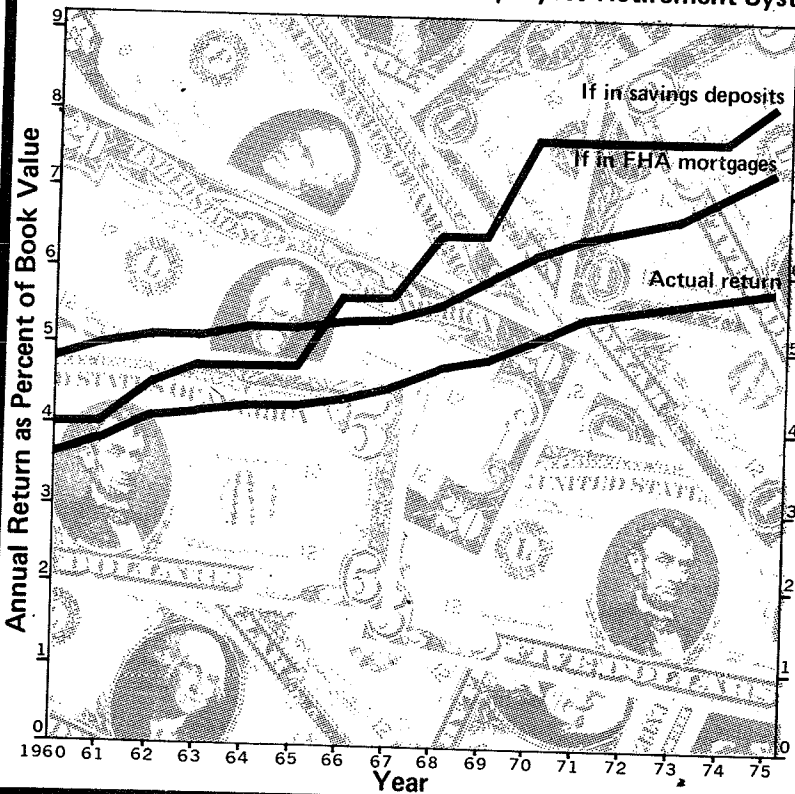


Billions of dollars and no sense

Public pension funds would have a higher return if they were invested in savings banks or FHA mortgages. Community development loans could produce at least the present actual return.

Performance of California Public Employees Retirement System



This fall, Chase Manhattan Bank bought full-page ads in the *New York Times* and the *Wall Street Journal* to lament that the U.S. now lacks the investment capital necessary to bring the economy out of the present recession. *Business Week* followed with a special issue on the "capital crisis." Both argued that further concessions must be made to private industry by the Ford Administration if housing and other deteriorating sectors of the economy are to be rebuilt sometime in the future.

These further concessions involve tax reductions, investment tax credits, government-backed loans, and as an implicit result, less government spending for social services and public employment. The net effect will be curtailment of "social overhead" to subsidize private corporate growth.

The raiding of public funds for private investment has in fact gone on for many years. Probably the most notorious example on the local level is the investment of billions of dollars of public employee pension funds in private stocks and bonds. California local and state officials, concerned at the continuing high unemployment in the state and a depressed housing industry, asked members of the COOP Project to propose a strategy for public investment in community development and job creation using available public pension funds.

Growing by millions of dollars every day, pension funds are a hidden cache of investment capital that could be used to revitalize state and local economies. The public retirement systems in California now hold almost fifteen billion dollars in assets. Most of this vast capital resource is held in private corporate bonds and stock. Despite the reputation pension fund managers would like to have for prudent investment, COOP has discovered that stock and bond market investments have proved very costly. The total value of the system is now 15-20%—or \$3 billion—below the original investment. Average yields are consistently lower than those returned by bank deposits or FHA mortgages. Ironically, risky market investments remain acceptable to fund managers, while far safer investments in community development are routinely rejected. About 85% of all California's public employee retirement system assets

are still invested in corporate stocks and bonds.

No one takes issue with the primary goal of state retirement systems in providing a secure pension for present and future public employees. The disagreement arises over definitions of adequate "funding," security, equity, diversification, and yield. These concepts have been used to justify funneling huge amounts of investment capital from individual workers to corporate giants.

The "funding" concept, borrowed from theories of private pension investment, has become a cornerstone of public pension policy as well. When a retirement system is fully funded, income from the assets of the system will be sufficient to pay all retiree benefits, even if contributions by employers and employees to the system ceased. The "full funding" goal applied specifically to corporations that might go out of business at any time.

The effect of "funding" in the public sector, however, is to greatly inflate the yearly contributions by both employees and their employers—the taxpayers of the state. Cities, counties and states don't go out of business. Since the financial health of state and local government is directly related to the health of the larger economy, deterioration of public systems to the point where they could not pay benefits from current employer and employee contributions is extremely unlikely unless the supporting economy were also in ruins. The federal Social Security System accepts this logic, paying benefits solely from present contributions.

Traditional definitions of "yield" and "security" have also led public pension fund managers to maintain policies favoring corporate stocks and bonds. When yield and security are discussed, the potential impact of billions in pension fund investments on the California economy and local property tax bases is completely overlooked. The choice to invest one billion dollars in local housing construction, for instance, would generate about \$30 million a year in additional property tax revenue and a few million dollars in increased income and other tax revenues. And this estimate doesn't include the thousands of jobs created directly by the investment, or the multiplier effect from pumping \$1

billion into the California economy.

Beneath the layer of rationalizations for public pension fund investment is a network of cozy relationships with major banks, private utilities and corporations. Approximately two-thirds of public pension fund investments in California are in telephone bonds, private utility bonds, and industrial bonds. Another 15-20% is invested in corporate stock—the rest in mortgages, real estate and government bonds. These retirement funds are essentially forced savings for the private sector. Corporations use the contributions of

Development Corporation to coordinate loans, COOP proposes that mortgages be made available primarily for low-to-moderate income non-profit housing, cooperatives, and members of the affected public retirement systems. Rehabilitation loans could also be offered to owner-occupants and owners of lower income rental units who agree to specified rent control requirements.

These insured mortgages would be at least as secure as the bonds that pension systems now consider to be their least risky investment. To assure that yield on

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public employees and the state's taxpayers to finance private growth, most of it outside the state and even outside the country.

COOP suggests that the billions in public employee pension funds be redirected into a State Development Bank & Development Corporation, which would in turn invest in California low-to-moderate income housing and community development. Currently, only about 10% of public retirement funds are invested in mortgages and real estate, and almost none directly in low-to-moderate income housing.

Local public pension funds have already been used for community development—Alameda County financed public buildings using the county pension fund, and Oakland used the city employees pension fund to buy redevelopment bonds for a subsidized housing project. Berkeley has also used its city employees fund to finance a housing rehabilitation program. Other communities and the state could begin similar internal financing and planning on a larger scale, with no loss in either yield or security on the investment.

Using the State Development Bank &

investments are not forfeited under the new policy, the average interest rate for housing and community development loans would be set using a standard of the yield on stocks and bonds held by the system for the prior three years—about 6% including mortgage insurance.

Initial objections to this community investment program are to be expected from state public employees as well as the traditional recipients of pension fund investments and their financial supporters in the major banks. COOP believes these objections can be answered by first bringing the entire portfolio of public employee pension fund investments into the open. Public disclosure of not only the poor performance of investments but also the potential conflict of interest between fund managers, banks, insurance companies and corporations can go a long way toward convincing employees to set new policies for their pension money. Billions of dollars for community development and job creation could be "found" overnight if city, county, and state workers realize the potential of their own pension funds. □

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