



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Julia H. Cooper

**SUBJECT: PUBLIC BANKING
REVIEW**

DATE: June 5, 2020

Approved

Date

6/5/2020

INFORMATION

BACKGROUND

On March 19, 2019, the City Council authorized the City Manager to reject all proposals for Banking Service RFP 17-18-05, explore the feasibility of an alternative delivery model for banking services, and report back to the City Council on or before June 30, 2020. City Council also directed staff to:

- 1) Explore the feasibility of public banking as an alternative delivery model;
- 2) Include in the City's legislative priorities California Assembly Bill 857;
- 3) Adopt a resolution urging California State legislators to enact legislation amending the Government Code to enable local agencies to create public banks through an option for a public banking charter.

This information memo provides an update on the direction provided by the City Council.

ANALYSIS

California Assembly Bill 857¹

In September 2019, California legislature passed Assembly Bill 857, the Public Banking Act. The new law provides a pathway for cities and counties throughout the state to establish public banks. The legislature requires a city or county to create a business plan to be presented to the public and approved by local legislature. Public banks shall be organized as a nonprofit public benefit or mutually benefit corporation, owned entirely by cities and counties, governed by independent boards of directors, and run by professional bankers. Public banks will be exempt from taxes and subjected to the Brown Act and the Public Records Act.

¹ [California Assembly Bill No. 857](#)

AB857 will be implemented over a period of seven years, with no more than two licenses to be issued each year, up to a maximum of ten licenses. The Department of Business Oversight will conduct a study on the efficacy of the banks. The program is intended to demonstrate how public banks benefit Californian's local communities and governments.

Public Banking History

Public banking is banking operated in the public interest, through institutions owned by the people through their representative governments. Public banking is distinguished from private banking in that its mandate begins with the public's interest. As of today, only two public banks exist in the United States: the Bank of North Dakota ("BND") and the Territorial Bank of American Samoa.

BND was founded in 1919 on a wave of economic populism, capitalized with a \$2 million bond offering and charged with "promoting agriculture, commerce and industry" in North Dakota. Under North Dakota state law, all state funds must be deposited into BND, which does not have deposit insurance but is instead insured by the "full faith and credit" of the State of North Dakota. BND primarily partners with local banks and credit unions to facilitate agricultural, commercial, real estate and student loans. The other public bank, the Territorial Bank of American Samoa, was founded in 2016 after the last commercial bank left the territory. It gained access to the Federal Reserve's payment system in 2018.

Studies of Public Banking by Government Agencies

Many state and local agencies¹ explored the idea of public banking and spent a great deal of time and resources to study the feasibility of public banking. Although the objectives of public banking vary, the common themes include:

- Gain greater access to credit or capital
- Help fund state government with bank profits
- Stabilize the state/city economy during economic downturns
- Provide a stable source of infrastructure funding and economic development
- Provide better banking services for public entities at fair price
- Fill in the gaps where there are not current financial services
- Set up participation loan programs and increase the lending capacity of community banks
- Provide cannabis banking options.

The studies widely concluded that public banking is costly and risky with relatively low return on investment. Many studies supported altering the existing banking structure and building targeted alternatives to support public interest. No public bank has been created resulting from the studies.

¹ Public Banking Institute Website highlights that [Local efforts and legislations on public banking by state](#)

The following are summaries of public banking studies completed by a few local government public entities.

I. San Francisco (March 2019)¹

San Francisco’s study aimed to analyze financial costs and benefits of a municipal bank and outline the policy and operational considerations if the city chooses to create a public bank. It points out that pursuing a public bank is a time intensive and expensive endeavor. The upfront short-term cost, in terms of time, money and energy, is significant; while the long-term payout is uncertain.

The study provides three financial models: a reinvestment entity that focuses on affordable housing and small business lending to achieve community goals, a divestment bank that performs the City’s cash management, and a combination bank that performs both the City’s cash management and affordable housing and small business lending.

	Model One: Reinvest	Model Two: Divest	Model Three: Combined
Years to Break Even	10	31	56
Size at Breakeven	\$1.1 billion	\$3.1 billion	\$10.4 billion
Estimated Appropriation Required to Break Even			
Start-Up Costs	\$6 million	\$119 million	\$119 million
Operational Subsidy	\$13 million	\$990 million	\$2.2 billion
Capital Investment	\$165 million	\$460 million	\$1.6 billion
Total	\$184 million	\$1.6 billion	\$3.9 billion

The study lists the following operational and policy challenges:

- Sources of banking capital is limited to general fund, philanthropy or crowdfunding.
- Sources of deposits and collateral requirements
- The bank’s governance structure needs to be independent of political process and pressures
- Tensions between a municipal bank and the State’s mandates of “safety, liquidity and yield”

In conclusion, the study recommends San Francisco take a phased approach that offers a logical progression and pursues interim programs capable of achieving the same goals of a municipal bank, including socially responsible banking, small business lending and serving un- and under-banked individuals. This approach may take five (5) years or longer before a municipal bank can be established.

¹ [San Francisco Municipal Banking Feasibility Task Force Report](#)

San Francisco Supervisor Sandra Fewer introduced legislation¹ on November 12, 2019 that would establish a nine-member task force to create a business plan for launching a public bank. The first report towards the goal is due by June 30, 2020.

II. City of Seattle (October 2018)

The City of Seattle's study targeted a primary goal to discontinue services with Wells Fargo and a secondary goal to provide services to the public.

The study designs a baseline model to accomplish the primary goal, in which Seattle is the sole depositor of a public bank, which attempts to replicate banking services provided by Wells Fargo. The study found that only the largest banks with national footprints typically possess the scale to competitively offer the full suite of the Seattle's treasury services. Capital-intensive operations such as payment processing and software platforms demand high start-up funding and ongoing fixed costs. As a result, a city-owned bank is unlikely to match the capital of national bank and should expect to outsource some of the city's services to other partners.

To support balance sheet activities in the baseline model, the public bank will need large deposit commitments (\$100 - \$250 million) from Seattle, would need to be reallocated from the city's investment pool. In addition, Seattle would need to appropriate a budget of \$10-\$25 million to provide start-up capital to establish the bank. This baseline model will have higher overhead (\$3.1 million annually) and likely need ongoing subsidy from the city. Compared to the existing relationship with Wells Fargo, the Seattle study concluded that the baseline model will not provide any cost savings.

To accomplish the secondary goal, Seattle is expected to engage in three activities that present some legal challenges:

Activities	Challenges
Accepting deposits from private citizens and business	FDIC insurance
Lending money to general public	Washington State Constitution
Providing banking services to legal cannabis industry	Federal Reserve Bank payment system

The City of Seattle noted that creating a public bank in Seattle would be at best a long-term process, requiring numerous layers of regulatory review and eventual compliance with a restrictive slate of limitations on its capacity to lend and raise capital.

Seattle City Council members introduced a Statement of Legislative Intent during the budget development process for 2019 to request and the development of a business plan for a municipal

¹ [Ordinance amending the Administrative Code to establish the Public Bank Planning Task Force to submit to the Board of Supervisors and to the Local Agency Formation Commission business and governance plans for a non-depository Economic Development Financial Institution and for a Public Bank](#)

bank by June 1, 2019. The Executive responded in May 2019 that the business plan development was not feasible due to significant legislative, electoral, regulatory and financial challenges. Instead, the Executive recommended working with legislative delegation to address state-level issues. Additionally, the response noted that beyond these important legal, regulatory and policy issues, actual implementation would require that the City of Seattle identify a funding source for at least \$125 million, in order to initially capitalize even a baseline model municipal bank.

III. King County, Washington State (March 2016)

King County did not launch a full-fledged feasibility study. It identified potential capital funding sources for public bank and possible negative impact for the county. Additionally, Washington State prohibits lending public funds to “any individual, association, company or corporate, except for the necessary support of the poor and infirm.”

Funding Sources	Potential Negative Impact
Issuance of debt	May lower bond rating and increase borrowing cost
General Fund reserves	Impractical, as reserves are already low
Investment pool	Exposure to credit losses
Equity investment from other governments and employees’ pension	High cost, difficult to attract investors

King County concludes that public banking comes with many legal uncertainties and operating risks. This concept is not feasible if it worsens the financial condition of the county’s general fund.

IV. City of Santa Fe, New Mexico (January 2016)

The City of Santa Fe model contains two parallel tracks: a city’s banking function and a crowd-funding platform.

City Banking Function: Create a Santa Fe public bank to receive and manage all public-sector deposits and use the bank to fund the city’s capital improvement projects. In this function, Santa Fe needs to consolidate cash management, lower deposit collateral requirements, and apply for a banking charter to allow access to other public entities. Santa Fe public bank forecasts a cumulative economic value of \$24 million over 7 years for the city. Most of the value comes from improved treasury management, not banking services.

Crowd Funding Platform: Provide support and convene local market participants to “jump start” a New Mexico intra-state lending portal. The study did not provide any analysis on economic impact from crowd funding.

The City of Santa Fe believes that a public banking initiative is feasible and has the potential to provide enhanced fiscal management, improved net interest rate margins, and a more robust local

lending climate. However, these goals can be accomplished by improving and integrating the city's current financial activities, developing relationship with local lenders for greater economic advantage, and encouraging new modes of lending to improve the over-all financial system in the region. Public banking is not the sole solution.

In August 2017, Santa Fe mayor appointed a Santa Fe Public Bank Task Force to spearhead the development of a public bank for the city. The Task Force issued a final report¹ to the Santa Fe City Council in April 2018, encouraging the city to participate in the development of a state-wide public bank. A city sponsored public bank was not recommended.

CONCLUSION

This report presents a summary of initial analysis and research conducted by the Finance Department in response to the Council referral in March 2019 to explore public banking as an alternative delivery option for the City's general banking services. This review results in a conclusion that public banking is very costly and highly risky endeavor for local governments. In the process of establishing a public bank, the City would face many operational and policy challenges and legal requirements as outlined in AB857.

Staff does not believe that public banking is a viable alternative banking service delivery model that the City of San Jose should pursue at this time. The Finance Department does not have sufficient staff or resources to undertake the necessary study required by AB857. If the City Council wants further research and analysis to be prepared, the item needs to be referred to Council Priority Setting for prioritization by the Council and to allow for identification of appropriate resources to allocate to the project.

/s/

JULIA H. COOPER
Director of Finance

For questions, please contact Julia H. Cooper, Director of Finance at (408) 535-7011.

¹ [Santa Fe Public Bank Task Force Final Report, April 17, 2018.](#)

