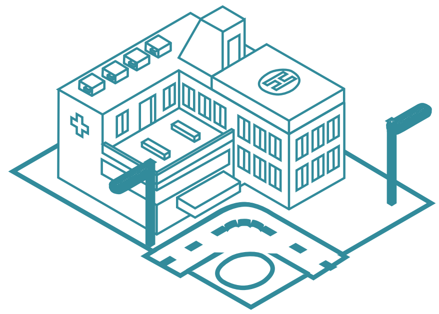
BUILDING *the* INCLUSIVE ECONOMY



# FINANCING MUNICIPAL ENTERPRISE

## Strategies for Financing the Inclusive Economy:

**Financing municipal enterprise as a tool to create jobs and build community wealth**

Marjorie Kelly, Violeta Duncan, and Steve Dubb *for The Democracy Collaborative*

This paper is an adapted excerpt from *Strategies for Financing the Inclusive Economy*, the third report in Citi Community Development's Building the Inclusive Economy series.

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DEMOCRACY COLLABORATIVE

**Building the Inclusive Economy series:** Through three groundbreaking reports funded by Citi Community Development, the *Building the Inclusive Economy* series sets out effective, cutting-edge economic development models for city leaders and community development practitioners interested in embedding equity, community wealth, and sustainability into their local economic growth plan. This series, authored by The Democracy Collaborative, the Democracy at Work Institute, and Project Equity, lays out key tools and building blocks for equitable local economic growth through which all residents are able to maximize opportunities, thereby expanding urban economies where all can meaningfully participate and benefit.

**The Democracy Collaborative:** This nonprofit, founded in 2000, is a leader in equitable, inclusive, and sustainable development. Its work in community wealth building encompasses a range of advisory, research, policy development, and field-building activities aimed at enhancing the economic prospects of low- and moderate-income individuals. Its mission is to help shift the prevailing paradigm of economic development—and of the economy as a whole—toward a new system that is place-based, inclusive, collaborative, and ecologically sustainable.

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Broad-based ownership models bring substantial benefits to communities and workers, particularly those of low and moderate income.

# INTRODUCTION

And in an economy where wages have been stagnant for decades—and a disturbing 40 percent of jobs are now part-time, temporary, or contingent—broad-based ownership models offer a promising alternative.[1]

Given their impact, worker-owned companies, employee stock ownership plan (ESOP) companies, social enterprises, municipal enterprise and new hybrid models with broad-based ownership are increasingly viewed as highly valuable tools for stemming and reversing rising economic inequality. But how to hasten their growth and build an inclusive economy, in which quality jobs are bountiful and ownership opportunities are widespread? How to increase understanding and comfort levels in these businesses' financing— *financing* being a key contributor to enterprise growth?

This paper—adapted from the *Building the Inclusive Economy* series' third report, *Strategies for Financing the Inclusive Economy*—begins to answer this question. It focuses specifically on how financial service providers, impact investors, foundations, local government, community development leaders, and others can finance municipal enterprises to build community wealth.

Municipal enterprises tend to employ traditional financing, primarily bonds. The municipal bond market is a highly evolved ecosystem; newer models of financing are also emerging, such as green bonds and public-private partnerships.

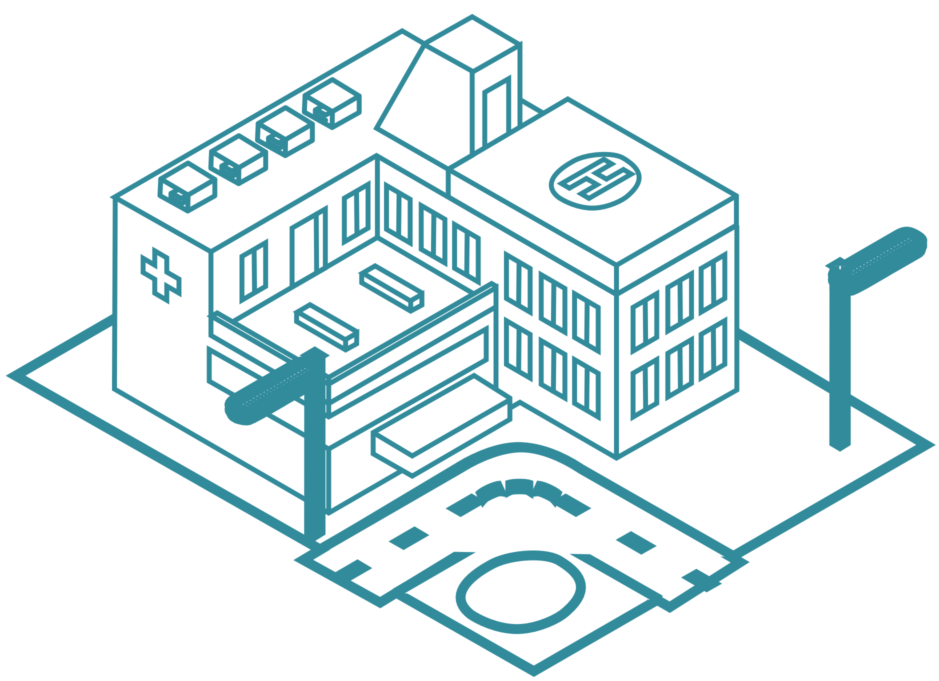
In the sections that follow, this paper explores innovative financing strategies, case studies of municipal enterprise financing, and additional resources to help scale municipal enterprises as a tool for creating jobs and building community wealth.

Mayors and local economic development departments are increasingly a locus of experimentation and innovation in creating inclusive local economies.

As Bruce Katz and Jennifer Bradley wrote in their book *The Metropolitan Revolution*, "Cities and metropolitan areas are the engines of economic prosperity and social transformation in the United States."[2] One potential element in play as local leaders innovate is the set of substantial local assets held by municipally owned enterprises.

## Financing Municipal Enterprises

Municipal enterprises—businesses owned or chartered by local public authorities that provide services and generate revenue—include water and sewer systems, electric utilities, waste management, broadband internet networks, hotels and convention centers, public transportation, golf courses, ports, airports, and land and real estate. Also included are municipal financing of economic development and public pensions. These various municipal assets hold the potential to be used as engines for local job creation and for building community wealth.



## Traditional Financing of Municipal Enterprise

**Municipal bonds:** Traditionally, the financing of municipal economic activity has been done substantially through the issuance of municipal bonds, a robust part of the U.S. bond market. In 2015, $403 billion in new municipal bonds were issued, bringing the total outstanding to $3.7 trillion—roughly nine percent of the nation's total bond market.[3] As Charles Schwab analysts Cooper Howard and Rob Williams observed recently, municipal bonds outperformed all other bond categories in 2015, as well as outperformed stocks. Municipal bonds are attractive to investors for their stable returns and low risk, as well as the fact that interest income is exempt from federal income tax, and often from state income tax as well.[4]

### CHALLENGES, SOLUTIONS, OPPORTUNITIES

- **Growth is stalled in some areas of municipal enterprise,** such as municipally owned electricity, a sector where creation of new enterprises is politically and financially difficult today.
- **While privatization once proved a challenge for municipal water, that trend has reversed.** Around 87 percent of all U.S. water systems are publicly owned at the local level. Attempts at privatization of water in recent decades have generally been disastrous, due to poor service and rising rates; many have been reversed amid public pressure. Between 2007 and 2014, the number of privately owned systems fell seven percent and the number of people served by private systems fell 18 percent.[5] Efforts at privatization now are often met with opposition—as in 2013, when residents of Bethel, Connecticut blocked a proposal to sell the town's water utility to Aquarion, with more than 70 percent of residents voting against the sale in a referendum.[6]
- **Municipal enterprises are more inclusive than private employers.** For decades, women and African-Americans have been employed in the local and state public sectors at rates higher than in the private sector. People of color in public sector employment also face smaller wage disparities across racial lines.[7]
- **Economically targeted investments (ETIs)—socially oriented investments by public sector pension funds—are on the rise** thanks in part to the U.S. Department of Labor's recent guidance that says pension fiduciaries can consider the social and environmental impacts of ETIs, so long as they are financially equivalent to competing investment choices.[8] This Labor Department action is helping broaden support for ETIs as an economic development strategy. Though most public pension funds are regulated at the state and local level, many states model their standards after federal rules.[9]
- **Four particular areas represent current opportunities for municipal enterprise growth and job creation:** municipal water, transit-oriented development, high-speed internet, and hotels.

## AREAS OF JOB GROWTH IN MUNICIPAL ENTERPRISE

**Municipal water systems:** These systems represent enormous assets for localities. The Los Angeles Department of Water and Power, for example, is the country's largest publicly owned utility, supplying water and electricity to the city's 3.9 million residents and 450,000 businesses.[10] Each year, it transfers about seven percent of its gross revenues from electricity ($261 million in FY 2014–2015) and five percent of its gross revenues from water to the city's General Fund, helping finance city operations and support public sector jobs.[11]

One city using its municipal water system for economic development is Chicago. In March 2016, Mayor Rahm Emanuel announced the launch of a new public-private research partnership called Current. The Metropolitan Water Reclamation District of Greater Chicago and the nonprofit business group World Business Chicago are working together to increase efficiency, improve wastewater treatment, and increase water industry employment. Chicago's water economy—today the fourth-largest in the nation—accounts for $14 billion in gross regional product. Regional water enterprises employ close to 100,000 workers. The city projects that the research and investment that the Current partnership is projected to undertake will support more than 400 businesses, creating $250 million in economic value over ten years.[12]

**Transit-oriented development**: Another set of growing assets for cities is local transit systems, which provide the opportunity for transit-oriented development as an approach to economic development. Transit-oriented development aims to develop compact, walkable, mixed-use communities around public transportation nodes. Often this form of development focuses substantially on real estate. But it also represents an opportunity for job development. That's the idea behind Jobs to Move America, a growing movement being promoted by advocates like Madeline Janis, national policy director for the Los Angeles Alliance for a New Economy (LAANE). This ambitious plan envisions bringing tens of thousands of manufacturing jobs back to America using the public dollars already pledged to mass transit development.

One project that Janis has her eye on is the $40 billion allocated to improve Los Angeles's mass transit with new light-rail cars. This project is financed by a half-cent tax increase over 30 years. Janis notes that there are virtually no American rail car manufacturers in the U.S. today. She and a coalition of advocacy groups in major cities are seeking to substantially increase the number of such companies. Robert Puentes, senior fellow with the Brookings Institution's Metropolitan Policy Program, said that LAANE's plan potentially represents a "permanent shift in the American economy."[13]

**High-speed internet:** More than 450 communities have already established publicly owned networks, including more than 50 in 19 states offering super-fast networks with at least 1 GB service. These publicly owned systems commonly provide higher speeds, better service, lower costs, and updated infrastructure in communities often neglected by large for-profit cable companies. In addition to providing a locality with revenue, these public broadband networks create the opportunity for locally owned businesses to flourish, and for residents to establish in-home businesses.[14] For example, the Chattanooga Electric Power Board (EPB), a municipally owned utility, in 2007 announced a ten-year plan to build a fiber network serving all of Chattanooga. Chattanooga became the first city in the country to make commercially available 1 GB high-speed broadband service. Today, the city-owned service serves 60,000 residential and 4,500 business customers.[15]

**Municipally owned hotels:** Hotels owned by municipalities can be found in communities as different as Austin, Texas; Overland Park, Kansas; Chicago; Omaha, Nebraska; Denver; and Sacramento, California. Robert Nelson, chair of the Department of Hotel, Restaurant, and Institutional Management at the University of Delaware, notes that many publicly owned hotels are constructed to support another prominent sector of municipal ownership—convention centers.[16] The Vancouver Hilton Hotel & Convention Center in Washington, for instance, is owned by the Vancouver Public Facilities District and leased by the Downtown Redevelopment Authority. Together, the hotel and convention center employ nearly 200 people, 80 percent of whom live in the area.[17] The tax laws were changed in 1996 to allow the use of tax-exempt municipal bonds to finance hotels, which fueled the increase in this sector.[18] Another financing mechanism is public pension funds. For example, the Retirement System of Alabama pension fund owns eight upscale hotels across the state.[19]

## Innovative Financing of Municipal Enterprise

**Mini-Bond Program:** The Los Angeles Department of Water and Power has created a Mini-Bond Program that enables its active and retired employees to purchase tax-exempt bonds without paying brokerage fees or commissions, providing a wealth-building mechanism for employees not able to reach the $5,000 minimum investment level of its regular bond program. LADWP expects to raise $15.9 million through Mini-Bond investments in a future bond offering.[20]

**Green bonds:** Institutional investors are increasingly attracted to green bonds, which address environmental challenges by channeling money to green projects. For example, Massachusetts in June 2013 floated the first municipal bond labeled green by its issuer, as part of a $670 million general offering. The Office of the State Treasurer said it would use proceeds from the $100 million bond to back environmentally sound infrastructure projects.[21] In another example, municipally owned utilities have banded together to float bonds for wind energy development. One example is the $65 million raised in a 2010 bond issued by the Berkshire Wind Power Cooperative Corporation, a cooperative composed of fourteen municipally owned utilities in Massachusetts that are seeking together to finance local wind development.[22] Worldwide, green bond issuance reached a record $41 billion in 2015.[23]

**Financing partnerships:** The City of Denver helped create a collaborative fund—the Denver Transit-Oriented Development Fund—now totaling $24 million, for residential and commercial development around transit areas. The city provided $2.5 million for the fund. Another $15 million was provided by the national nonprofit Enterprise Community Partners. Other investors and multisector partners include private banks, CDFIs, the County of Denver, the Colorado Housing and Finance Authority, and the Colorado Division of Housing.[24] Program related investments came in from the Ford Foundation, the Denver Foundation, and the Gates Family Foundation.[25] Since 2010, nearly $200 million has been leveraged from public, private, and nonprofit sources. To date, 700 jobs have been created and eight properties acquired, helping to preserve and create more than 600 homes and 120,000 square feet of commercial space.[26]

**Economically Targeted Investments:** In 2014, public sector pension plans held close to $4 trillion in assets and, increasingly, portions of these funds are invested for social impact.[27] A recent Deloitte survey found that 64 percent of the country's pension funds intend to make an impact investment in the future.[28] ETIs provide an opportunity for municipalities to finance inclusive economic development. ETIs are not an asset class themselves, but are distributed over fixed-income securities, private equity, and real estate.[29] One prominent ETI investor is the New York City Retirement System (NYCRS), comprised of the pension funds of municipal workers and teachers, with $165 billion in assets. NYCRS aims to invest 2 percent of assets into low- and moderate-income areas in New York City.[30] At the end of 2014, NYCRS's ETI portfolio yielded a ten-year net return of 6.3 percent, 1.4 points above its benchmark.[31]

Seattle has embarked on an ambitious $73 million project, the MarketFront, to expand Pike Place Market, which was chartered by city government and is one of the country's leading public markets. MarketFront will add 47 rooftop day stalls for farmers and artists. The project also includes 40 new units of low-income senior housing and a new neighborhood center with expanded social services.

Photo c/o Pike Place Market Foundation

# Case Studies in Financing Municipal Enterprise

CASE STUDY

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## PIKE PLACE MARKET: FINANCING THE EXPANSION OF THIS SEATTLE ICON

Seattle has embarked on an ambitious $73 million project, the MarketFront, to expand Pike Place Market, one of the country's leading public markets.[32] In so doing, it provides a valuable demonstration of how municipally chartered enterprise can finance and support local community wealth building.

Since 1973, Pike Place Market has been governed by the Pike Place Market Preservation and Development Authority (PDA), a nonprofit corporation chartered by the city "to increase the opportunities for farm and food retailing, support small and marginal businesses, and provide services for low-income individuals."[33] By charter, the PDA is governed by a 12-member council that has four mayor-appointed representatives, four publicly elected representatives (any state resident can pay $1 a year to join the "constituency" group), and four appointed representatives. The directors serve staggered four-year terms and must be confirmed by the Seattle City Council.[34]

Pike Place currently serves 80 farmers, 220 small business, and 250 artisans. With the expansion, MarketFront will add 47 rooftop day stalls for farmers and artists. The project also includes forty new units of low-income senior housing and a new neighborhood center with expanded social services.[35] The expansion financing plan is illustrated below:[36]

## Financing the Expansion of Pike Place Market

| Source | Amount | Notes |
| --- | --- | --- |
| City of Seattle general obligation bonds | $34,000,000 | Debt |
| Low Income Housing Tax Credits (& related low-income housing finance) | $9,200,000 | Equity |
| Pike Place Market Preservation & Development Authority (PDA) bonds | $8,500,000 | Debt, amortized over 20 years at 4 % interest |
| WSDOT Alaska Way Viaduct parking mitigation funds | $6,000,000 | Equity |
| Pike Place Market Foundation capital campaign | $6,000,000 | Equity |
| New Market Tax Credits | $4,000,000 | Equity |
| PDA | $3,000,000 | Equity |
| State of Washington grants | $2,500,000 | Equity |
| **Total** | **$73,200,000** | |

As can be seen, the City of Seattle provides nearly half of the funds, which come from general obligation bonds. This support covers a portion of construction and the full cost of the land.[37] The PDA will also, for the first time in its history, issue its own bonds (raising at least $8.5 million, but authorized to go as high as $18 million if needed), amortized over 20 years, with a 4 percent coupon.[38] The PDA will also contribute $3 million in equity.[39]

The Washington State Department of Transportation awarded the PDA $6 million as a grant. It is tied to Pike Place Market parking fees, so, in theory, Pike Place "pays back" the $6 million by entering into contracts (restrictive covenants) that limit what it charges the public to park. But no cash needs to be paid back.[40]

Of the $9.2 million needed to finance the on-site senior housing, PDA has already raised $1.4 million from the Seattle Housing Levy.[41] The PDA procured a New Market Tax Credit allocation from Morgan Stanley, and has, with the support of the Pike Place Market Foundation, raised more than half its $6 million capital campaign goal.

Denver is a leading innovator with its first-in-the-nation Transit-Oriented Development (TOD) Fund, the result of a collaboration between the local government, public and private lending institutions, CDFIs, philanthropy, and a community development corporation. The fund helped to finance the $32 million Avondale Apartments, which includes a new public library, commercial space, and affordable housing.

Photo c/o studiotrope Design Collective by David Laurer


CASE STUDY

Click for info

## DENVER TOD FUND: FIRST-IN-NATION LOCAL FUND FOR TRANSIT-ORIENTED DEVELOPMENT

Denver is a leading innovator in transit-oriented development finance through its first-in-the-nation Transit-Oriented Development (TOD) Fund, the result of a collaboration between nonprofit developers, local government, foundations, and financial institutions. Transportation costs today devour a rising share of the budgets of low-income families in the Denver region, many of whom live in outlying areas. Making sure these families benefit from transit-oriented development is the aim of the new fund, which seeks to make development affordable and equitable as the transit system expands over the next two decades, building 122 miles of rail transit, 18 miles of bus rapid transit, and 57 new stations.[42]

The TOD Fund was launched in 2010 with $15 million in capital and has leveraged close to $200 million from other partners. Those investments have funded 626 affordable homes as well as mixed-use commercial spaces. To build on that success, the fund is today expanding regionally and has grown to $24 million.[43]

Helping to conceive the fund were the nonprofits Enterprise Community Partners and the Urban Land Conservancy (ULC), which partnered in launching the fund with the city, public and private lending institutions, CDFIs, philanthropy, and a community development council. The aim was to purchase and develop real estate around planned transit corridors. Enterprise Community Partners is the fund manager and the ULC is one of the borrowers. To date the fund has invested in 13 TOD projects, with ULC completing nine of the transactions.

One notable TOD site is the Avondale Apartments at Mile High Vistas. The $32 million development, led by the ULC as the master site developer, includes a new public library, 10,000 square feet of commercial space, and 80 units of permanently affordable housing. It has helped to create 195 jobs—65 of them permanent—and spur an economic renaissance along the Colfax Avenue corridor.[44] A 2013 study found that without the $2.35 million from the TOD Fund, the project likely would not have been completed.[45]

## Financing the Denver TOD Fund[249]

| Source | Amount | Notes |
|---|---|---|
| Colorado Housing and Finance Authority & Colorado Housing Authority | $10,500,000 | 2% interest (CHFA)<br>1% interest (CHA)<br>Top loss outside of city of Denver |
| Enterprise Community Loan Fund, Mile High Community Loan Fund, & banks | $5,500,000 | 6.65% interest<br>Senior debt |
| Rose Community Foundation & MacArthur Foundation | $4,500,000 | 2% interest<br>Third position |
| City of Denver | $2,500,000 | 0% interest<br>Top loss within city boundaries |
| Enterprise Community Partners | $1,000,000 | 2% interest<br>Second position |
| **Total** | **$24,000,000** | |

Finance has a vital role to play in advancing cooperatives as a tool for job creation and reducing wealth inequality.

# CONCLUSION

This survey shows key areas poised for growth and social impact, indicating where finance can play a vital role.

**Institutional investors of all kinds can continue to advance green bonds to support a host of needed infrastructure investments in energy, water, and elsewhere.** Bond instruments like the Berkshire Wind Power Cooperative Corporation—funding wind development by fifteen municipally owned utilities in Massachusetts—show how these environmentally oriented bonds can be an important tool for a sustainable and inclusive economy.[47]

**Transit-oriented development provides plentiful opportunity to support community wealth building.** As seen above, Denver, Colorado's transit oriented development fund provides a model for how to do this, combining municipal bonds, public and private lending institutions, CDFIs, and philanthropy to create a $24 million land acquisition fund. The fund supports affordable housing, improves transit access for low- and moderate-income residents, and increases the access of these residents to employment and wealth-building opportunities.

It is clear that community wealth building approaches centered in broad-based ownership of business are poised to grow and can be important tools for addressing the economic inequality challenges that we face. Finance cannot do it alone. Yet it is an essential partner, and potentially a powerful force in leading this work. The municipal enterprise models highlighted here shine light on diverse ways to build the partnerships between development and finance. And, by forging these connections, finance and community development can work together effectively to build community wealth and a truly inclusive economy.

## ADDITIONAL RESOURCES:

- ***Steps to Avoid Stalled Equitable Transit Oriented Development Projects,*** Living Cities, April 7, 2014, https://www.livingcities.org/resources/259-steps-to-avoid-stalled-equitable-tod-projects
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