PUBLIC BANK FEASIBILITY STUDY

for the City of Philadelphia

September 2020

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September 2020

City of Philadelphia
1401 John F Kennedy Blvd
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To the people and City of Philadelphia:

On behalf of HR&A Advisors, Inc. (HR&A), I am pleased to submit this feasibility study for a City-controlled public bank in Philadelphia. For over 40 years, HR&A has worked at the forefront of urban transformation, building local capacity in cities across the country, from developing innovative economic development entities, to leading publicly accountable procurements, to reviewing public incentives and guiding disaster recovery and resilience strategies.

When we began this assignment, Philadelphia welcomed new economic activity as people and businesses moved to the city. But the city grappled with big questions about deeply entrenched poverty alongside widening cracks in federal and state social safety nets, persistent structural exclusion based on race and class, and macroeconomic factors such as wage stagnation that continue to squeeze the middle class. Unsurprisingly, Philadelphia, which has one of the highest poverty rates also, has the highest rate of un- and underbanked residents among major U.S. cities, according to data from Prosperity Now.

A public bank promised a different path forward, one that was worth exploring. The City Council in its Resolution No. 160075 envisioned a public bank that offered the possibility of achieving multiple policy objectives by potentially learning from to the model set out by the Bank of North Dakota, partnering with community banks, reinvesting in the community, and facilitating additional goals for residents and businesses. Empowered with this Resolution and a clear understanding of financial service gaps in Philadelphia, the City leadership overseeing this study gave us the vision that a Philadelphia public bank's dual mission should be to (1) provide the City with autonomy over their financial resources; and (2) support small businesses and job growth in the local economy to reduce poverty, especially for communities of color.

Enter COVID-19, an unprecedented public health emergency and an economic and fiscal crisis. COVID-19 has made the second charge of the public bank—supporting small businesses—even more acute. The federal government turned to commercial banks to rapidly distribute Paycheck Protection Program (PPP) loans, who in turn, prioritized larger and more profitable businesses and garnered billions of dollars of origination fees. Small businesses, especially those owned by people of color, are less likely to have long-term relationships with banking institutions and have fewer employees and less revenue to garner higher bank fees. These disadvantages culminate in a frustrating, if not familiar, catch 22: small businesses waited longer to receive PPP funds, making it more difficult to stabilize their businesses in the first place.

On top of COVID-19 and its disparate impact on communities of color, as we were drafting this paper the murders of George Floyd, Breonna Taylor, Ahmaud Arbery, and countless other Black people energized an anti-racism movement across the country. We produce this report in a moment that in which it is increasingly understood that (a) our country's battle with racism is systemic and we need big structural solutions for remedy and repair; and (b) those solutions must prioritize the building of Black wealth. Thus, this investigation into a public bank that is inspired and overseen by the visionary leaders of Philadelphia comes at no better time.

Our previous work involving public banks, including a feasibility study on behalf of the City of Seattle, has grounded our understanding and recognition of the extreme complexity of the proposal, and the limitations presented by existing regulatory regimes. Indeed, establishing a Philadelphia public bank will not be easy, but is possible. The model we determined could feasibly fulfill the vision established by the City and the Working Group is one in which a Philadelphia public bank serves as a City-controlled authority that lends capital—directly or indirectly—to small businesses. Now more than ever, such a leadership role is required to direct capital to those businesses in light of the historic racial disparities evident in the commercial banking landscape. We hope that this study makes the case for the City to do so, as we provide a calculation of the actual gap in funding available as well as a model for how the public bank or another such entity might meet it feasibly and immediately.

We hope this study is a contribution to the discourse about how best to serve the residents of Philadelphia, reduce poverty by unleashing the power of small businesses, many in the Black and Latinx communities, and offers a launching point for both immediate action and systemic change.

We are grateful to the City Treasurer's Office, the office of City Councilmember Derek Green, and to the members of our working and advisory groups who provided input for this study. This study and the views set forth herein are those of HR&A Advisors, Inc., and not the City. We look forward to continuing to work in this field, and hope that our work contributes to a more autonomous and equitable financial system for the City and those who live and work there.

All the best,

Andrea Batista Schlesinger
Partner
HR&A Advisors, Inc.

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EXECUTIVE SUMMARY

It is no coincidence that Philadelphia, which has one of the highest poverty rates among American cities, also faces the highest rate of unbanked and underbanked residents of all large cities across the United States.[1] A lack of accessible financial services for low-income residents and small-business owners has had a lasting negative impact on the city and its residents, limiting the growth of small businesses, new job creation, and opportunities for establishing economic stability among low-income households—most of which are Black and Latinx in Philadelphia.

To disrupt this status quo, the City of Philadelphia commissioned HR&A Advisors to conduct an independent feasibility analysis for an entirely new way of banking: a City of Philadelphia public bank. This bank would be directly or indirectly owned and operated by the City, oriented towards the public good, and directly accountable to publicly elected bodies. Across the United States, advocates are calling for public banks at each level of government, from independent municipal public banks to a national public postal bank or infrastructure bank. Public banks have existed throughout history, across geographies, in many forms, and for many reasons—such as to finance major public projects that stimulate economic recovery, as the FDR-era Reconstruction Finance Corporation served to do. Today, the only public banks that exist in the U.S. are the Bank of North Dakota, the Puerto Rico Government Development Bank, and the Territorial Bank of American Samoa. The most well-known example is the Bank of North Dakota (BND), a public bank that has provided economic development support and disaster relief since its founding over 100 years ago. BND has achieved record returns in recent years, and it principally serves the state and does not require local governments to deposit their funds. International examples, such as Germany's *Sparkasse Finanzgruppe* and Japan's Finance Organization for Municipalities, show that given a compatible regulatory and legal framework, public banking can thrive alongside private institutions. Still, the United States lacks a precedent for a municipally owned public bank.

The Bank of North Dakota's success and a historical frustration with how commercial banks have poorly served low-income communities and communities of color and invested taxpayer dollars in ways that are inconsistent with local values, make a compelling argument for exploring public banking, despite the novelty of the pursuit. Further, as we begin an era of profound fiscal challenges, local governments must continue to think deeply about how to leverage each dollar of public taxpayer revenue to create the most value for their cities.

So, the question in this city, home to the first bank in the United States, established in 1781, is: could a public bank better serve Philadelphians? By what measures?

This study explores the feasibility of establishing a public bank in Philadelphia, which would be the first municipally-owned and operated bank in the country, that would replace the current ways that the government banks via contracts with private commercial banking institutions.

Given the inequities in banking services described above, the Philadelphia Public Banking (PPB) Working Group[2], the entity convened by the City Treasurer's Office and authorized by the City Council to oversee

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[1] Underbanked households are defined as those that may have a checking or savings account, but often rely on alternative banking services, such as payday lenders and check-cashers, to manage their finances. Unbanked households do not have bank accounts at all.

[2] Including representatives from the City Treasurer's Office, Commerce Department, Finance Department, Mayor's Office, City Commercial Law Unit, PIDC, and a member of the public bank advocacy community

this endeavor as part of Resolution No. 160045, determined that **the Philadelphia public bank's mission should be twofold:**

1. Provide the City with autonomy over their financial resources; and
2. Support small business and job growth in the local economy as a means of reducing poverty, especially for communities of color.

HR&A Advisors was selected in a competitive RFP process to conduct a study that would examine the feasibility—financial, legal, administrative—of a public bank designed to fulfill the above mission. This study and the views set forth herein are those of HR&A Advisors, Inc., and not the City of Philadelphia's.

Approach to the Study

In Part I of this study, we give context to local banking needs which motivated the City to commission this study of public bank feasibility. In Part II, we evaluate the legal, financial, and administrative feasibility of establishing a "foundational" public bank model that houses the City's municipal deposits and operating accounts and a "small business support" model, including three independent activities that a public bank could do to extend access to credit to underserved businesses across Philadelphia. We developed these models to directly respond to the City's goals and position a public bank to best serve the public interest.

We begin with the baseline questions of whether it is legally possible for the City of Philadelphia to establish a public bank. What would it require for the City to have the powers to do so? We then independently assess the bank's potential capital structure and whether the bank can financially sustain its operations. Finally, we look at the personnel capacities, administrative costs, and governance considerations to support a successful bank.

The foundational and small business support models are designed to be symbiotic banking structures. Thus, we are testing the feasibility of the foundational public bank model such that it ensures that the City's deposits are always liquid and protected. And, we are further testing the feasibility of the small business support model to generate income for the City, and then to deliver capital to small businesses by increasing the amount of money available for loans and by expanding lending coverage to reach small businesses that otherwise cannot access or benefit from market-value loans or any loans at all.

Findings

With help from the Commonwealth, the City may be able to establish a Philadelphia Public Bank itself. The City of Philadelphia could establish a public bank with the approval of both houses of the General Assembly in two consecutive legislative sessions and a "yes" vote from the public to change the State Constitution, as well as state enabling legislation and amendments to the City Code and Investment Policy. This would likely take several years to complete, including a minimum of two years to change the State Constitution. However, a City-controlled authority offers a path of less resistance—with enabling state legislation, but not a constitutional amendment, the public bank can be structured as a City-controlled authority, allowing the authority to lend its credit as seeded by the City. Practically and fiscally, the bank must be capitalized through the dedication of the City funds, and the City's deposits must be sufficiently collateralized to uphold the government's fiduciary responsibility of safeguarding taxpayer money.

If the public bank does not lend money (i.e. the foundational model), then the bank runs at a loss and costs the City money. The foundational model is projected to return a negative Return on Average Assets (ROAA) (-0.17%), which alone, is financially infeasible and particularly impractical compared to returns the City earns from its current consolidated cash accounts[3].

While the foundational model of a bank may meet the Philadelphia Public Bank Working Group's first goal of autonomy, it would not meet the second goal of supporting small businesses. Further, it can only meet the first goal if the City is willing to accept a loss, calling into question its value against the parameters of this study.

A public bank that lends money—such as our small business support model—could be an attractive proposition for the City. Adding small business lending allows the small business support model to achieve ROAA of 1.42% to 1.46%. The small business support model could create a financially sustainable bank and support Philadelphia's underserved small businesses. Through its three envisioned activities (1) direct lending to small business (2) loans to mission-driven banks and (3) risk mitigation, the bank could fulfill the Philadelphia Public Bank Working Group's second goal of supporting small businesses and job growth in the local economy.

Either model requires significant action. To create a public bank authority that fulfills both goals, i.e. the small business support model, the City should:

1. Work with the Governor and General Assembly to persuade the latter to enact laws permitting the City to establish an authority, probably under the Economic Development Financing Law, to serve as a public bank with the desired powers, potentially including the acceptance of deposits from as well as the making of loans to others
2. Establish such a public bank authority
3. Apply to become an enumerated bank in the Commonwealth of Pennsylvania
4. Serve as a City depository, after changing the Philadelphia Code
5. Change the collateralization requirement and/or accept deposits from non-City entities
6. Amend City investment policies to allow a public bank to invest in small businesses
7. Build internal banking capacity, including staff whose core competencies include origination/transaction, accounting, compliance, risk management, administrative support, underwriting, portfolio management and banking partner relations.

Today, the City of Philadelphia's financial programs and resources are mostly predicated on partnerships. The City serves as a conduit—streamlining the application process and providing technical assistance to Philadelphia residents and businesses seeking access to credit. For some programs, the loans themselves are underwritten by local financial institutions or funded through state or federal government money, such as Community Development Block Grants.

A public bank differs from existing City financial programs in that it empowers the City to directly control a large flow of capital and could do so without being beholden to the City's annual budgeting process. A public bank could allow the City to lend directly to small businesses at a larger scale than City-led programs do today, provide local funding to mission-driven banks, and participate in the capital stack for small business loans. While the City can be directly involved in lending through non-bank authorities or special purpose vehicles, a City-controlled public bank is the only tool that would allow Philadelphia to

[3] In Calendar Year 2019, the City of Philadelphia earned a 1-year return of 2.20% on its consolidate cash accounts, net of fees.

leverage the nearly-unprecedented scale and magnitude of its municipal deposits—potentially to the tune of $255 million[4].

Regardless of whether the City initiates the longer-term and more complicated process of establishing a public bank, there are several steps that the City can take to fulfill the mission of supporting small businesses in the absence of a public bank. Those steps can be taken independently of a public bank, or simultaneously with the pursuit of the creation of a public bank. For example, the City could:

- Deliver market-rate and below market-rate loans to small businesses that achieve City priorities
- Deploy patient capital with less pressure to foreclose on delinquent loans
- Leverage stable capital to be a trusted guarantor and attract private investment
- Incentivize private capital to participate in small businesses loans

For the City to make an impact, it will need to mobilize sufficient dollars to tackle the gap in lending to small businesses in Philadelphia, which we estimate in this report's lending impact target analysis (page 34). That is, it will be insufficient to simply create small and boutique programs. The City will need a plan for how to match the gap at scale by leveraging its own dollars and mobilizing the private banking sector to do better.

INTRODUCTION: WHAT IS A PUBLIC BANK?

In this study, we refer to a "public bank" as a financial institution that serves as a depository for municipal funds and operates with a mission to serve the public interest. A public bank is owned by the government for the good of the municipality and its people.

Since the 2008 financial crisis, which exposed many of the private banking sector's failures, public banking advocates have increased their call for governments to offer an alternative that serves the public interest as a private bank would its shareholders. Besides offering a mission-driven institution for governments to bank their assets, advocates list other benefits that a public bank could achieve for a wide variety of stakeholders—homeowners, students, employers, employee, and City government itself. These benefits include:

- Create the capacity to extend affordable and flexible capital for community-projects and the general public, as well as other financial services for businesses and individuals not adequately served by the private market;
- Spur economic growth and job creation through investments in local communities;
- Provide accountability over the use and investment of public funds;
- Reduce the cost of borrowing and support financing for infrastructure projects;
- Secure loans to worker cooperatives and students;
- Support local economies during times of economic stress and uncertainty.

The United States is currently home to three public banks—The Bank of North Dakota, the Puerto Rico Government Development Banks, and the Territorial Bank of American Samoa. Perhaps the most famous national public bank example is the Bank of North Dakota (BND), as it is the longest-running public bank in

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[4] The City of Philadelphia's FY20 revised fund balance estimate is $254.9M; FY2-25 Five Year Adopted Plan

the U.S., as well as the largest and most successful in the country with $7 billion in assets. BND was founded in 1919 with the mission to "promote agriculture, commerce, and industry" in the state of North Dakota. BND serves as the state government's exclusive depository and accepts deposits from local governments who may choose to bank with BND. BND also partners with community banks in the state to issue loans to farmers, school districts, and students. Unlike most commercial banks, the BND is not a member of the Federal Deposit Insurance Corporation and the North Dakota Century Code 6-09-10 provides that all deposits are guaranteed by the full faith and credit of the State. The BND offers limited scope retail banking products and retail deposits, which account for only 1.5% of its total deposits. Most of the bank's deposits come from tax collections and state fees[5].

While public banking advocacy efforts in the U.S. at both the city- and state- levels have created promising momentum, only the State of California has enacted the enabling legislation necessary for the establishment of a public bank—and even that milestone far from guarantees a public bank from coming to fruition. Many of the existing legal and regulatory barriers to public banking were originally designed to mitigate the financial risk for taxpayer dollars, which act as the primary source of leverage in a public bank, allowing for capital investments in communities of need. Forged over a hundred years of perennial crises, current banking laws and regulatory norms are staples of common practice, which makes new ideas, such as public banks, so difficult to implement.

A public bank must find balance atop a three-legged stool—accountability to local values and priorities, the fiduciary responsibility to be stewards of taxpayer dollars, and the business of banking. It must chart a new course, navigating policy, law, and economics to establish an alternative to the system itself.

PART I: DEFINING THE PROBLEM THAT A PUBLIC BANK NEEDS TO SOLVE

Lack of Accessible Financial Services Contributes to the Cycle of Poverty

There is urgency within Philadelphia to address its high poverty rate. Almost a quarter of Philadelphia's residents, or about 400,000 people, live below the poverty line.[6] Blacks and Latinxs represent a disproportionately high share (78.8%) of Philadelphia's residents who live in poverty, despite constituting 63.7% of the city's total population. At the time of the writing of this report, the full effects of COVID-19 have yet to be understood, but it can be safely predicted that more Philadelphians will be plunged into economic insecurity and that this will be disproportionately true for Black and Latinx residents.

In a direct relationship to its poverty rate, today, more than 35% of Philadelphians are either unbanked or underbanked—a figure that is larger in Philadelphia than in any other major U.S. city[7]. Seven percent of Philadelphians are unbanked: they do not use banks or banking institutions in any capacity. More than 27% of Philadelphians are underbanked: these residents rely on non-traditional banking services, such as payday lenders and check-cashing, to supplement checking accounts and traditional banking services.[8]

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[5] Public Banking Institute, Bank of North Dakota: https://www.publicbankinginstitute.org/wp-content/uploads/2019/09/BND-FAQ.pdf

[6] Philadelphia's Poor: Experiences from Below the Poverty Line, PEW Charitable Trusts (2019)

[7] Reported in Philadelphia Business Journal "Branched Out" (2019); City-level data from Prosperity Now (2017)

[8] Prosperity Now (2017)

In Philadelphia residents from low-income communities, are disproportionately underserved by the banking industry. According to the City's annual report on lending practices of its authorized depositories, fewer than 30% of these bank's branches are located in low- or moderate-income tracts, which house 65% of households. Non-traditional banking services fill a need while disproportionately burdening low-income individuals. These service alternatives, such as payday lenders or check-cashing services, provide a lifeline to people seeking banking services—for a price. While the average American pays $100 in annual checking account overdraft fees,[9] a typical payday borrower spends $520 on interest each year.[10] Non-traditional banking services can be an appealing and even rational choice for customers because they offer quicker liquidity, more transparent fee policies, are more welcoming than traditional banks in their design and customer support, and provide convenience—which, for individuals living paycheck to paycheck, may be worth the price tag.[11] More data on underbanked Philadelphians can be found in **Appendix B**.

Lack of access to banking services is also highly correlated with race—Black and Latinx residents are 18 times more likely to be unbanked than white residents in the Philadelphia region.[12] Black and Latinx residents are also more likely to be poor in Philadelphia, as they make up about 68% of the households living below the poverty level. As a result, most Black and Latinx residents face barriers due to their economic circumstances, on top of the issues they may face due to racial discrimination. Nationally, majority Black counties have 50% fewer banks per 100,000 people than white counties, and they also are required to deposit twice as much as a percentage of their paychecks to open checking accounts and avoid the fees[13]. Reports suggest that nationally, financial institutions could realize an additional $2 billion in revenues if Black households had the same access to financial products as white households[14].

Systematic and historically discriminatory practices[15] result in the perpetuation of poverty, trapping individuals in an endless cycle of financial insecurity. The result is that low-income and Black and Latinx residents are less able to access financial services while higher-income Philadelphians and those living in wealthier neighborhoods can leverage affordable financial services to seek economic opportunities, save money, and finance major purchases (such as a home) as a means of wealth-building and economic advancement. Residents without access to financial services therefore turn to non-traditional banks.

Small businesses are also underserved by traditional banking services. According to *Growing with Equity: Philadelphia's Vision for Inclusive Growth,* Philadelphia is behind its national peers in terms of new business creation and Black-owned business creation and growth.[16] One likely cause of Philadelphia's lag is stifled access to capital in the form of loans. Loans allow small businesses to form, grow, and stabilize, and in turn, create permanent local jobs. In Philadelphia, 88% of small businesses in low- and moderate-income census tracts are not receiving any loans[17]. National surveys estimate that only 29% of Black small businesses that applied to loans received them, compared to 60% for white small business owners.[18]

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[9] Nerdwallet; PB, FDIC

[10] Payday Lending in America: Who Borrows, Where Theythey Borrow, and Why, PEW Charitable Trusts (2012)

[11] The Unbanking of America: How the New Middle Class Survives, Lisa Servon (2017)

[12] FDIC (2013-2017 Estimates), Philadelphia MSA

[13] McKinsey & Co. 2020. "The case for acceleration financial inclusion in Black communities"

[14] Ibid

[15] Historically discriminatory practices include redlining which prevented entire neighborhoods and communities of color from securing home mortgages, and a banking market failure to provide financial products that meet the needs of low-income households.

[16] Growing with Equity: Philadelphia's Vision for Inclusive Growth, City of Philadelphia (2019)

[17] Lending Practices of Authorized Depositories for the City of Philadelphia (2017)

[18] Brookings Institution, analysis of Small Business Credit Survey (2018)

Across the country, underwriting standards are especially unfavorable to low-income households and small businesses, and adversely affect Black and Latinx households. Commercial banks evaluate a person or business's likelihood to repay and price the financial risk through interest rates and fees. Anyone seeking an auto loan, mortgage loan, personal loan, business loan, or similar loan must meet credit score minimums, and/or prove a history of borrowing and repaying loans. Credit score and credit history directly affect access to capital, which naturally results in a disadvantage for unbanked and underbanked individuals who do not have access to banking services in the first place. A lack of capital or inability to take out loans prevents small businesses from being able to grow or start-up, and prevents them from producing local jobs, which comes at a cost to the City and its residents. Businesses without access to capital are also more vulnerable to failing and more likely to resort to costly alternatives to traditional business loans such as credit cards.[19]

Reports by the National Community Reinvestment Coalition show that businesses owned by people of color seeking small business loans faced more scrutiny and worse treatment from lenders than equally or less-qualified white counterparts. In a blind "mystery shopper" test, these studies found that Black loan seekers were given less information about the financial products and more questions about personal or family finances than white applicants.[20] In Philadelphia, low- and middle-income applicants were denied 2.42 times more often than higher-income applicants[21].

Philadelphia — where close to 25% of its residents living below the poverty line and over 10% living in deep poverty—is disproportionately affected by the national circumstances that continue to keep low-income households and small businesses from accessing affordable financial services. Low-income Black and Latinx households and small businesses owned by Black and Latinx people are especially vulnerable due to systemic racial bias. This situation motivates the call for an entirely new way of banking, in which a public bank would be able to make different determinations about risk, account for inherent biases in these calculations, and value community well-being ahead of profits beyond what is needed to ensure the safety of taxpayer dollars.

The Philadelphia Public Bank Working Group expressed supporting small businesses as its top priority, with attention to uplifting underserved Black and Latinx businesses so that they grow, create more jobs, and build community wealth. Therefore, we focus the remainder of our landscape analysis on Philadelphia's personal and commercial banking industry and its relationship to small businesses.

Setting the Stage: Philadelphia's Personal and Commercial Banking Landscape

Personal and small business banking in Philadelphia mirrors banking in communities across the United States, with services and accounts unevenly distributed among four general bank types:

1. Commercial banks;
2. Mission-driven banks;
3. Non-traditional banking services; and

[19] Institute for Local Self-Reliance, Independent Business Survey (2014)

[20] Disinvestment, Discouragement, and Inequality in Small Business Lending, National Community Reinvestment Coalition, 2019; as reported by the Washington Post; Shaping Small Business Lending Policy Through Match-Paired Mystery Shopping, 2017; as reported by Patch.com

[21] Lending Practices of Authorized Depositories for the City of Philadelphia (2017)

4. Government-led financial service programs

The following table lists the financial institutions with a physical presence in Philadelphia by bank type and evaluates each type of institution's ability to meet local banking needs. We find that commercial banks are the most prolific banking institutions in the city and offer convenience and security for those who appear to meet minimum income and credit requirements. The other types of banks—mission-driven banks, non-traditional banking services, and government-led programs —work to fill the need that the commercial banks don't, but even together, fail to fix the City's underbanked problem.

Figure 1: Banking Landscape in Philadelphia

Financial Service Provider	Meeting Local Banking Needs: Needs Met (Pros)	Meeting Local Banking Needs: Needs *Not* Met (Cons)
Commercial Banks *Traditional Banks, Savings Institutions* • Wells Fargo • PNC Bank • Bank of America • Citizens Bank • TD Bank • Santander • Capital One • HSBC • Citibank • JP Morgan Chase Bank • Fulton Bank • Asian Bank • Truist Bank, formerly BB&T Bank • Republic Bank • M&T Bank • United Bank of Philadelphia • KeyBank • Univest Bank and Trust Co. • Tioga-Franklin Savings Bank • Beneficial Bank • Wilmington Savings Fund Society • Parke Bank • Meridian Bank • Port Richmond Savings • VIST Bank • The Bryn Mawr Trust Company • Prudential Bank • Firstrust Bank • United Savings Bank • Abacus Federal Savings Bank • Second Federal Savings and Loan Association • Washington Savings Bank • Hyperion Bank • Philadelphia Trust Company • East Riverbank	• Low-cost accounts and credit, to the extent that the account holder is above the threshold/identified as non-risky • Secure and insured place to deposit money • Small community banks successfully support small businesses • Large banks achieve efficiency and scalability	• Branches concentrate in high-income communities • High and non-transparent fees (e.g. overdraft fees) • Underwriting practices often leave small and non-white owned businesses without full or any access to credit
Non-Traditional Banking Services *Cash Checking, Payday Lenders* • Western Union • Money Mart • Fast Cash • ACE Cash Express • OneMain Financial • Mariner Financial • Payday Loans USA • Advanced Money Loan • Jolley's Money Loan • LendYou • Greenlight Cash • Credible	• High demand products offer insight into the type of financial products that low- income individuals need, including: - Micro-lending - Fast, convenient access - Wire transfers - Transparent fees - Customer service	• "Transaction-based" business model, leads to costly fees for users • Limited services, not a "one-stop shop" for banking needs
Mission-Driven Institutions *CDFIs and Credit Unions* • Entrepreneur Works • PIDC Community Capital • Reinvestment Fund • The Enterprise Center Capital Corporation • FINANTA • Women's Opportunities Resource Center – Economic Opportunities Fund • Asbestos Workers Local 41 Credit Union • Franklin Mint FCU • Freedom CU • Holy Trinity Baptist FCU • IUPAT DC 21 FCU • MABC FCU • Media Members FCU • Mount Camel FDCU • New Life Federal CU	• Small-dollar lending for residents and businesses, including credit-building opportunities • Flexible and affordable terms for loans, including for business, personal and community projects • Technical assistance—including business	• Model is not scalable, often limited by federal restrictions on banking volume and business value • Slim profit margin makes business model risky; reliance on "smart subsidy"

• Kiva Zip • Impact Loan Fund • Opportunity Finance Network • Economic Opportunities Fund • Beech Capital Venture Corporation • The Merchants Fund • First State Community Loan Fund • West Philadelphia Financial Services Institution • Hebrew Free Loan Society • Community First Fund • Trouvaille Federal Credit Union • Enterprise Center Capital Corp. • Advantage Financial Federal Credit Union • American Heritage Federal Credit Union • Ardent Credit Union • Democracy FCU • Eagle One FCU • FedChoice FCU • Northwood FCU • Paper Converters Local FCU • Philadelphia FCU • Philadelphia Letter Carriers FCU • Pinn Memorial FCU • Police and Fire FCU • Reliance FCU • Service Station FCU • SI Philadelphia FCU • South Jersey FCU • St. Pauls FCU • Student FCU • Sun FCU • Transit Workers FCU • Trouvaille FCU • TruMark FCU • U of P FCU • Ukranian Selfreliance FCU • Virvia Community Credit Union • Wayland Temple Baptist FCU • White Rock FCU	planning, financial literacy • Self-sustaining model, although certain products do require cross-subsidy	
City Efforts *Programs and resources* • Financial Literacy Programs • Homeownership Programs: Homeowners Emergency Loan Program, Zero Interest Loan for Replacing Lead Service Lines • Startup: Seed Fund, Technology, and Entrepreneur Training Program • Philadelphia Business Lending Network • Restore, Repair, Renew • Basic Systems Repair Program • InStore Forgivable Loan Program • Storefront Improvement Program • Kiva Philadelphia (Small Business Loans) • Heater Hotline Program • PIDC Partnerships, Loans, and Support products • Restore and Reopen Program • COVID-19 Small Business Relief Fund • COVID-19 Emergency Rental Assistance Program	• Targeted support to populations financially underserved by the market—low-income households, people of color, small businesses, businesses owned by people of color • Technical assistance • More patient payback terms than commercial banks and mission-driven institutions	• Inefficiencies in program deployment (e.g. managed by multiple departments.) • Annual funds to operate programs are not guaranteed • Opportunity for a more financially sustainable model

Source: Policy Map, Philadelphia Business Journal, City of Philadelphia Treasurer's Office

Challenge: Barriers to Small Business Formation and Growth

According to Community Reinvestment Act (CRA) data, loans to small businesses in Philadelphia have increased by almost 70% in the years from 2009 to 2017[22]and almost doubled for those businesses with annual revenues below $1 million. Although the data shows promising improvements in Philadelphia's small business lending environment, small businesses—especially those owned by people of color—remain without adequate access to reasonably-priced business loans.

Small businesses in Philadelphia are disproportionally located in the city's upper-income neighborhoods. Philadelphia's lowest income census tracts (>50% Area Median Income) are home to 50% of the City's households. Yet, these tracts have just 9% of the City's small businesses. Conversely, 40% of the Philadelphia small businesses are in city census tracts with >120% Area Median Income[23]. This disparity means that Philadelphians living in poorer neighborhoods have less access to the goods and services offered by small businesses. Low-income census tracts also have the lowest percentage of small business loans across the city[24]—undoubtably an outcome of where business are located, but undeniably a barrier to new business growth in lower income neighborhoods.

According to national data from the Small Business Credit Survey, which surveyed more than 2,300 national businesses in 2018, 18% of small businesses applying for financing were denied, and another 22% were only partially approved, which left more than 40% of small business applicants with capital shortages, not including non-applicants who may also be facing shortages and did not seek financing for other reasons. According to another source, more than 40% of local businesses who sought loans in the previous two years were unable to obtain one. Large banks had the lowest rate of credit approval at 58%, compared to 71% for small banks and 82% for online lenders—small businesses also reported the highest satisfaction with smaller banks[25].

While small business loan denial rate data is not available for Philadelphia, according to the City's lending study data, the home loan denial rate for low-income applicants is 2.42 times larger than for upper-income borrowers, while Black applicants were denied 2.23 more often than white applicants.[26] Local small business owners expressed similar concerns regarding small business lending, in conversations with the Philadelphia Public Bank Advisory Group[27]. We encourage the City to collect localized data and continue to have conversations with small business owners and bankers for a deeper understanding of obstacles to small business capital. This data can also reveal the effectiveness and limitations of government programs and policies.

Nationally, reports suggest that there are a variety of factors that make Black business owners more likely to be denied credit than white businesses. According to a report by McKinsey, Black business are more likely to be asked for additional detailed information on their personal financials when applying to loans. Additionally, Black-owned businesses are more likely to start up with less capital than white-owned businesses, and on average, they are also more likely to be smaller, employing 32% less people than white-

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[22] Lending Practices of Authorized Depositories for the City of Philadelphia (2017)

[23] HR&A analysis based on data in Lending Practices of Authorized Depositories for the City of Philadelphia (2017)

[24] Lending Practices of Authorized Depositories for the City of Philadelphia (2017)

[25] National Small Business Credit Survey, Federal Reserve Bank of New York (2019)

[26] Lending Practices of Authorized Depositories for the City of Philadelphia (2017)

[27] PPB Advisory Committee describes a group of stakeholders, including bankers, academics, advocates, small business owners, CDFI and cooperative experts engaged as part of this study. Notes from the PPB Advisory Committee Meetings can be found in **Appendix A.**

owned businesses[28]. Other experts suggest that many Black business owners also lack access to relationships within their local banks. These factors are importantly linked to systemic racism and create disadvantages for Black businesses facing capital needs.

Government Programs to Support Small Businesses

The City of Philadelphia is supporting un- and underbanked businesses through financial resources, programs, and partnerships with non-profit organizations and mission-driven banks. City-sponsored programs include financial support and incentive programs such as the Seed Fund, Technology and Entrepreneur Training program, InStore Forgivable Loan, Storefront Improvement Program, and Kiva Philadelphia. Programs including Business Coach and Power Up Your Business provide technical assistance and training to small businesses. The City organizes the Small Business Lending Network (SBLN), established in 2016 as one-stop shop for local businesses seeking financing. SBLN brings together over 40 commercial and mission-driven financial institutions in Philadelphia and has provided over $1.5 million in loans to over 30 businesses since its inception. PIDC, Philadelphia's quasi-governmental economic development agency, provides services to low-credit businesses that cannot access traditional financing. PIDC provides direct lending and technical assistance services to small businesses through "PIDC Community Capital", a 501(c)(3) community development financial institution (CDFI), wholly owned and managed by PIDC. PIDC Community Capital directs at least 60% of its lending activity to low-income census tracts and Black-owned businesses.[29]

Despite the City's important work to improve access to financing for small businesses, many small businesses, particularly those that are owned by Black and Latinx people, face significant credit and capital shortages. HR&A estimates that the lending gap for small businesses in Philadelphia is at least $840 million. The gap measures businesses with fewer than 500 employees and non-employer firms[30] (businesses with no paid employees) in Philadelphia that either applied for financing but did not receive it or were discouraged from seeking financing but may still have a funding shortfall. This estimate also includes small businesses that are ineligible for loans from commercial banks and mission-driven banks, due to factors such as extremely low credit and no collateral availability (see page 34 for full methodology). This gap does not include duplicate requests from a single business which may extend beyond a 12-month period. This small business lending gap is sizable and any program seeking to change Philadelphia's banking landscape must close or otherwise narrow the gap in a meaningful way.

Philadelphia's current banking landscape leaves thousands of Philadelphians unbanked or underbanked, and small businesses without full access to credit. While some, typically smaller, commercial banks have long been resources for low-income households, including entrepreneurs and minorities, onerous federal regulations have driven up costs for smaller banks, forcing them into mergers and limiting their ability to offer flexible financial products that serve the communities who need it most. Mission-driven banks successfully serve low-income residents, small businesses, and communities of color, but they require additional resources to scale their human and financial capacity to meet the demand of the communities they serve.

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[28] McKinsey & Co. 2020. COVID-19's effect on minority-owned small businesses in the United States.

[29] Per CDFI Investment Area and Target Market policies.

[30] SUSB Census, Philadelphia County (2012)— Adjusted for 2019, there are an estimated 22,000+ employer firms with <500 employees and 83,000+ non-employer firms in Philadelphia.

Opportunities for a Public Bank to Alleviate Problems of Un- and Underbanked

How the City of Philadelphia Banks Today

Municipal Banking Needs

Cities have complex banking needs. Like people and businesses, cities have an income—they receive money from taxpayers and receive funding from state and federal governments. Cities, too, must pay bills. Cities pay employees and contract services to operate and provide services to residents. Cities are entrusted to make decisions over where they keep and how they bank their money and a fiduciary responsibility to spend and invest responsibly.

Local governments bank taxpayer money—tax collections, federal and state grants, contract revenues, and other revenues—in commercial banks as common practice. Commercial banks are federally insured and draw upon the assets of multiple depositories and securities to collateralize City assets and safeguard taxpayers' money. To support the volume and complexity of municipal transactions, banks offer services that allow the City to manage thousands of transactions, from collecting taxes and revenues to paying bills on time. The City also earns interest on its deposits (0.50% in FY19). In exchange for these services, institutions charge service fees depending on overall transaction volume. The country's largest commercial banks benefit from economies of scale and are typically able to offer municipalities competitive service fees.

The City's Approach to Banking

The Philadelphia Code details the requirements that a bank must satisfy to hold the City's funds, also known as a "City depository." Under these regulations, City depositories must be federally insured, independently audited, non-predatory, and meet minimum size and establishment requirements. To do business with the City, authorized depositories are required to adhere to fair lending practices for home lending, small business lending, and branching patterns and to report their compliance. The City of Philadelphia chooses its banking partners based on their capacity to manage the City's complex banking needs and ability to meet the City's investment policy.[31] Like many cities, Philadelphia uses a competitive RFP process to choose its banking partners, which encourages the pool of respondents to offer competitive fees based on the City's needs.

The City has a comprehensive investment policy that governs all funds other than the Municipal Pension Fund, Philadelphia Gas Works Retirement Reserve (PGW Pension Fund), and the Fairmount Park and Free Library Trust Funds. The investment policy limits credit risk by limiting the types of allowable investments and the maximum percentage of the portfolio that is invested in each type.

City Operating and Investment Accounts

The City of Philadelphia houses its operating and investment accounts in authorized depository institutions, which currently include 11 banks in Philadelphia, using commercial banks for payroll management, benefit/pension payments, payments to vendors/service providers, and a range of transaction services. As of 2019, the City of Philadelphia has 12 authorized depositories: Bank of America, Bank of New York Mellon, Citibank, JP Morgan Chase Bank, PNC Bank, Republic First Bank, TD Bank, Citizens Bank, U.S. Bank, Fulton Bank, United Bank of Philadelphia, and Wells Fargo. In 2019, the City of Philadelphia spent

[31] Chapter 19-200 City Funds—Deposits, Investments, Disbursements.

approximately $1.2 million in fees at Wells Fargo, PNC Bank, and Citizens Bank, which manage most of the City's general fund accounts, city payroll, disbursement, and pension payroll.

In 2019, the City's General Fund investments totaled over $970 million, which includes a portfolio of securities ranging from U.S. government securities to corporate bonds (**Figure 2**). These investments provide income to the City while keeping its money liquid to cover unforeseen needs.

Figure 2: City of Philadelphia's General Fund Investments; FY19

Investment Type	Value	% of Total	Avg Yield
Short-Term Investment Pools (Cash)	$1 M	1%	0%
Commercial Paper	$228.5 M	24%	1.51%
U.S. Government Treasury Securities	$679 M	69%	1.55%
U.S. Government Agency Securities	$50 M	5%	0.25%
Municipal/Other Debt (Money Market)	$11.8 M	1%	1.46%
Total	**$970.3 M**	**100%**	

**Values include City investments only*
Source: City of Philadelphia Comprehensive Annual Financial Report (CAFR 2019)

The City's Future Financial Positioning

The City of Philadelphia has been awarded an "A" credit rating from Moody's (A2), Standard & Poor's (A), and Fitch (A-), indicating that the City is not likely to default on its loans. In 2019, the City's financial outlook has been described by S&P as positive and by Moody's as stable, due in part to improvements in the City's financial position, General Fund and revenue growth, increases in the City's reserves, and the overall positive economic trends within the City. Note that the term *credit rating* applies to businesses and government and *credit score* applies to individuals, but their impacts are similar: perception of creditworthiness affects access to loans or favorable terms for loans.

Today, however, the COVID-19 global health pandemic and economic crisis threaten the City's financial standing. The City will likely experience lower tax revenues in FY20 resulting from the economic downturn, and a draw on emergency funding will leave the City with a lower reserve balance than planned for. Pre-COVID, the City was projected to end FY20 with a fund balance of 6.9% of its obligations, which stands within the City's target of 6% to 8%, but is below the Government Finance Officer Association recommended level of 17%.[32] In April 2020, S&P Global downgraded the City's outlook from positive to stable, due to challenges resulting from the COVID-19 pandemic.[33] If the City's reserves are lowered significantly, the City's credit rating may be lowered, which would limit its ability to access inexpensive capital and increase the interest paid on its municipal bonds. The City's revised Five-Year financial plan (FY21-25) estimates a budget balance of $254.9M, at 5% of its obligations.

[32] City of Philadelphia Comprehensive Annual Financial Report (CAFR FY 2019)
[33] COVID-19: A Closer Look at How It Affects 10 Major U.S. Cities, S&P Global Ratings (2020)

The Argument for a Public Bank

With all of the above in mind, HR&A and the Philadelphia Public Bank Working Group[34], informed by conversations with local stakeholders, determined that a Philadelphia public bank's mission should be twofold: (1) to provide the City autonomy over their financial resources; and (2) to support small business and job growth in the local economy. These goals have shaped the inquiry in Part II: designing two potential public bank models and testing the feasibility of establishing and operating a public bank that meets these goals.

If feasible, a public bank could be uniquely positioned to change the status quo of how the City and its small businesses bank. The public bank could enable the City to gain independence from commercial banking interests and increase the control of investment practices and can be one way of practicing socially responsible investing (including divestment from private prisons, fossil fuels, etc.). If feasible, the public bank could support local economic development and financial inclusion by offering low-cost loans to small businesses and worker cooperatives, and providing funds to support affordable housing, land trusts, and cooperative housing. The public bank could increase capital to small businesses by increasing the amount of money available for loans, and also by expanding lending coverage to reach small businesses that otherwise cannot access or benefit from market-value loans, or any loans at all.

Regardless of whether or not the City pursues a public bank in the definitional sense—a municipally-controlled financial institution that takes in deposits—as its vehicle, there are steps it can take to fulfill the goals identified by the Philadelphia Public Bank Working Group and Advisory Group of doing more to provide capital to small businesses as a step towards eliminating poverty. For example, the City could:

- Deliver market-rate and below market-rate loans to small businesses that achieve City priorities
- Deploy patient capital with less pressure to foreclose on delinquent loans
- Leverage stable capital to be a trusted guarantor and attract private investment
- Incentivize private capital to participate in small businesses loans

With that said, there may be arguments for City action that can only be taken through a public bank. For example, a public bank, unlike a City program, could keep whatever profits may be generated and reinvest them locally. A public bank may be the only City-controlled vehicle that would be allowed access to favorable borrowing terms from the Fed, which are extended to chartered commercial banks only. The Bank of North Dakota (BND) shows that a public bank can play a critical role in expediting federal loans money quickly and providing bridge funding in times of economic uncertainty[35].

In Part II, we move on to test the feasibility of the above arguments for why a public bank would help the City of Philadelphia (1) uphold autonomy over financial resources, and (2) support small business and job growth in the local economy as a means of reducing poverty, especially for communities of color.

[34] Including representatives from the City Treasurer's Office, Commerce Department, Finance Department, Mayor's Office, City Commercial Law Unit, PIDC, and a member of the public bank advocacy community

[35] BND, Role in Disaster Relief; https://thebndstory.nd.gov/an-agile-partner/role-in-disaster-relief/

PART II: FEASIBILITY OF A PUBLIC BANK

This analysis tests the legal, financial, and administrative feasibility of establishing a public bank in Philadelphia to meet the PPB's Working Group's dual goals of autonomy and increased access to financing for small businesses in Philadelphia.

To determine feasibility, we developed two bank models to test assumptions and evaluate performance. In our **foundational model**, the City banks its own deposits and *only* its deposits and fulfills the Working Group's first goal of autonomy. Unlike many commercial banking institutions, this model does not provide retail banking services; there are no checking or savings accounts, other deposits, or loans to individuals and businesses of any kind. There are, therefore, no branches. This foundational model will help highlight the core issues surrounding feasibility.

We then layer on a menu of additional activities to support small businesses and local job growth. In the **small business support model**, the bank receives municipal deposits and (1) makes loans directly to small businesses, (2) makes loans to mission-driven financial institutions who in turn support small businesses, and (3) participate in riskier tranches of the capital stack (the sum of various financing sources) to increase small businesses' access to capital. Likewise, we evaluate the legal, financial, and administrative feasibility of these activities and how effective they might be at closing the lending gap. We estimate that closing this gap (see page 34) would make a meaningful difference in the growth of small businesses and, therefore, job creation. For purposes of this report, we define small businesses as businesses with fewer than 500 employees to align with available data sources and make to make fair comparisons regarding small businesses accessibility. However, we understand that acute support is needed among Philadelphia businesses with fewer than 100 employees and businesses owned by Black and Latinx people, who face the biggest hurdles in obtaining loans from the Philadelphia banking ecosystem.

These models are summarized as follows:

Foundational Model

- **Hold Municipal Deposits & City Operating Accounts.** Safely hold the City of Philadelphia's municipal funds. Generate returns for reinvestment and increase City autonomy and control over investment decisions.

Small Business Support Model

Foundational Model activities plus any of the following activities:

- **Lend to Small Businesses.** Lend to small businesses directly, with attention to the Black and Latinx-owned small businesses that are underserved by commercial banks today.
- **Lend to Mission-Driven Banks or Lending Institutions.** Provide loans and technical assistance for local banks and lenders to sub-lend to small businesses in Philadelphia neighborhoods.
- **Mitigate Lenders' Risk.** Provide riskier investments or guarantees in the capital stack, encouraging the private market to offer more robust lending to projects that serve the community and capital projects for small businesses.

The purpose of this analysis is to set a direction for an optimal public bank structure in Philadelphia. As opposed to rendering a public bank feasible or infeasible, we evaluate "*feasible if*," identifying the regulatory changes and financial resources necessary to create a public bank and to enable it to accomplish the stated goals.

To determine legal feasibility, we worked closely with the City of Philadelphia's Commercial Law Unit to understand the Commonwealth of Pennsylvania and City of Philadelphia laws we could leverage to establish and capitalize a public bank, and the laws that need to be amended. Together, we outlined the regulatory process the City might take to get the bank up and running, and the process that would enable the City to lend its money to small businesses via a public bank. We also considered different governing entities for the bank—City entity, City-controlled Authority, or a City-controlled Credit Union—and analyzed which of these vehicles could offer a legally feasible path forward, and how much time would be required for execution.

To assess financial feasibility, HR&A developed a basic profit and loss framework using private financial institutions' proforma as a model for how a City-controlled bank might be structured. We adjusted assumptions to reflect the public bank's core operating conditions. For example, in the foundational model, City deposits are 100% collateralized with government securities, limiting the bank's ability to extend loans. We also adjusted for differences in operating expenses across the bank models and activities. Our financial analysis culminated in a Return on Average Assets (ROAA) calculation to assess profitability. That is, we assessed whether the bank will make sustainable revenues, such that it can exist, survive, and fulfill the Philadelphia Public Bank Working Group's goals.

To evaluate administrative feasibility, HR&A analyzed the potential personnel costs and number and types of employees required to support the bank's activities. HR&A also evaluated governance considerations, including by-laws and Board structure that can offer the bank both power and independence.

The following sections detail HR&A's feasibility analysis, assumptions, and findings for the foundational model.

The Foundational Model: The City's Depository Bank

Legal Feasibility — Foundational Model

Today, a public bank in Philadelphia can be legally established only with changes to Commonwealth and City laws. Laws can be amended, and new policies enacted—but these actions may require significant time and effort.

Pennsylvania's Constitutional limitations on municipal investment were originally drafted in the spirit of avoiding catastrophic losses—such as the loss the Commonwealth faced after backing the Pennsylvania canal system just as railroads boomed as the more economical form of freight transportation.[36] Changing the Constitution would take political will. It requires the approval of identical versions of the proposed amendment by both houses of the General Assembly in two consecutive legislative sessions *and* a majority vote from the public.

Proceeding through a City-controlled authority, however, would likely require only enabling legislation from the General Assembly instead of a Constitutional amendment, meaning passage once by each house. A City-

[36] The Influence of the Pennsylvania Mainline of Public Works, Strausbaugh (2006)

controlled authority is this report's preferred legal structure for the public bank because of its relatively streamlined approval process.

In addition, Philadelphia City Council would need to enact an ordinance to change local requirements for city depositories. Approvers must find careful footing to navigate an ethical pendulum: a public bank will always face internal conflicts from its dual mission of protecting taxpayer dollars and using its capital to support inherently un-profitable public services.

To render a public bank legally feasible, the City of Philadelphia—and once established, the City-controlled public bank authority—must act at the City and Commonwealth to:

1. Secure enabling legislation through the Commonwealth's Economic Development Financing Law (EDFL) to permit the City to create and control an authority that would serve as a public bank
2. Apply to become an enumerated bank through the Pennsylvania Department of Banking and Securities, in compliance with the Pennsylvania Banking Code of 1965 regulations
3. Serve as a City depository, after changing the Philadelphia Code

Step 1: Establish a Public Bank Authority through the Pennsylvania Economic Development Financing Law

The City of Philadelphia could create a public bank through a separate entity, such as a City-controlled authority or credit union. Article 9 Section 9 restricts a public bank as a City entity; however, that same law makes way for a City-controlled authority—a public instrument of the Commonwealth—to enter the banking business, potentially allowing the City to hold shares in the authority without pledging its credit. The second sentence of Article 9 Section 9 provides as follows:

> *… The General Assembly may provide standards by which **municipalities** or school districts **may give financial assistance or lease property to public service**, industrial or commercial enterprises if it shall find that such assistance or leasing is **necessary to the health, safety, or welfare of the Commonwealth or any municipality** or school district.*

The General Assembly has used that existing language in enacting Pennsylvania's Economic Development Financing Law. The EDFL grants broad power to the authorities that are created under it to "*promote economic activity and efficiency*." Municipalities, including the City of Philadelphia, can support the authority towards allowable purposes, and debts of the authority are not considered debts of the municipality. The City used this statute to create the Philadelphia Authority for Industrial Development (PAID), a vehicle that manages some City property and industrial sites, issues bonds, and administers contracts, grants, and loans relating to commercial and industrial development. Authorities established under the EDFL have the power to make loans but not to accept deposits. However, the General Assembly could amend the EDFL or pass other stand-alone enabling legislation to find that the needed aspects of banking are necessary to the welfare of the Commonwealth, the City, or the School District of Philadelphia, and could thus add those aspects to the powers of such authorities, enabling one to serve as a public bank. Any legislation to accommodate banking by a government authority would also need to establish sufficient mechanisms to collateralize and protect the City's money. The General Assembly would also need to amend various banking statutes, for example requirements of the Banking Code of 1965 that individuals, rather than a corporate entity like an authority, incorporate and hold shares in a bank that accepts deposits. Absent a veto, statutes require only a single passage by both houses.

Finally, the Philadelphia Code also presents an alternate option—a neighborhood-based credit union may collateralize municipal deposits. In the early 2000s, City Council dissolved explicit powers of local credit unions (now all long defunct), likely with the understanding that small Credit Unions were not secure enough for the City's large deposits. A City Credit Union may be possible but requires further review of the Credit Union Code, 17 Pa. C.S.A., as well as the Federal Credit Union Act, 12 U.S.C. §§ 1751-1795k.

Step 2: Receive a Bank Charter

Any institution engaging in "the business of receiving money for deposit or transmission" must comply with the requirements set out in the Pennsylvania Banking Code of 1965 (7 P.S.). To establish a bank, whether public or private, and to accept deposit from anyone, including the City, incorporators must first apply for approval with the Pennsylvania Department of Banking and Securities (DoBS).[37] DoBS then evaluates the applications and determines whether to approve, with or without conditions[38] and sends the articles of incorporation to the Department of State. DoBS then issues a "certificate of authorization to do business" once a bank has met all conditions, including capitalization to DoBS satisfaction, payment of at least 50% of the required paid-in capital, and funding an expense fund equal to at least 5% of required paid-in capital.[39]

Step 3: Serve as a City Depository

Once the public bank is chartered by the Commonwealth, the public bank authority must become a City depository. City depositories must meet the following local qualifications regarding insurance, reporting, maturity, and fair lending, per Philadelphia Code:[40]

1. Be insured by a Federal Corporation;
2. Make available to the City quarterly statements of condition and earnings;
3. Provide the City with independently audited Annual Statements;
4. Provide the City with an affidavit certifying that neither it, nor any of its affiliates, is, and none will become a high-cost lender or a predatory lender;
5. Provide the City with predatory lending information;
6. Provide the City with an annual statement of community reinvestment goals;
7. Provide the City with notice of branching closings;
8. Be established for a minimum of 5 years, be profitable for the last 2 years, and hold a minimum of $100,000,000 in assets.

A public bank should have no issue satisfying requirements numbered 2 through 7. However, FDIC has never provided insurance to a public bank, presenting an unproven challenge. Also, any new bank cannot meet the City's tenure and initial profitability requirements, therefore the City Council will need to change the

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[37] 7 P.S. § 1005

[38] 7 P.S. § 1007. Banks must satisfy a series of conditions that demonstrate an ability to achieve financial feasibility, serve the needs of the public, and uphold a commitment to ethical business practices.

[39] 7 P.S. § 1010

[40] Philadelphia Code 19-201(2)-(3); requirements listed above have been abbreviated for concision.

Philadelphia City Code.[41] City Council may pass City depository requirements that apply only to public banks and not to commercial financial institutions.

Financial Feasibility — Foundational Model

The Capital Structure of a Public Bank

The study evaluates the financial performance of the public bank, focused on the bank's financial feasibility at the time of stabilization once the bank has settled into steady operations. We note that, however, after the Commonwealth and City authorize the creation of the public bank, the City must provide the bank with startup funds. Private investors start commercial banks by committing seed capital, or equity, and raising deposits from customers. To start a public bank, the City will need to commit a minimum amount of its assets as deposits and equity. During this startup period, the bank is unlikely to return profits to the City, which would require continued funding until it generated enough profit to become self-sustaining — for example, the State of North Dakota first began using the Bank of North Dakota's profits when money was first transferred to the General Fund more than 20 years after it was founded[42]. Additional specificity on how a Philadelphia public bank should be structured and funded during its startup period should be explored in a business plan, which is beyond the scope of this report.

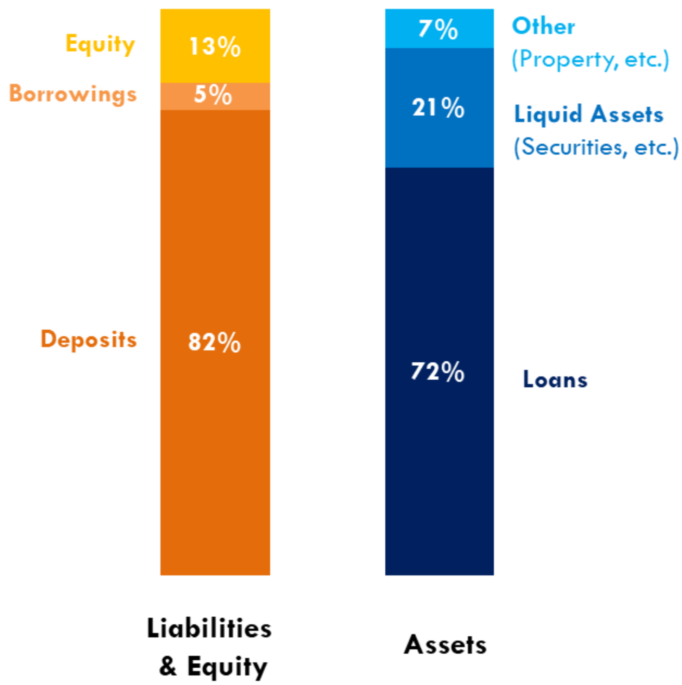
HR&A used Federal Financial Institutions Examination Council (FFIEC) data to understand the structure of a typical commercial bank in Pennsylvania and to apply the general framework to the public bank model. **Figure 3** below details the balance sheet composition of a typical commercial bank: assets, liabilities, and equity. **Figure 4** shows how the average Pennsylvania bank structures these components.

Figure 3: Commercial Bank Balance Sheet Composition

Adapted from Banking for Society

[41] Changing the Code requires Council approval and action by the mayor, but not a public vote.
[42] Public Banking Institute, Bank of North Dakota FAQ https://www.publicbankinginstitute.org/wp-content/uploads/2019/09/BND-FAQ.pdf

Figure 4: Average Pennsylvania Bank Balance Sheet



Source: FFIEC, Graphic adapted by HR&A Advisors

Customer deposits are the primary source of funding for commercial banks. Deposits are the money that the bank receives before any money is earned from it, such as checking accounts, savings accounts, and Certificate of Deposits (CD). Equity is the startup capital to establish a bank, which is used to absorb potential losses during the startup period. A businesses' equity typically comes from private investors, but in the case of public banks, it comes from a public entity.

The FFIEC's state average report shows that almost 82% of a private bank's assets are funded by deposits, while the remaining 18% are leveraged with borrowings (5% of assets) to support short-term cash needs and match asset maturities and equity (13% of assets). A bank's revenue potential is heavily dependent on loans, which make up 72% of total assets, while securities make up only 21% of the total (refer to **Figure 4**)

In the foundational model, the City provides both the deposits and equity portions of the capital stack. Based on the FFIEC data, the average Pennsylvania bank should expect to obtain 95% of its total liabilities from its customers' deposits and 5% from borrowings by the time the bank is at full-scale operations. Equity, on average, accounts for 13% of total assets. These borrowings typically come from the federal funds market, the Federal Home Loan Bank, other non-depository institutions, or the Federal Reserve as a last resort— a useful benchmark for a revenue-maximizing bank operations.

Loans represent most bank assets and include mortgages, business loans, and government loans. In any typical Pennsylvania bank, as illustrated in **Figure 6**, loans make up 72% of typical assets, while liquid assets, such as securities, make up 21%. Private banks rely on lending as a major source of revenue to pay for their operations and to churn a profit. Banks also own securities, an ownership position in US treasuries and municipal bonds, for example, as well as cash, which enable banks to maintain solvency against their liabilities and meet cash demands from their customers.[43] Under Commonwealth law, all municipal deposits must be 100% collateralized, meaning that the City's deposits must be protected by the bank through pledging of high-quality government securities with a market value equal to the balance of the City's deposits.[44] The City's Investment Policy requires a 102% collateralization for the City's deposits.[45] For more information about the City's Investment Policy, see page 35.

The State and the City's collateralization requirements are intended to protect municipal funds from un-recoverable financial loss. This risk-mitigating strategy, while important to conserve liquidity and safeguard the City's money, profoundly impacts the public bank's ability to leverage its assets, limiting revenue potential[46] and bank sustainability. A bank unable to extend credit via lending must instead resort to purchasing liquid assets such as US Securities and bonds that have a lower yield than lending operations.

To extend credit (via loans, etc.), a bank must have liquidity and unrestricted deposits to protect against potential loan losses. If the City is the sole depositor of funds in the public bank, the bank's ability to extend loans is limited to the equity portion of assets, as the City's deposits must be backed by government securities. The City could not pledge its own bonds and notes, which are already City liabilities. Securities on the bank's balance sheet would be those purchased and not those issued or sold by the City. These limitations make it difficult to have a sustainable business model, as banks depend on higher yield returns from lending activity to make a profit and pay for the costs of operating a bank. In addition to supplying income, lending is the means for the public bank to support the City's goals of extending financing to small businesses.

Because of the collateralization requirement, the public bank can only extend loans if it obtains deposits from other sources. Otherwise, the City would be circling back its own money to itself, which raises many potential issues and conflicts of interest. For example, if the City is a lender to the public bank, where would the City stand on the list of creditors? In a crisis, does the bank pay the City back first or the private owners of the City's debt, and what implications does this have for the City's credit rating? Additionally, there could be ethical and political implications in the case that the public bank accepts deposits from the public and uses those to fund City services and investments, instead of offering back lending services to Philadelphia's businesses.

Deposits from non-City entities would differentiate the public bank's cash and allow more funds to be allocated towards equity (to support loans) while still safeguarding City deposits with securities. These other sources may wish to deposit with the public bank because they support its mission of economic democracy, municipal autonomy, and supporting community investment—but they would only rationally bank if their funds could achieve returns comparable to banking with private banks. Future public bank deposit sources could include:

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[43] The Federal Reserve determines the legal reserves the banks must hold in their accounts as a percent of their loans and demand deposits; most banks maintain excess reserves as a buffer.
[44] Pennsylvania Act 72 (Aug. 6, 1971, P.L. 281), 72 P.S. § 3836-4.
[45] City of Philadelphia Investment Policy (2014)
[46] Government issued bond and securities, while generally less risky than other investments, return the lowest yields compared to income-earning assets such as commercial real estate loans or individual credit cards.

- **Other Municipalities and Public Institutions**: neighboring municipalities, school districts, transportation authorities and other governmental entities whose goals presumably align with the public bank's could provide potential deposits.
- **Non-City, Mission-Driven Entities**: local non-profits and/or educational institutions could contribute funds towards the public bank's deposits, perhaps as part of payments in lieu of taxes.

Equity, or startup funds to capitalize the bank, will likely be obtained from the City's fund balance, which totaled $438.7 million in FY 2019 and was revised to $254.9M in FY2020.[47] While the City's reserve funds were at a historical high (9.1% of revenues in FY19), Philadelphia's reserve accounts are well below the Government Finance Officers Associations' (GFOA) recommendations (17% of revenues) and trail behind peer cities' reserve funds in terms of percentage of revenues. Lowering the City's reserve balance by allocating funds to a public bank would adversely affect the City's credit rating and ability to obtain low-cost financing, among other challenges.

Commercial Bank Performance Benchmarks

While a public bank differs in many ways from a private financial institution, we assume that the basic profit and loss statement framework used for private institutions would be applicable for measuring the performance of a public bank. Given the lack of precedent for a City-controlled public bank, this study relies on private bank data to benchmark financial inputs (e.g. yields on earning assets such as loans, overhead costs as a % of assets) and outputs (e.g. return on average assets or ROAA) and to determine feasibility.

HR&A created a hypothetical "average private bank" income statement (**Figure 5**) to understand banking activities as a portion of asset size and loan value. These metrics are based on the average asset size and average performance of Pennsylvania's 91 insured commercial banks, obtained from the FFIEC statistical analysis of the Uniform Bank Performance Report (UBPR) data for banks in Pennsylvania.[48] The database includes banks as large as the First National Bank of Pennsylvania, which holds over $30 billion in assets, and banks as small as the United Bank of Philadelphia, with fewer than $50 million in assets.

This assessment captures typical private bank operations and provides a benchmark to understand a public bank's potential performance. In the following section we modify important variables, such as profitability targets, to reflect functional differences between a private and a public bank's operations and investments.

[47] City of Philadelphia Comprehensive Annual Financial Report FY2019
[48] Data is accessible via the FFIEC's State Average Report and Uniform Bank Performance Report

Figure 5: Representative Income Statement for Average Pennsylvania Bank

Average Assets	$2,084,861,000	*Avg. assets*
Average Earning Assets	$1,969,777,000	*94.5% of avg. assets*
Average Loans	$1,413,709,000	*71.8% of earning assets*
Estimated Gross Income (EGI)	$85,336,000	*4.33% avg. yield on earning assets*
Non-Interest Income	$11,819,000	*0.60% of earning assets*
Total Projected Income	$97,155,000	
Interest Expense	($18,319,000)	*0.93% of earning assets*
Non-Interest Expense	($56,083,000)	*2.69% of average assets*
Provision for Loan Losses	($1,272,000)	*0.09% of loans*
Pre-Tax Net Income	**$21,481,000**	
Pre-Tax ROAA	1.03%	

Source: HR&A Advisors, FFIEC

The ROAA (Return on Average Assets) is the standard measure used by banks and financial institutions to measure the profitability of its assets and is calculated by dividing the total net income over total bank assets. Nationally, commercial banks have an average ROAA of 1.30%, while banks in Pennsylvania have a lower average return, closer to 1%[49] according to data from 2019. In Q1 2020, the ROAA at the national and regional level have decreased to 0.36% and 0.61%, respectively.

As shown in the sample income statement **(Figure 5)**, based on a combined average yield on earning assets, which includes loans and securities of 4.33%, this benchmark model suggests a total projected income of $97.15 million for a bank that holds just over $2 billion in assets. To generate this revenue, the bank incurs a total of $18.3 million in interest expenses, around 0.93% of total assets. Given the difference between the interest income and the interest expenses, the "net interest margin" on this bank is $103.6 million. Additionally, the bank spends $56 million, or almost 75% of all expenses, on non-interest expenses which include overhead, personnel, and occupancy expenses. It also holds loan loss reserves that, on average, make up 1.02% of total loans extended, and the provision for loan losses in the income statement is 0.09% of loans. These figures result in over $21.5 million of pre-tax net income and a Return on Average Assets (ROAA) equal to 1.03% for the average Pennsylvania bank.

Expected Costs & Returns of the Foundational Model

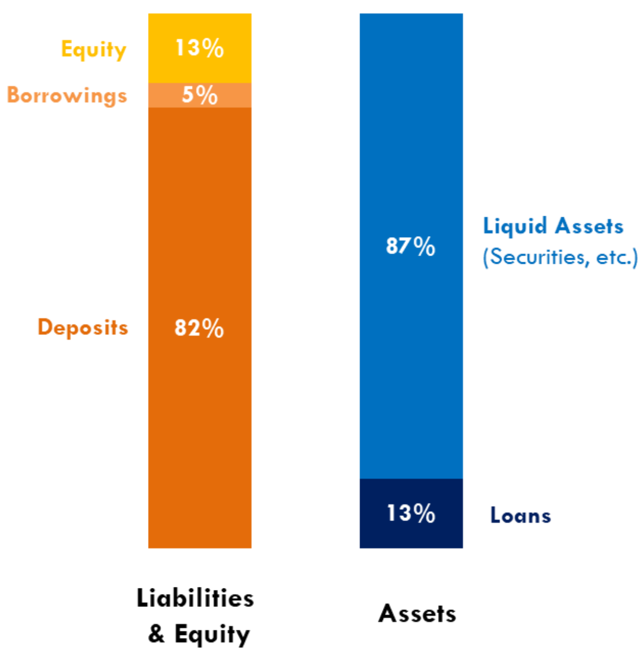
While the average private bank's income statement is a useful benchmark, a public bank must bank differently to comply with State and local laws that safeguard taxpayer money and uphold public values. To model the financial feasibility of a public bank, we assume that all City deposits are invested as government-backed securities, which complies with the Commonwealth requirement[50] that municipal deposits be fully collateralized. We also assume that the bank does not accept deposits from any entity aside from the City of Philadelphia.

49 Federal Reserve Bank of St. Louis, (2019); Return on Average Assets for all U.S. Banks and Pennsylvania Banks.
50 Act 72 of 1971, 72 P.S. § 3836-4

The foundational model differs from our "average Pennsylvania bank" model in the following ways:

- Only the City's equity (13% of assets) is extended as loans
- Yields on earning assets are adapted to match the earning asset composition for the foundational model, which considers 100% collateralization of all deposits with securities; the majority-security composition reduces the average yield on earning assets by more than 150 basis points.
- Overhead costs are reduced by 12%, assuming the foundational model would not require additional brick and mortar for retail bank branches.
- FFIEC data reflects the performance of established institutions with stabilized operations. We expect newly chartered banks, including a new public bank, to incur losses in the initial years.

Figure 6: Foundational Model Balance Sheet



Source: FFIEC, Graphic adapted by HR&A Advisors

The City's $255 million deposits (liabilities) are used to purchase securities and give out loans (assets). The City also puts in additional equity, which creates a bank with $293 million in assets. We estimate that the foundational public bank model with $293 million in assets will incur $9.8 million in estimated annual operating expenses. A private bank of a similar size would likely incur at least $2.7 million (28%) more, mainly due to increased occupancy expenses and increased loan loss reserves which are directly related to loan value.

A public bank's Non-interest Expenses include personnel expenses, equipment, data processing, and other general operating fees; it does not include occupancy expenses as the bank is not expected to operate retail branches. The public bank is also expected to incur interest expenses associated with interest paid to depositaries, as well as short- and long-term debt obligations. This public bank would accrue $2.6 million (or 0.93% of earning assets) in interest expense, in line with the average for private institutions.

Our foundational model—a public bank that holds the City's municipal deposits and serves solely its own banking needs—receives a Return on Average Assets (ROAA) of approximately -0.17%. In other words, it would *cost* the City money to bank its deposits with a foundational model public bank.[51] By comparison, the City currently receives an average return of 2.20% on its cash account with Wells Capital and 0.50% on its deposit accounts.

Figure 7: Income Statement for Foundational Bank Model in Philadelphia

Average Assets	$293,000,000
Avg. Earning Assets	$276,826,000
Avg. Loans	$35,960,000
Estimated Gross Income (EGI)	$7,309,000
Non-Interest Income	$1,661,000
Total Projected Income	$8,969,000
Interest Expense	($2,574,000)
Non-Interest Expense	($6,856,000)
Provision for Loan Losses	($32,000)
Pre-Tax Net Income	**($494,000)**
Pre-Tax ROAA	-0.17%

Source: HR&A Advisors, FFIEC

Administrative Feasibility — Foundational Model

Administrative Costs

A Philadelphia public bank, like all banks incorporated in the Commonwealth of Pennsylvania, must meet specified conditions,[52] including "having sufficient personnel with adequate knowledge and experience to administer fiduciary accounts." Based on its capital structure, the foundational model will require a staff whose core competencies include accounting, administrative support, compliance, risk management, and technology/cyber security. We estimate that the foundational model with $293 million in assets will accrue $4.3 million annually in total personnel expenses (1.48% of total assets), proportionate to the personnel expenses for commercial banks.

Personnel expenses of $4.3 million translates to 55-70[53] public bank employees, assuming salaries and benefits commensurate with PIDC and City of Philadelphia departments with banking functions (City

[51] The foundational model assumes non-interest income from fees such as deposit and transaction fees, totaling 0.60% of earning assets.

[52] Pennsylvania Banking Code of 1965, Section 1007

[53] Range accounts for a 10% margin of error

Treasurer, Airport/Commerce, Finance) which HR&A estimates is $68,600 per employee. Comparatively, data from the FFIEC reports an average cost of $80,000 for a Pennsylvania commercial bank employee[54].

In 2018-2019, the City spent approximately $1.2 million annually in fees to Wells Fargo, PNC Bank, and Citizens Bank,[55] equal to 0.19% of City deposits with those institutions—a relative "deal" compared to the $4.3 million (1.48% of assets) of personnel costs to operate the foundational public bank model. The foundational model would accrue an additional $2.6 million (0.9% of assets) in operational expenses and incur significant capital costs through its startup phase.

It is cheaper for the City to pay service fees to commercial banks because City depositories subsidized the administrative costs of banking the City's money. Commercial banks make this cost structure feasible by collecting fees from different banking services and types of depositors,[56] in addition to collecting interest and revenues from lending activities that are not included in the foundational public bank model. By leveraging City accounts for other lending activity, these commercial banks recover the subsidies and earn additional profit.

Sensitivity Analysis for Administrative Costs

HR&A tested a sensitivity on the non-interest expenses to determine the impact on the public bank's bottom line under more optimistic conditions. If the public bank achieved a non-interest expense of 0.44% of assets or $1.29 million, then the foundational model could be sustainable. If the City determines that this public bank would be able to successfully operate with limited staff, due to the limited banking functions, directionally, the foundational bank model can become feasible. The assumption for personnel expenses for the optimistic scenario is based on the percent of assets that the bank of North Dakota spends on overhead expenses. In this scenario, the City is only able to hire about 10 employees at an average salary and benefits of $68,600 to support the public bank's operations. At $293 million asset size, the Philadelphia public bank is unlikely to achieve the same economies of scale as the Bank of North Dakota with $7 billion in assets.

Figure 8: Foundational Model Income Statement Sensitivity (Optimistic Scenario)

Total Projected Income	$8,969,000	
Interest Expense	($2,574,000)	
Non-Interest Expense	($1,289,000)	*0.44% (BND average)*
Provision for Loan Losses	($32,000)	
Pre-Tax Net Income	**$5,073,000**	
Pre-Tax ROAA	1.73%	

Source: HR&A Advisors, FFIEC, BND

[54] FFIEC (2019), Average State Report for Pennsylvania Commercial Banks

[55] Together, Wells Fargo, PNC Bank, and Citizens Bank hold 93% of the City's deposits. TD Bank and Republic Bank hold the other 7%.

[56] The City's fees are below market rate and secured through a competitive bidding process

Governance

Philadelphians should be confident that their public bank implements best practices based on guiding principles that include transparency, accountability, equity, independence, democracy, meaningful public involvement, and professional management.

As with any other corporation or bank in Pennsylvania, a public bank's articles of incorporation and by-laws will guide its mission, management, and oversight. Like any well-designed government organization, a public bank should have a governance structure that provides subject matter expertise, allows for effective decision making, and earns widespread support inside and outside of government. Due to the political nature of amending State laws, the creation of a public bank must have the support of political leadership but must be independent of political control. This may mean that the bank's Board of Directors, or portions of the Board, should be appointed by City leadership, people who represent the interest of the bank itself (i.e. the public bank president), and people who represent the constituencies that the bank intends to serve—especially small business owners and Black and Latinx communities. As an example, the Philadelphia Authority for Industrial Development (PAID), a precedent authority, is governed by an all-Mayor appointed Board. Notably, PAID is operated by PIDC with its own Board of Directors appointed Mayor of Philadelphia and the President of the Greater Philadelphia Chamber of Commerce.

The bank's charter should outline a schedule for independent audits, providing the City government and the public with transparency to bank performance. The bank's governance should also set performance metrics to evaluate a holistic value, beyond Return on Average Assets, based on commitments to serving the public interest and supporting the local economy and job creation.

The public bank should protect against conflicts of interest. The public bank should have the liberty to operate independently of City government, even if the City is its sole depositor. To assure the independence of the public bank, the City should not be responsible for executing enforcement actions against the public bank. State and federal regulators will monitor the activities of the public bank as they do for all depository institutions under their jurisdiction. The City will provide assurance to the state and federal regulators that the City would not seek to alter the mission of the bank or exert influence over its funding following issuance of its charter.

A public bank is feasible from a governance perspective, so long as it structured in the context of these considerations.

The Small Business Support Model

The study explores the feasibility of a secondary model, the small business support model, designed to expand access to credit for small businesses in Philadelphia. Supporting Philadelphia's small business community is one of the City's top priorities: a healthy, thriving small business landscape provides pathways to financial security for low-income and households of color, promotes job growth, and fortifies culture and community in neighborhoods. The racial wealth gap found in Philadelphia and across the country has resulted in disparate access to capital for Black and Latinx small businesses, cutting off the potential supply of jobs in those communities. City-led programs, mission-driven banks, and other support organizations like PIDC, successfully provide capital and financial services to low-income communities, yet a lending gap still exists. In workshops led by HR&A to define this study's research purpose, City staff and public stakeholders alike identified small business growth as a driving motivation for a Philadelphia public bank.

The foundational and small business support models are symbiotic banking structures. Commercial banks purchase treasury bonds to counterbalance any potential losses from lending/investing activities. These federal bonds are highly rated and provide guarantees on revenue that allow commercial banks to leverage other funds confidently. Similarly, the structure of the foundational public bank model allows for City deposits to be liquid and protected, while the lending activities of the small business support model introduce ways for the public bank to earn income. A public bank, as a State recognized financial institution, can also increase the City's small business lending impact by leveraging near-zero interest rate federal loans that are otherwise unavailable to municipalities today.[57] The careful balance between the security and risk supports financial sustainability and longevity of the public banks and supports a meaningful scale to impact Philadelphians.

We estimate that Philadelphia had a shortage of about $840 million of small business loans in 2019. In 2020, this lending gap, defined as the demand for small businesses seeking or discouraged from applying for small business loans less the supply of small business loans, will likely widen due to the economic implications of COVID.

The small business support model envisions three independent activities that a Philadelphia public bank can do to increase lending to small businesses and reduce the lending gap. Any one of these activities would be *in addition to* the foundational banking model.

1. The public bank can **lend directly to small businesses**, offering Small Business Administration (SBA) loans, lines of credit, invoice factoring, among other services.
2. The public bank could act as a **low-cost lender to local mission-driven banks**, including CDFIs and community development credit unions which face capital shortages to be able to meet demand.
3. The public bank could support small businesses by **mitigating lending risk through credit enhancement tools**, such as letters of credit or first-loss capital lending. The goal of this activity is to encourage private investment into otherwise high-risk or unattractive investments.

Context for Small Business Support

Risk Perception for Small Business Lending

A public bank could upend traditional underwriting practices to those who have been historically disadvantaged. Traditionally, banks evaluate risk through a variety of measures: access to collateral assets, credit scores and history, access to references, and historical business performance—quantitative metrics that are diced and blended to determine the credit-worthiness of a potential borrower. This evaluation informs underwriting principles that define a standard for lending and a risk score for the deal.

These quantitative metrics are supplemented by far less scientific qualitative assessments. Sometimes, banks use qualitative factors to course-correct lending in industries where quantitative metrics are systematically limiting, like affordable housing projects that are expected to meet metrics used for traditional commercial real estate transactions. More often, qualitative factors invite generalizations and biases about the creditworthiness of certain populations and communities. Perceived investment risk, through traditional

[57] The Web of Debt, Ellen Brown; https://ellenbrown.com/2020/04/03/was-the-fed-just-nationalized/#more-14585

underwriting practices, has negatively impacted capital available to small businesses, especially in Black and Latinx communities.

Small businesses are typically less profitable for commercial banks than their larger counterparts. Businesses owned by people of color face entrenched lending biases. Together, both types of businesses, are likely to be deemed high risk under traditional lending standards due to the following reasons:

- Limited or no credit history
- Operational risk: businesses have limited ability to pay debt service and withstand financial shocks; and
- Neighborhood biases: generalized assumptions based on community demographics, including income, race, or ethnicity

Small business underwriting principles stewarded by the public bank and adapted by partnering institutions, including private and nonprofit lenders, could reduce perceived risk and increase the extension of credit towards the small business community in Philadelphia. For example, data from CDFI Loan Funds performance shows there is no heightened risk in small business loans of investments as CDFI loan defaults rates are fewer than 1% historically.[58] A public bank, like other mission-based lending organizations, could have more lenient and patient payback periods than commercial banks. These practices can result in low default rates and help small businesses—and the jobs they support—stay afloat especially in economically challenging times.[59]

Lending Impact Target

While small business lending in Philadelphia has grown tremendously—almost 70% from 2009 to 2017[60]—data and conversations with local small business owners suggest that not all small businesses who need loans can obtain them. The purpose of the small business support model is to fill this lending gap, with a special focus on extending capital and financial tools to small businesses that are otherwise underserved by the commercial banking market.

We estimate that the lending gap for small businesses in Philadelphia is at least $840 million (**Figure 9**). The gap describes the loan value that is needed but not provided to businesses. The gap considers the share of employers with fewer than 500 employees and non-employer firms (businesses with no paid employees) in Philadelphia who sought financing and those that were discouraged from seeking financing yet may still be experiencing a shortfall. At a conservative average loan amount sought of $48,300[61] per small business per year, HR&A estimated a capital demand of over $2.5 billion from small businesses in Philadelphia. According to data from the Small Business Lending Network, small business loans in Philadelphia can range from $15,000 to $250,000 or even higher for larger businesses. The resulting gap is a comparison between the estimated demand and the estimated supply of loans to small businesses in Philadelphia—estimated at

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[58] CDFI Industry Analysis, Carsey Institute (2012)
[59] Weathering the Great Recession: A CDFI Case Study in Patient Capital, Federal Reserve Bank of San Francisco (2015)
[60] Lending Practices of Authorized Depositories for the City of Philadelphia (2017)
[61] Small Business Lending Network data provided by the CTO (2016-2019)

around $1.7 billion, based on the underlying assumption that about 34%[62] of businesses receive full or partial financing nationwide.

Figure 9: Philadelphia Lending Impact Target Calculation

DEMAND	Amt.	Source
Est. # Phila. Businesses with <500 Employees	22,200	*US Census*
% Seeking Loans and/or Experiencing Shortfall	52%	*National SB Credit Survey*
Est. # Phila. Non-Employer Businesses	83,700	*US Census*
% Seeking Loans and/or Experiencing Shortfall	50%	*National SB Credit Survey*
Total # Phila. Small Biz Seeking Loans and/or Experiencing Shortfall	**53,000**	
Est. Loan Amount Demand per Firm	$48,300	*Philadelphia SB Lending Network*
Total Est. Lending Demand	**$2.58 B**	
SUPPLY	Amt.	Source
Total Firms with <500 Employees in Philadelphia	105,900	*US Census*
% Receiving Financing	34%	*National SB Credit Survey*
Est. Loan Amount Received per Business	$48,300	*Philadelphia SB Lending Network*
Total Est. Lending Supply	**$1.74 B**	
Estimated Lending Gap	**$840 M**	*Lending Demand - Lending Supply*

A public bank would be the City's boldest attempt to fill the lending gap, however even with the most favorable lending conditions and terms the bank is unlikely to fill the City's lending need in its entirety. This calculation captures small businesses that are ineligible even for mission-driven lending, which often has looser restrictions on credit than commercial loans. These businesses do not meet mission-driven lending thresholds—and potentially, lending thresholds of the public bank—due to factors like extremely low or no income, no collateral availability, and a poor history of debt payback.

Legal Feasibility — Additional Considerations for the Small Business Support Model

Pennsylvania's Economic Development Finance Law generally permits authorities to administer small business loans, including the three types of loans considered by our small business support model. The Philadelphia Authority for Industrial Development (PAID) provides a useful precedent a City-controlled authority that can and does make loans. For a public bank in Philadelphia to make loans, it must have the capital to lend and the ability to invest in small businesses.

[62] National Small Business Credit Survey, Federal Reserve Bank of New York (2019)

The small business support model is legally feasible if the Commonwealth and City can change the following laws and policies:

- **Collateralization.** Under current public depository requirements, any bank that accepts public deposits must provide collateral equal to 100% (State law[63]) to 102% (City policy) of these funds. In the case of an institution where the City is the sole depositor, this effectively prevents the public bank from lending City funds since these deposits must be collateralized through government securities. For the public bank to have funds to lend, it must either change the collateralization law or take in funds from outside of City government[64].

  Statutes and Charter and Code sections[65] might need to be amended if the City were to allow a public bank— even as an authority—to take substantial amounts of money from City deposits without appropriations and without authorization by Finance and the City Controller. State and City policy makers may be resistant to changing current collateralization laws, given that someone—likely taxpayers—will have to cover any City asset losses should the bank be unsuccessful.

- **Depositories.** The Pennsylvania Banking Code of 1965 will need to change to permit a public bank to be a bank under State law and to accept deposits from anyone, including the City. The law could be amended to permit such a public bank to accept only City deposits, or only governmental deposits, or only deposits from persons doing business in Philadelphia, or deposits from anyone and everyone. Expanding the pool of depositories will give the bank capital to lend to small businesses, so long as these depositories have confidence and certainty in the bank to protect their money (this confidence will be difficult to achieve without federal insurance protections).

- **City Investment Policy.** For the City to meet its small business lending goals, it needs to amend its investment policies to allow a public bank to invest in small businesses, even if those policies expose City funds to greater risk. The City invests its capital to earn a stable return while safeguarding taxpayers' funds. Three clear objectives guide the Philadelphia's Investment Policies: (1) preservation of principal, (2) ensuring liquidity, and (3) maximizing return on investments. Today, the investment policy allows mainly liquid investments such as government and general obligation bonds, US securities, US treasury obligations, repurchase agreements, commercial paper, corporate bonds, and money market mutual funds, among others. The investment policy places further limits on terms of these investments, including maturity, credit ratings, and portfolio composition. The City holds investment accounts with 10 different entities including BlackRock, Piedmont, Smith Graham, PNC Advisors, and Wells Capital, and notably, does not participate in and lending to small businesses.

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[63] Act 72 of 1971, 72 P.S. § 3836-4

[64] For purposes of our financial analysis, we assume that the 100% collateralization requirement is lifted

[65] Partial list of State laws that may need to be amended or circumvented to allow a Philadelphia public bank to take significant amounts of City deposits for lending:

- 7 P.S. § 105 (Banking Code of 1965) (only enumerated types of institutions, not including cities or authorities, may engage in the business of receiving money for deposit or transmission)
- 7 P.S. § 1002: only adult individuals may incorporate banks and subscribe as shareholders
- 73 P.S. § 371ff.: authorities under Economic Development Financing Law not authorized to accept deposits
- 73 P.S. § 376(d)(3): such authorities may not engage in business for profit
- 73 P.S. § 380: such authorities must deposit funds in banks, bank & trust companies, or savings banks under Banking Code of 1965

Still, the City's small business support is a public policy matter and one that could be incorporated into the City's Investment Policy with changes to state and local law.[66]

Financial Feasibility — Small Business Support Model

Direct Small Business Lending

If the public bank directly served small businesses[67] through commercial lending, this model would net the public a return of approximately 1.46%, which slightly exceeds the return on average assets for Pennsylvania banks in 2018 of 0.98%.[68] For a bank with $293 million assets, the study estimates that annual returns may reach $4.3 million annually. The increased return, as compared to the foundational model, is largely due to a loan portfolio in the public bank that excludes individual loans such as credit cards. Bank profits can be redirected towards the bank's small business loan fund, and to support additional services which may include technical assistance and business planning support.

The modeled $293 million asset public bank dedicates at least $196 million towards commercial lending (71.6% of earning assets, minus a 1.02% allowance for loan loss reserves), which is a considerable contribution to the estimated lending gap in Philadelphia in 2019. The larger the bank's deposit pool, the greater its ability to relieve the small business financing gap.

Figure 10: Income Statement for (2A) Small Business Support Model, Direct Lending

Average Assets	$293,000,000
Avg Earning Assets	$276,826,400
Avg Loans	$198,263,000
Estimated Gross Income (EGI)	$12,235,000
Non-Interest Income	$1,661,000
Total Projected Income	$13,896,000
Interest Expense	($2,574,000)
Non-Interest Expense	($6,856,000)
Provision for Loan Losses	($178,000)
Pre-Tax Net Income	**$4,287,000**
Pre-Tax ROAA	1.46%

Source: HR&A Advisors, FFIEC

We note that the lending calculations consider an allowance for loan and lease losses based on the private bank average in Pennsylvania according to the FFIEC, equivalent to (1.02% of loans). For clarity, the typical bank income statement does not include the allowance for loan losses, only the provision, which represents the growth and change in portfolio risk and is equal to 0.09% of loans for the typical Pennsylvania bank. Allowance for loan and lease losses are considered an expense on the balance sheet, which estimates the "uncollectible" amount of loans or leases offered by the bank. Loss reserves can vary by institution type and by asset size. Banks that lend to small businesses, including both commercial and mission-driven banks, often rely on SBA loan guarantees to keep loan reserves low, which allows lenders to recover 50 to 85 percent of

66 The Investment Policy is derived from the state constitution, Philadelphia Code, and Finance Director's policy

67 Small businesses are defined as businesses having >500 employees for this context, they also include non-employer businesses.

68 FFIEC; Average ROAA for all national banks was 1.30% in 2019, ROAA for Pennsylvania Banks was lower at 0.98%.

outstanding balances from the SBA.[69][70] CDFIs, on average, have loan reserves of about 1.59%,[71] while we have heard from PIDC, that loss reserves in their portfolio can reach up to 13%. The larger loss reserves in a business model like PIDC's can be supported due to the nature of their mission-driven business, which allows for patient and flexible debt collection and decreases the risk of default on their loans. We note that the public bank may require larger allowance for loan reserves as it engages in lending activity that might be risker than the average commercial bank. Should this be the case, the public bank would hold additional capital reserves to balance the risk, therefore lowering return.

Loans to Mission-Driven Banks

The public bank can engage in partnerships with mission-driven banks and credit unions to further the City's goal of increasing financing access to small businesses. While these banks already support Philadelphia's local businesses, due to challenges of scale, they are unable to meet the city's full lending needs. The public bank can provide low-interest capital to mission-driven institutions which will enable them to increase their lending capacity, and therefore impact, in communities. For example, the public bank can provide alternative capital such as secondary capital[72] loans to low-income community development credit unions (LICUs), which enable LICUs to increase their net worth and therefore lending impact in underserved communities. We describe Philadelphia's mission-driven banking landscape in greater detail on page 13.

Secondary capital lending is a strategic mechanism that could enable a public bank to leverage community development credit union (CDCU) resources. A direct loan (or deposit) towards a CDFI would allow that institution to extend loans at that exact amount. However, a secondary capital loan to a CDCU, which increases its net worth, would increase the credit union's capacity to accept deposits by a larger proportion, therefore expanding its lending capacity by a larger amount. Reports on secondary capital loans show that a $250,000 loan can allow a CDCU to take in an additional $1.75 million in deposits and expand its lending capacity by $2 million. On average, reports cite that loan capacity for secondary capital increases by 3X the amount lent by the lender.[73] While secondary capital loans may carry a higher than average loan loss rate closer to 1%, 60-day delinquency rates on these loans remain low at about only 3%. The public bank can also provide additional services to its partners such as technical assistance, to support CDFI and CDCU growth and operational capabilities.

The resulting stabilized return for the CDFI lending model is a 1.42% ROAA, in line with the estimated return for the public bank's direct lending activities.

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[69] The SBA has three lending programs, each with specific lending practices and eligibility requirements for lenders. The Philadelphia public bank would likely qualify for the Microloan program and may qualify for the 7(a)-loan program with flexibility around the regulatory authority requirements. More information about SBA lender eligibility can be found here: https://www.sba.gov/partners/lenders/become-sba-lender.

[70] U.S Small Business Administration

[71] National Community Investment Fund, CDFI Banking Industry Profile (2015)

[72] Callahan & Associates, "What Is the State of Secondary Capital At U.C. Credit Unions?" (2017)

[73] National Federation of Community Development Credit Unions, Inclusiv (2020)—report from 61 national, SBA-certified credit unions

Figure 11: Income Statement for (2B) Small Business Support Model, Mission-Driven Bank Lending

Average Assets	$293,000,000
Avg Earning Assets	$276,826,400
Avg Loans	$198,263,000
Estimated Gross Income (EGI)	$12,111,000
Non-Interest Income	$1,661,000
Total Projected Income	$13,772,000
Interest Expense	($2,574,000)
Non-Interest Expense	($6,856,000)
Provision for Loan Losses	($178,000)
Pre-Tax Net Income	**$4,163,000**
Pre-Tax ROAA	1.42%

Source: HR&A Advisors, FFIEC

A report published by the CDFI fund and Carsey Institute found that there are significant scale effects for CDFIs, concluding that larger CDFIs are more likely to be self-sufficient and increase their lending capacity.[74] Within the studied sample, larger CDFIs were shown to have (1) lower interest and operating expense ratios, (2) higher leveraging ability, (3) higher loan deployment ratios,[75] and (4) lower charge-offs from outstanding debt, and (5) lower margins allowing them to deliver more affordable services. The public bank can support mission-driven banks through capital access, allowing them to scale and to maximize their impact on small businesses and entrepreneurs in Philadelphia.

Risk Mitigation

We tested the feasibility of the public bank attracting private capital to small business loans that commercial banks would not otherwise participate in. Commercial banks avoid small business lending because of the limited return potential and perceived risk. The public bank could use a broad range of tools to attract these investments, including letters of credit, first-loss capital, over-collateralization, insurance, and reserve accounts. Ultimately, these techniques improve the creditworthiness of small businesses and create more certain returns for the private sector, in turn, increasing small businesses' access to capital. Unlike direct lending to small businesses and loans to mission-driven banks, these risk mitigation activities serve to mobilize commercial banks to provide small business loans.

A first-loss lender in the capital stack is an example of a credit enhancement tool used to increase creditworthiness. A first-loss lender is one of several lenders in a capital stack who absorbs potential financial losses before those losses can affect co-lenders, as demonstrated in **Figure 12** below. Adding a first-loss lender to the capital stack can encourage capital to flow to these opportunities by improving their risk-return profiles and, therefore incentivize others to invest. Other benefits of a first loss lender include:

- Lending more capital to address social challenges than the first loss lender can provide on their own
- Introducing sustainable investment to markets that traditional capital markets have avoided or underserved

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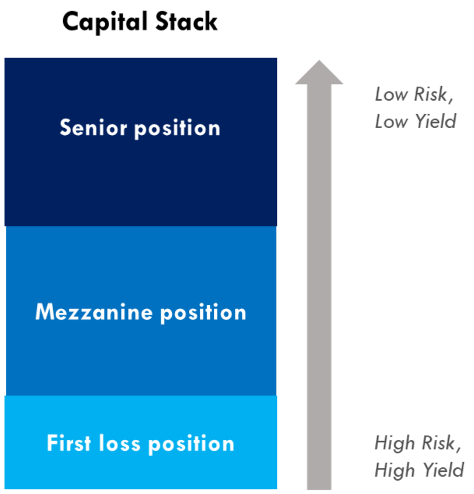
[74] CDFI Industry Analysis, Carsey Institute (2012)

[75] Deployment ratio is defined as gross loans outstanding divided by the total capital available for lending

- Improving loan terms for borrowers

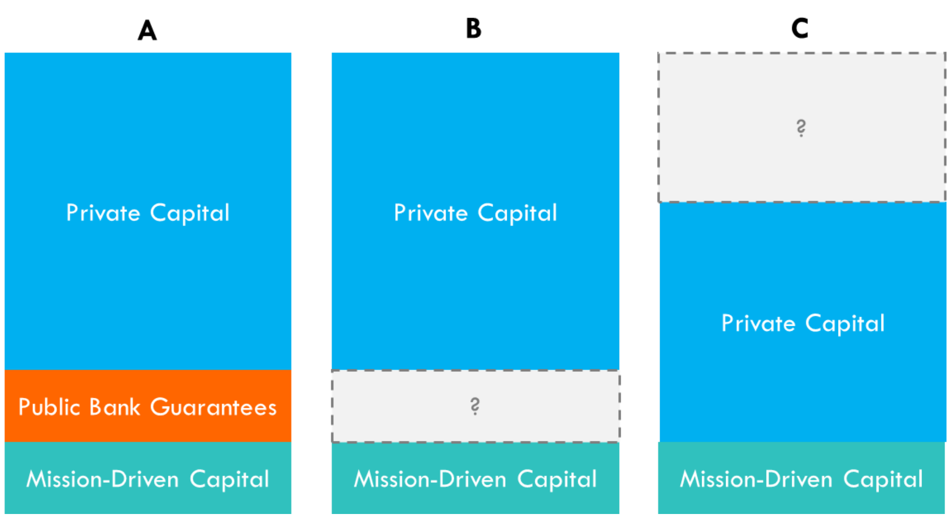
Figure 12: First-Loss Position in the Capital Stack



Source: HR&A Advisors

The conceptual diagram below, **Figure 13** shows how public banks could provide guarantees as a first-loss lender to reduce other lenders' risk and incentive private capital (Scenario A). Scenarios B and C show conditions without a public bank, where a lack of guarantee weakens the impact of private capital or lessens the total amount of funds raised. If the "gap" or guarantee goes unfilled by mission-driven capital or public grants (both funding sources are typically constrained), the borrower should expect less private capital partnering with mission-driven capital and a lower potential impact.

Figure 13: First-Loss Lender Scenarios



Source: HR&A Advisors, Global Impact Investing Network

Habitat for Humanity (HFH) FlexCAP program is an example of how a public bank can mitigate investment risk to increase the flow of capital to small businesses in Philadelphia. In HFH's case, the FlexCAP program is designed to increase low-cost loans to families whose credit history and limited income would otherwise deter private banks from issuing home loans. The program successfully uses two credit enhancement tools to mitigate risk and incentivize private capital. First, HFH guarantees five percent of the outstanding loan note. HFH also funds a cash-reserve account equal to one quarterly payment (principal and interest) of the loan note. By guaranteeing the first five percent of any loan loss on top of providing a cash reserve to cover any incremental shocks on the borrower's ability to pay the loan, HFH reduced the risk profile of the transaction and in turn incentivized private capital to participate in a market with limited private capital investment. 271 HFH affiliates have participated in the FlexCAP program, with 21 investors investing more than $141 million since its inception in 1997. Today, $100 million of the total note issuance has been repaid. HFH reports a 100% repayment record and zero delinquencies at the investor note level.[76]

Administrative Feasibility — Additional Considerations for the Small Business Support Model

A public bank that provides services to small businesses either directly or indirectly will require more intensive resources to operate than the foundational model, reflected in the non-interest expense line on the income statement. Full-time employees for this public bank model should have the same core competencies as the foundational model (including origination/transaction, accounting, compliance, risk management, administrative support, and underwriting) plus the capacity to manage the bank's lending portfolio relationships with banking partners.

To implement direct small business lending activities, the public bank is likely to manage a greater volume of transactions, due to the nature of its offerings such as direct micro-lending, than through the mission-driven lending or risk mitigation activities, resulting in less administrative costs due to the inefficiencies from smaller transaction amounts. Additionally, in both the mission-driven and risk-mitigation models, the public bank partners with private and/or non-profit institutions, which would lessen the administrative burden for the City compared to the direct small business lending activities.

NEXT STEPS & RECOMMENDATIONS

Philadelphia's current banking landscape does not meet the needs of its residents and businesses. Thus, the City of Philadelphia commissioned this inquiry to determine whether a public bank was feasible and whether it could meet the goals of autonomy and supporting local small businesses. We created two banking models to test the bank's viability and found that these structures are interdependent: **the foundational model harnesses the power of municipal deposits, while the small business support model directs that power.**

Today, the City of Philadelphia's financial programs and resources are predicated on partnerships. The City serves as a conduit—streamlining the application process and providing technical assistance to Philadelphia residents and businesses seeking access to credit. The loans themselves are primarily underwritten by local financial institutions or funded through State or Federal government money, such as Community Development Block Grants.

A public bank differs from existing City financial programs in that it would empower the City to directly control the flow of capital. A public bank allows the City to lend directly to small businesses, provide local

[76] Catalytic First Loss Capital, Global Impact Investing Network (2013)

funding to mission-driven banks, and participate in the capital stack for small business loans. While the City can be directly involved in lending through non-bank authorities or special purpose vehicles, a City-controlled public bank is the only tool that allows Philadelphia to leverage the nearly-unprecedented scale and magnitude of its municipal deposits—potentially to the tune of $293 million.

Establishing a Philadelphia Public bank is a political and financial feat: it would require the approval of both houses of the General Assembly, amendments to the City Code and Investment Policy, and would likely take several years to complete. Practically, the bank must be capitalized through the dedication of the City funds and the City's deposits must be sufficiently collateralized to uphold the government's fiduciary responsibility.

If the public bank does not lend money (i.e. the foundational model), then the bank runs at a loss and costs the City money. The foundational model is projected to return a negative ROAA (-0.17%), which alone, is financially infeasible and particularly impractical compared to returns the City earns from their current consolidated cash accounts. On the other hand, adding small business lending allows the small business support model to achieve ROAA of 1.42% to 1.46%.

While ROAA is an important metric to understand financial feasibility, it is does not account for the more holistic public benefit that a public bank can provide. A public bank is positioned to bolster the City's economy by supporting small businesses underserved by the commercial banking sector, in turn generating jobs, economic stability, and community wealth. The City also stands to benefit from incremental tax revenue generated by business activity supported by the Philadelphia Bank—this incremental tax revenue could be estimated with further study.

The barriers to creating a public bank are steep. However, it is only fitting that the City's ambitions meet the scale of the challenge. **A City-controlled public bank can be feasible if the City and Commonwealth undertake a series of legal actions and structure the bank to maximize lending impact.**

First, a public bank in Philadelphia should be structured as a **City-controlled authority,** which can offer a relatively streamlined path to allow the City to create and control a public bank. Furthermore, it must be designed to **lend money to small businesses,** to support the bank's financial health and to achieve the City's stated goals for a public bank. Leveraging capacity is positively correlated to impact and small business support activities can attract private capital and create multipliers on every public dollar invested.

Once these preconditions are met, the following City actions are required to ensure feasibility of the public bank:

A public bank is <u>legally</u> feasible if the City of Philadelphia…

- Persuades the State to allow the City to establish an authority that creates a vehicle for City deposits and lending;
- Charters the bank in the State of Pennsylvania; and
- Changes local law to permit the public bank to be a City depository.

A public bank is <u>financially</u> feasible if the City of Philadelphia …

- Can sustain initial financial loss during start-up years; and
- Can incur annual loss OR

- Leverages its deposit pool to makes loans to businesses and/or other institutions.

A public bank is administratively feasible if the City of Philadelphia…

- Subsidizes its administrative costs with fees from other depositors, other financial products, and/or revenues from lending activity; and
- Establishes a governance structure that provides subject matter expertise, allows for effective decision making and earns widespread support inside and outside of government and adopts best practices.

To create the small business support model, we recommend the City undertake the following steps:

1. Work with the Governor and General Assembly to persuade the latter to enact laws permitting the City to establish an authority, probably under the Economic Development Financing Law, to serve as a public bank with the desired powers, potentially including the acceptance of deposits from as well as the making of loans to others
2. Establish such a public bank authority
3. Apply to become an enumerated bank in the Commonwealth of Pennsylvania
4. Serve as a City depository, after changing the Philadelphia Code
5. Change the collateralization requirement and/or accept deposits from non-City entities
6. Amend City investment policies to allow a public bank to invest in small businesses
7. Build internal banking capacity, including staff whose core competencies include origination/transaction, accounting, compliance, risk management, administrative support, underwriting, portfolio management and banking partner relations.

A public bank is among a suite of tools that the City can implement to support small businesses and address the problems identified in Part I: namely, the ongoing and racialized poverty that characterizes this otherwise proud city. Other levers and programs—including progressive procurement policies or thoughtful grant programs; directly deploying City resources to lower perceived lending risk; and enticing private investment through incentives, tightened regulation, and political pressure—can work together to meet City goals. While exploring the creation of a public bank, we hope that the City takes immediate and bold steps to support its Black and Latinx small businesses, and we hope that this study serves as a roadmap for making an immediate impact while laying the groundwork for systemic reform.

APPENDIX A: PPB ADVISORY COMMITTEE MEETINGS — NOTES AND TAKEAWAYS

Philadelphia Public Banking Study

PPB Advisory Committee Meetings—Notes & Takeaways

Meeting Date: Jan. 13, 2020

Participants:

Session 1
10am-12pm

Advisory Committee: *Brittany Alston, Emma Chappell, Valerie Mosley, Mark Pinsky, Andy Rachlin, Lisa Servon*
City Council: *Councilmember Derek Green, Frank Iannuzzi*
City Treasurer's Office: *Christian Dunbar, Jackie Dunn*
HR&A Advisors: *Andrea Batista Schlesinger, Ariel Benjamin, Eric NeSmith, Isabella Mayorga*

Session 2
2pm-4pm

Advisory Committee: *Beth Finn, Kaye Lasker, Vanessa Lowe, Stan Shapiro, Lin Thomas, Peter Winslow, Marva Williams*
City Council: *Councilmember Derek Green, Frank Iannuzzi*
City Treasurer's Office: *Christian Dunbar, Jackie Dunn, Keola Harrington*
HR&A Advisors: *Andrea Batista Schlesinger, Ariel Benjamin, Eric NeSmith, Isabella Mayorga*

Meeting Objectives:

1. Understand the relationship between banks and financial service institutions, and entrenched poverty in Philadelphia
2. Surface potential strategies to increase financial services to unbanked and impoverished communities
3. Share use cases and ideas for how public banking activities may benefit (1) Philadelphia residents and (2) municipal functions

Notes:

Role banks and financial services institutions have played in the creation and/or persistence of poverty in Philadelphia.

- **Most commercial banking services are not designed to serve or help the poor.** Causes of under-banking include historical and ongoing redlining; lending and underwriting practices that are unfavorable to entrepreneurs, small businesses, businesses owed by people of color (due to pre-existing bias and racism, the notion that small accounts are expensive to big banks, risk-adjusted returns); predatory practices (fee-driven business models, 95% of fees being collected from low-income people); large private banks practice of undercutting interest rates offered by smaller local banks

- Some employees rely on their employers for financial services. Companies are establishing internal credit unions (NYT Marriott Workers Article) that expose low-income employees to predatory practices that persist in the private market, including high fees that are deducted directly from employees' paychecks.

- **Federal regulations make it difficult for small banks to scale.** These regulations force small banks—often banks who are mission-driven and/or service the local community—to set aside outsized reserves for loans. Loans issued by small banks are second-guessed or turned down by federal regulators. As small banks grow to mid-sized banks, they face steeper regulations that undermine potential profits (Philadelphia has small and large banks, no middle-ground). Regulation is largely designed for big banks, often resulting in negative impacts for small and mid-tier banks.

Reasons for un/underbanked Philadelphians today.

- **Low-income communities are often making rational decisions to use non-traditional banking services.** Check cashers and similar businesses can offer more transparency (about fees, for example), timely service and high liquidity, and convenience compared to commercial banks. Customers especially value a place where "everyone knows their name".

- **Philadelphia's position as one of the poorest major US cities is deeply related to the City's high unbanked and underbanked populations.**

Existing challenges that small/local banks currently face.

- **Smaller, local and regional banks have an interest in these communities, but resources are lacking**—they could do more if they had the capacity. Scaling, in-turn creates regulatory and financial challenges for banks. Valley Green Bank, founded to support local businesses throughout Philadelphia, is an example of a bank that went through a merger and who's portfolio no longer represents its community.

- **The general size of the City's deposit accounts limits the City's ability to bank with small/local banks due to required financial thresholds required federal government.** The City has limited influence on the behavior of private banks due to limited options of banks that have the capacity to service the City's deposit accounts.

- **Small-business don't have access to credit in part because lending is typically not very profitable**—it is expensive and difficult to do small-business lending well, and it doesn't scale well. At CDFIs, these loans are often subsidized by other products. Net interest margins of banks are narrow, banks are buying securities instead of lending, that's where they are making money.

Potential challenges the public bank structure could face as it seeks to serve Philadelphia's un/underbanked.

- **Banks are less agile when it comes to addressing public challenges** due to regulatory requirements/restrictions and investor required return thresholds.

- **If a public bank is created today, some challenges would prevent that entity from holding the City's deposits and re/financing the City's debt**. For example—The City charter requires that the City's assets are collateralized at 102% (State requires 100%), the City doesn't have enough resources to fund the bank ($5 billion in assets, but most are bond proceeds and are "spoken for"), if the City were to borrow from its pension it would be violating fiduciary responsibility and not have enough resources to pay beneficiaries.

Previously existing programs whose success can contribute to potential public bank models.

- **Philadelphia Minority Business Authority**—existed during the Casey administration (1987-95), was a successful revolving fund model offering technical assistance along with loans to small and non-white owned businesses who were un/underbanked mainly due to racist/bias practices (including underwriting).

Potential banking/banking-related activities for a Public Bank in Philly.

- **Increase credit available to small businesses.** In the last 20 years, there have been repeated, unsuccessful efforts to expand small business lending in Philadelphia. Banks have been successful in partnering with CDFIs in other cities but not in Philadelphia. *Why?*
- **Absorb "first-loss" and encourage lending in places where they won't.** This is dependent on a partnership model in which the City's public bank would take the "riskiest" position by absorbing the first loss, enhancing the credit quality of the consumer and the partnering institution's "risk" profile would be lowered. "A Public Bank can help solve the greatest pain points for private banks".
- **Offer Social Impact Bonds, or a similar version,** that leverages impact investment capital. Impact bonds utilize outcome-based financing thus are dependent on generating measurable impact, which can present many challenges.
- **Offer low-interest student loans.** A public bank could provide lower-cost capital for students—similar to the [public] Bank of North Dakota.
- **Develop a "Public Purpose" Balance Sheet.** This would be a guiding principle for a public bank that prioritizes profit-making over profit-maximizing, allowing the bank to participate in the areas which the private market chooses not to because their priority is to maximize profit.
- **Leverage technological advances including FinTech.** Is the evolvement of FinTech a possible solution or can it contribute to alleviating poverty in Philly by increasing access to capital and financial services?

Potential benefits of a Public Bank for Philly residents.

- **Provide Philadelphia residents long-desired transparency about investments and financial plan**s. The City would be accountable for updating the "shareholders a.k.a. City residents" on all financial plans and changes. A public bank offer offers an opportunity to keep the City's money local".

- **A public bank can offer a sustainable, long-term solution** to issues that the City and its residents are facing [poverty]— which one-off City Council appropriations or programs exposed to political changes won't solve sustainably.

Characteristics that should be considered for a Public Bank in Philly.

- **A public bank should not compete with CDFIs or other national banks.** The opportunity is in that it can partner with CDFIs and other institutions to use and leverage their investment in a way to increase the impact for low- and moderate-income people. **A public bank can offer loans to community banks.**
- **Govern and operate independently from politics.** A public bank must be completely de-politicized and able to establish trust with the public, and other institutions. Also, if formed, the City will need a PR campaign to build trust in this new entity.

APPENDIX B: DATA ON UNDERBANKED PHILADELPHIANS

FDIC five-year (2013-2017) estimates for unbanked and underbanked rates show that household income is a strong predictor of being underbanked in Philadelphia and in major cities in the United States. In the Philadelphia area,[77] more than 57% of individuals earning fewer than $15,000 are unbanked or underbanked, with figures improving significantly for higher income brackets and only 16% of households earning above $75,000 reported being underbanked. Minorities are also more likely to be underbanked in Philadelphia, with 14.5% and 28% of Black and Latinx residents, respectively, reported to be underbanked, compared to only 1.5% of white residents (**Figure 14**). [78]

The Latinx community of Philadelphia experiences unique and disproportionate challenges. In comparison to other large cities like New York, DC, Baltimore, and Chicago, Philadelphia had the largest percentage of unbanked and underbanked Latinxs, which is not surprising considering Latinx households in Philadelphia are most likely to be living in poverty (Latinxs make up 38% of households living in poverty while accounting for only 12% of the city's population).[79]

Conventional mortgage lending in Philadelphia is racially inequitable. In 2016, Black Philadelphians were found to be almost three times more likely to be denied a conventional home purchase loan than white applicants, even for those applicants shown to have similar credit profiles.[80] Data on lending practices of authorized city depositories in 2017 found that African American borrowers were denied over twice as often as white borrowers in Philadelphia.[81]

FFIEC data (**Figure 14**) shows how most mortgages are given to residents living in Philadelphia's wealthier census tracts, with high-income neighborhoods receiving almost eight times the number of loans (7,291) received in neighborhoods where average resident income is less than 50% of the MSA median (935 loans). Income also affects a household's ability to access mortgages. As shown in **Figure 14**, fewer than 5% of conventional home purchase loans in Philadelphia are awarded in low-income census tracts (<50% AMI).

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[77] FDIC Data is only available at the MSA level.

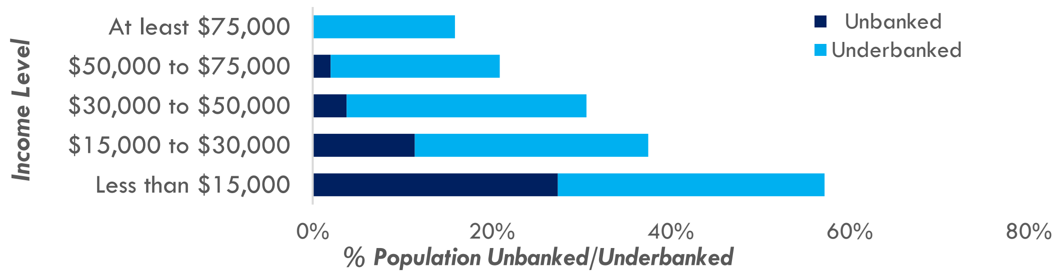
[78] FDIC (2013-2017 Estimates), Philadelphia MSA

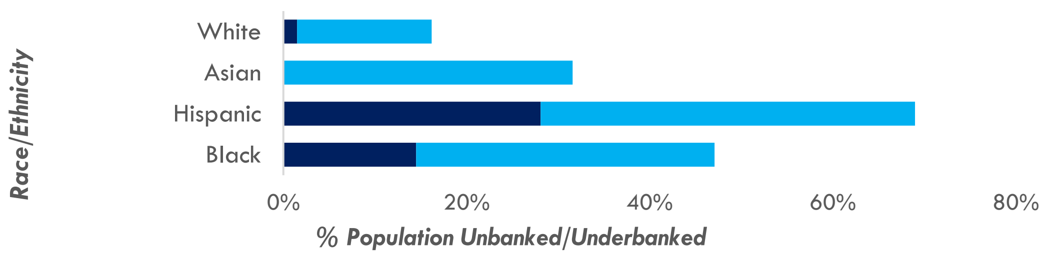
[79] Philadelphia's Poor: Who they are, where they live, and how that's changes, PEW Charitable Trusts

[80] Home Mortgage Disclosure Act Data (2016), Shared Prosperity, The Reinvestment Fund, Reveal

[81] 2.23 times as often as white borrowers. CRA, Lending Practices of Authorized Depositories for the City of Philadelphia (2017)

Figure 14: Access to Banking Services by Income and Race/Ethnicity (Philadelphia MSA)





Source: FDIC (2013-2017 Estimates)

Figure 15: Mortgage Activity & Household Tenure by Census Tract Income (Philadelphia County)

Census Tract Income	% All Loans	Number of Loans	% of Households Who Own Their Home
<50% AMI	**4.90%**	**935**	40%
50-80% AMI	**27.03%**	**5,161**	55%
80-120% AMI	**29.88%**	**5,705**	64%
>120% AMI	**38.19%**	**7,291**	72%

Source: PolicyMap and FFIEC

Residents in less affluent neighborhoods in Philadelphia, and similarly in other cities, are less likely to have convenient access to a commercial bank. More than 30% of low- and moderate-income households in Philadelphia do not have a commercial branch within their neighborhood, while only 7% of affluent households lack access to a convenient branch.[82] Cash checking and storefront payday lenders, however, are widespread, located at stores like Walmart and 7-Eleven, offering convenience and accessibility for individuals living in such "banking deserts."[83]

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[82] 'Branch Deserts' Hurt Key Markets Even in Mobile Banking Era, The Financial Brand (2020)

[83] Financially Underserved Market Size Study, Financial Health Network (2017)