-fund-infrastructure-projects-341

[viii]See: Ellen Brown, Infrastructure Sticker Shock: Financing Costs More Than Construction, The Web of Debt Blog at http://ellenbrown.com/2014/06/01/infrastructure-sticker-shock-financing-costs-more-than-construction/

[ix]BND only cut its lending to small businesses by 30% to 45% during the last economic downturn. By contrast, Bank of America cut its small business lending in Massachusetts by 98%. Most of the studies of counter cyclical lending to local businesses by public banks are of foreign banks. Studies have been done of both Latin American public banks (such as Chile's Banco Estado that has a counter-cyclical strategy for business lending) and European public banks (such as Germany's network of local, cooperative banks and regional public banks). Most studies seem to be of larger national, regional, and state public banks, but a similar counter-cyclical benefit could also be had by a municipal, public bank. Direct investment in public assets such as education, healthcare, land acquisition, renewable energy, green infrastructure (water/wastewater etc.), and transportation can function counter-cyclically and generate additional revenue.

[x]For example in 2013, Bank of America paid Boston .49% on over $2 billion of deposits.

[xi]There is a higher return for deposits in a public bank compared to those in a private megabank. In 2009-2010, the State of Washington earned $2.53 per dollar while North Dakota earned $5.28 per dollar deposited including the profit dividend. See: "What Our State Legislators Need to Know," at http://www.shareable.net/blog/the-joy-of-public-banking-what-our-state-legislators-need-to know/

[xii]BND loans meant that Grand Forks rebuilt speedily and preserved its tax base with less than a 3% loss. In contrast, Minnesota's East Grand forks across the river did not have a public bank to support rebuilding and it lost 17% of its tax base.For the role of a public bank in disaster relief see: Jim Morrow and Ira Dember, "Hurricane Sandy and the Red River Flood, How the Public Bank of North Dakota Saved Grand Forks," Sky Valley Chronicle,

November 3, 2012, at http://www.skyvalleychronicle.com/BREAKING-NEWS/HURRICANE-SANDY-THE-GREAT-RED-RIVER-FLOOD-BR-I-How-the-Public-Bank-of-North-Dakota-saved-Grand-Forks-I-1165139.

[xiii]One year, the Bank of North Dakota bailed out the State government when its budget experienced a shortfall. Finance arrangements with its public bank could make rainy day funds such as Boston's $130 million "free cash" fund unnecessary. Instead such funds may be used to capitalize a public bank, which working in partnership with its many community banks, could generate a steady profit after three years of operation.

[xiv]Public banks use a range of strategies to provide additional capital for community bank loans, sometimes as secondary partnersthrough legal contracts and often by providing letters of credit that enable the community bank to accept public deposits without providing collateral.

[xv]BND also has a fund for low interest loans to enable local citizens to buy the stock of their community banks. This helps keep local banks independent in their communities and promotes customer loyalty.

[xvi]It is instructive to compare the financial statements of community banks in North Dakota with similarly capitalized and sized community banks in Massachusetts. Those that work in partnership with the State public bank appear much more profitable. See https://www2.fdic.gov/idasp/main.asp. andhttp://www.bankingencyclopedia.com. The Massachusetts Bankers Association is funded by major international banks who tell community banks that a public bank would be competition despite its nature as a non-depository institution. Through research, Hub Public Banking hopes to highlight the opposite. We hope to document instances where the same major banks that lobby against public banks, take over the loan servicing, the lion's share of fees, and eventually the clients of the smaller community banks with which they partner. They often obtain information about local banks and buy them out.
For more on the benefits of a public bank partnership for community banks see "Benefits for Community Banks of a Public Bank Partnership," soon available at www.HubPublicBanking.org.

[xvii]Public banks do not necessarily invest a municipality's pension funds. However, proposals to do so are being considered in order to preserve principal, gain consistent returns, and minimize taxes. Some cities are exploring using pension funds to launch public banks that then invest operating profits to both buy back municipal bonds and fund their pensions.

[xviii]***Private Equity at Work; When Wall St. Manages Main St***, a May 2014 book by Eileen Appelbaum and Rosemary Batt examines equity funds to find that the returns of only 25% have beaten a stock market index fund each year since 2005. The problem is that different funds exceed that benchmark in each year. The book is a balanced expose of hedge and equity funds revealing that they work for only 2% of the companies that the funds buy, generally small businesses that are helped to scale up and for whom bank capital is not available. Most other companies are looted within three to five years and about half end up bankrupt. Both the profit figures and the jobs created statistics are detailed as to the ways in which the equity companies manipulate them. Though CALPERS, the California Pension System, recently exited such investments, they are involved in other sorts of direct equity investments. See also: KKR's Botched Document Cover-Up Reveals Washington Public Pension Fund Cronyism, Naked Capitalism Blog, January 23, 2015, Yves Smith at: http://www.nakedcapitalism.com/2015/01/kkrs-botched-document-cover-reveals-washington-public-pension-fund-cronyism.html

[xix]For a dramatic presentation of the safety of public deposits in the age of derivatives, see the YouTube presentation: https://www.youtube.com/watch?v=jPsOopzp7e4. See also these articles: "*Winner Takes All: The Super Priority Status of Derivatives*," Ellen Brown, Web of Debt Blog, April 10, 2013; "*The Armageddon Looting Machine: The Looming Mass Destruction From Derivatives*", Ellen Brown, Web of Debt Blog, September 18, 2013; and "*The SEC Finally Takes an Interest in Collateralized Loan Obligations*", Yves Smith, Naked Capitalism Blog, March 25, 2014; and this study:*Derivatives: Innovation in the Era of Financial Regulation*, Wallace C. Turbeville,

Financial Pipeline Series, Americans for Financial Reform, Washington, DC, June 13, 2013 and Americans for Financial Reform reporting on Derivatives bills before the US Congress.

[xx] In the event of another bank failure, municipalities that thought they had a claim on the bank's collateral may find themselves interminably standing in line in bankruptcy court fighting for pennies on the dollar. The math makes this clear. The Office of the Comptroller of the Currency reports $25 billion in FDIC insurance funds. There are $9,283 billion in total US deposits. Add to this equation a figure that dwarfs both; namely, $297,514 billion (nearly $300 trillion) which is the derivative exposure of the 25 largest banks.