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Pension Funds and Urban Revitalization

New York Case Study: Competitive returns and a revitalized New York

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Abstract. Public pension fund investing in urban revitalization historically has been a contested issue. Opponents argue that public pension monies could be used for risky public purpose, neglecting fiduciary duty for the sake of ancillary social benefits. At the center of the debate is a fear that these investments sacrifice returns for social good and are prone to political interference. We argue the driver of urban investments is the risk-adjusted market-rate return, with the social benefit as a spillover effect. Public pension funds' primary objective, through strategic asset allocation, is to achieve a competitive return for its plan participants and beneficiaries. Market-rate returns in urban investments are achieved through prudent investing across asset classes. Evidence for this argument is derived from the asset allocation policies and targeted investing programs of the New York City and State public retirement systems. The research analyses urban investment strategies that achieve risk-adjusted market-rate returns evaluated against established performance benchmarks.

Keywords. Urban revitalization, risk-adjusted market-rate returns, benchmarks, asset allocation policy.

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Executive Summary

The objective of this study is to show that pension fund targeted investing is based on sound investment practices driven by a market rate of return. The New York case revealed that investments in urban revitalization are made in line with the pension fund's fiduciary guidelines and achieve competitive returns while also revitalizing communities. Key findings include:

- Investments are consistent with sound fiduciary standards and the collateral benefits are considered only after an investment is determined to be financially sound. A reasonable weighting in the portfolio is required and returns must be comparable to non-targeted investment products. The investments are programmatic and call for reporting to and evaluation from the Board of trustees, in an effort to deflect political interference.

- Urban investments consist of traditional investments (real estate & fixed income) and alternative investments (equity real estate, private equity, and venture capital).

- Investments are guided by a strategic asset allocation policy and the prudent person rule. The New York City Retirement case showed that investments were based on a strategic asset allocation policy, calling for 2% of total assets to ETIs that may cross asset classes (fixed income, real estate, and private equity).

- The policy included both a geographic target and a requirement to fill a capital gap in low-income areas of an underserved market. Pension funds provide the finance commitment, without which additional capital would not get placed in the market. Pension fund investments in national funds leverage the fund to make direct investments in New York.

- The economic returns in affordable housing investments consistently outperformed the established benchmark or industry standard—Lehman Aggregate Bond Index. The ten year net return on the New York City Retirement System's forward-rate commitment program yielded 9.33%. In the case of New York State private equity returns were not available given the life of the fund is usually between ten and twelve years.

- Affordable housing investments are often supported by government guarantees (e.g. State of New York Mortgage Agency) yet we also found a nascent initiative to move beyond guarantees and expand into the third generation of economic development investing. We found that a housing finance partner (e.g. Community Preservation Corporation) was essential, offering the local track record and expertise to place the funds and provide a pension fund with the scale needed to participate.

- The challenges include identifying the market opportunities that address a capital gap and sufficient staff resources to implement, develop, and evaluate the program.

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Glossary

AIPs - Alternative Investment Products
BAM - New York City Bureau of Asset Management
CPC - Community Preservation Corporation
CRF - New York State Common Retirement Fund
ETIs - Economically Targeted Investments
ERISA - Employee Retirement Income Security Act
HIT - AFL-CIO Housing Investment Trust
NCCUSL - National Conference of Commissioners on Uniform State Laws
NYCERS - New York City Employees' Retirement System
NYSLRS - New York State and Local Retirement System
PTIs - Politically Targeted Investments
PPAR - Public Private Apartment Rehabilitation Program
SONYMA - State of New York Mortgage Agency
UMPERSA - Uniform Management of Public Employee Retirement Systems Act

1 Introduction

Public sector pension fund investments in urban economic development revitalize neighborhoods through affordable housing, retail, and commercial development. This practice could be described as investing with intent and is not restricted to a single asset class but can be found in private equity, venture capital, real estate, and fixed income products. Such investing in turn creates jobs, housing, and returns property to the tax roles. Innovative pioneers have designed a craft that is now a hot industry with savvy real estate and private equity fund managers competing for deals. Public sector pension funds can have a significant role in urban economic development as they bring projects to scale and provide inner cities with access to capital.

Historically such investments have been referred to as economically targeted investments (ETIs) and are sometimes contested within academic, government, and business circles. The terminology is continually changing and now includes: investments in the emerging domestic markets (EMD)[1], investing in underserved capital markets, and double bottom line investing to name a few.

Community based investing has undergone a paradigm shift over the last three decades. The first generation focused on capital preservation together with collateral benefits with acceptable low rates of return through government guarantees. In the second generation, urban economic development investment is embedded in the rate of return and risk is managed through private partnerships without a reliance on government guarantees. The now emerging third generation of investment projects shows that urban economic development is regarded as an economic opportunity, driven solely by potential rates of return (Clark and Hebb 2004; Daniels and Nixon 2003). Within the second and third generation there has been an increasing awareness of the "opportunity" of investing in the

[1] This term is coined by the Milken Institute, Emerging Domestic Markets research division. The Institute states that the use of Emerging Domestic Markets "refers to people, places or enterprises with growth potential that face capital constraints due to systematic undervaluation as a result of imperfect market information. These markets include ethnic- and women-owned firms, urban and rural communities, companies serving low-to-moderate-income populations, and other small- and medium-sized businesses" (The Milken Institute, "Emerging Domestic Markets," http://www.milkeninstitute.org/research/research.taf?cat=detail&ID=17/).

inner city. There is an emphasis to promote the “locational” advantage of a city and its regional link through “cluster participation”. (Harrison and Glasmeier 1997; Porter 2000).

The current debate surrounding pension funds and inner city revitalization concerns the fear that these investments sacrifice the market rate of return for the sake of social benefit. These investments are often criticized because politicians can promote the social returns for their own political gain. Investments in urban economic development can then be perceived solely as a social investment and not driven by the economic returns. Critics view this type of investing as social activism with the pension fund’s fiduciary duty taking a secondary role. Such ETIs have been referred to as “Politically Targeted Investments (PTIs)” and have instigated spirited discussion (Clark 2000).

We argue that urban investments by public pension funds are driven by risk-adjusted market rates of return given the fund’s fiduciary duty and the prudent person rule, with collateral returns as a secondary benefit. The evidence behind the argument is set out in the following paper through a case study of the New York City and State retirement systems. These systems invest in assets that are in fact not so alternative. They can often align more with conventional products than perceived by those opposed to targeted investments and taking on seeming excessive risk.

Within the theoretical framework of the modern portfolio theory, investment officers broadly allocate investments across asset classes (Clark 2000; Fabozzi and Modigliani 1992). Markowitz (1952) discusses portfolio diversification and the concept that the investor can maximize expected return by increasing variance. Investors seek to optimize their portfolio by minimizing risk and striving for the highest possible return through portfolio diversification. In this process the investor seeks to construct an “efficient frontier” that offers the maximum possible expected return for a given level of risk. Appendix figure 8.1 (Efficient Frontier) graphically depicts the risk/reward relationship and where an optimal portfolio lies on the curve.

The research examines specific projects that fall within the asset class of alternative investments (equity real estate, venture capital, and private equity) as well as conventional investments such as fixed income and core real estate. In examining the deal structure, the pension fund partner or investment vehicle returns are highlighted. Through the case study these vehicles are explained in the context of how returns drive the investment process. Research shows that the New York investments have characteristics of both the second and third generation, yet are always driven by the internal rate of return through a strategic asset allocation policy.

The paper is laid out in the following manner: section two discusses the legal debate surrounding ETIs, then section three moves to an analysis of the importance of strategic asset allocation and the types of investments in urban economic development. Section four describes the projects and investments made by the New York City and State pension funds. Section five looks at the economic returns against established benchmarks. In section six we make some conclusions and present ideas for further research.

2 Economically targeted investment

Private pension funds are governed by the federal law of the Employee Retirement Income Security Act of 1974 (ERISA). State and local retirement systems are exempt from ERISA and governed by state laws that vary considerably in each state. While ERISA covers only private pension funds, many states cite ERISA standards and it is worthwhile to mention ERISA's treatment of ETIs as a transferable legal framework. There has been substantial discussion regarding ETIs and pension fund fiduciary duty under ERISA through interpretive bulletins issued by the Department of Labor beginning in 1994. In a recently revised Interpretive Bulletin (2004) under ERISA the bulletin sets out that:

> The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally. Therefore if the above requirements are met […giving appropriate consideration to the role that the investment or investment course of action plays (in terms of such factors as diversification, liquidity and risk/return characteristics) with respect to that portion of the plan's investment portfolio within the scope of the fiduciary's responsibility.], the selection of an ETI, or the engaging in an investment course of action intended to

> result in the selection of ETIs, will not violate section 404 (a) (1) (A) and (B) and the exclusive purpose requirements of section 403 (Sec. 2509. 94-1 Interpretive bulletin relating to the fiduciary standard under ERISA in considering economically targeted investments).

In essence, private pension funds may pursue ETIs as long as they meet standard prudent investment guidelines and seek appropriate risk/return characteristics.

For public sector pension funds, state laws mandate the types of investments the funds can make and are subject to the prudent person rule (Romano 1993; Gordon 1987). States may also have "legal list" statutes that detail the types of investments allowed. These lists can have percentage limits on the amount invested in equities or stock of any single firm. Some states combine both legal lists and the prudent person approach, while others do away with legal lists and replace them with the "more flexible prudent person fiduciary standard" (Romano 1993, 800). In 1997 the Uniform Management of Public Employee Retirement Systems Act (UMPERSA) was approved by the National Conference of Commissioners on Uniform State Laws (NCCUSL) to address the need for a state law governing public pension funds. In brief, UMPERSA protects benefits of public retirement systems, provides clarification and uniformity on rules governing the management of public retirement systems, and facilitates monitoring of systems through disclosure requirements. UMPERSA follows prudent investment rules, promoting the modern portfolio theory and diversification as a means to reduce risk (National Conference of Commissioners on Uniform State Laws 2002).

Though UMPERSA was approved, states have not been quick to adopt the Act. During the economic boom of the 1990s states overlooked the need to adopt legal measures. However the corporate misconduct evidenced by Enron and others created a need for legislative intervention. Wyoming became the first state to adopt UMPERSA in February 2005, introduced as HB 155, and signed into law by Wyoming Governor Dave

Freudenthal, as Chapter No. 119, Session Laws of Wyoming. The law goes into effect on July 1, 2006. UMPERSA has also been introduced in 2005 in the state of Maryland.[2]

Academic debate surrounding ETIs deals with failed and possibly politically motivated investments. At the center of the debate are well publicized investment failures. In these cases, the driver of the investments has been the social benefits with the market rates of return secondary. These investments can fall within the first and sometimes the second generation of investments and differ from the emerging third generation. In the case of the third generation, the market-based investments are driven first by the rate of return.

Romano (1993) cites several examples of failed social investments and notes pressures placed on funds to engage in social investing, arguing that pension funds with more "politicized board structures" do not perform as well as those with more independent boards. There is literature from government reports (GAO Report to Joint Economic Committee on Pension Plans 1998) as well as independent studies (Hoffer 2004; Kaplan and Zelermyer 1999; Mitchell 1998; Moore 2005; Trimble and Nofsinger 1994) that cite failed or politically motivated investments. Many of these investments were made in the 1980s and were part of the first generation of urban investments. A sampling of these cited investments include: the Pennsylvania state employees' and public school employees $70 million investment in an in-state Volkswagen plant in the early 1980s, Alaska public employees' and teachers' retirement systems $165 million loan (35% of total assets) for in-state mortgages in 1980, Kansas Public Employees Retirement System investment in direct placements in various local businesses (steel mill, Tallgrass Technologies, and a Kansas-based Home Savings Association), and Connecticut pension fund $25 million (47% stake in the company) investment in a distressed local firm (Colt Firearms of Colt Industries) in 1990.

These cases have garnered attention and are often the center of political debates. ETIs have been mistakenly viewed as illegal, concessionary, and prone to politics (Zanglein

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[2] National Conference of Commissioners on Uniform State Laws, "Wyoming enacts important state law on managing public employee retirement systems," press release, March 18, 2005.

2001). We argue that such investments are legal, programmatic (to insulate trustee members from political pressures), and governed by a prudent asset allocation policy.

As is often the case, headlines of failed investments raising legal questions often supercede the best practices and success stories. There will always be political contention among Democrats and Republicans on the use of public pension fund monies for in-state economic development. The challenge is to show the evidence and rationale for successful investments in line with pension fund best practices—strategic asset allocation policy. Hebb points out (2001,11), "For any ETI to be judged "more equal" than the next available investment opportunity, it must deliver a market rate of return with appropriate risk characteristics and be fully compatible with the fund's investment plan." In an effort to move beyond the rhetoric of failed ETIs and regain the legitimacy of urban investments, data must show that practices follow the prudent investor rule. These failed investments indicate that standard investment rules were not always practiced. The following sections will present the case that successful urban investments are not politically motivated but follow prudent asset allocation policies.

3 Strategic asset allocation

Targeted investing is not about forsaking investment returns for the sake of social good but rather involves sound investment policy decisions. In making the case for such investments it is important to deconstruct the types of assets in urban economic development and how they help diversify risk through a strategic asset allocation policy.

3.1 Asset allocation

The fund's asset allocation policy is the most important investment decision governing the fund's ability to reduce risk. Ambachtsheer and Ezra (1998) note that asset allocation policy is the key investment decision and that the long-term asset allocation policy, "…represents the trade-off between seeking opportunity and seeking safety that feels most comfortable to decision makers, given the characteristics of their liabilities, what they hope to achieve, and the state of the capital markets". In order to achieve the fund's objectives it can be looked at in terms of: 1) the legal perspective—knowing the status of the fund and its benefit and 2) the financial perspective—the focus on the fund's investment returns (p.45).

In the case of urban investments the rules are the same, achieving the fund's objectives from the legal and financial perspective. A well diversified portfolio is made up of a spectrum of asset classes as a means of spreading risk across classes. A fund's asset allocation policy is the targeted percentage of funds to be invested in an asset class as a percentage of total assets, and is assessed by the actual investment mix. In the case of the New York City Employees' Retirement System (NYCERS) the investment philosophy incorporates a long-term investment focus through:

> …a policy of rebalancing assets to policy weights on a regular basis. Although the Board reviews performance of the Fund, and of individual Managers, on a quarterly basis, and compares them to established benchmarks, the Board establishes long-term strategy through asset allocation studies conducted at least every five years (or more frequently if the Board deems appropriate) (NYCERS Investment Policy Statement (IPS) 2004, 7).

NYCERS board conducts an asset allocation review working with the Bureau of Asset Management (BAM) and NYCERS' general consultant. The Investment Policy Statement (IPS) reflects on the asset allocation decision-making process such that, "The Board establishes an asset allocation based on the analyses and recommendations of BAM and the Consultant (in particular, on a mean-variance optimization model) and on the input provided by the Actuary" (NYCERS IPS 2004, 7). Table 3-1 shows the adopted long term strategic allocation policy, the interim allocation, and the rebalancing range (needed to ensure NYCERS actual investment mix stays consistent with its asset allocation policy). The Board reviews the asset mix on a quarterly basis and BAM implements the Board's rebalancing policy. While ETIs is not an asset class, the program's possible investments in different asset classes (fixed income, private equity or real estate) incorporate the Board's long-term strategic asset allocation policy. NYCERS ETI policy calls for 2% of total assets (approximately $855 million) for investments in low-moderate income areas in the five boroughs of New York (NYCERS ETI Policy 2004) to date the majority of these investments fall within fixed income securities, "Core+5 Fixed Income" detailed in Table 3-1. The recently revised ETI Policy (2005, 2) states, "The System will seek to achieve a target allocation of 2% of assets to ETIs, by setting a target of 6% for the fixed-income asset class and a target of 2% for the private equity and real estate asset classes respectively."

Table 1 NYCERS asset allocation policy

Investment	June 2003 Adopted Long Term Strategic Asset Allocation	November 2004 Interim Allocation	Rebalancing Range
Equity Securities			
Domestic Equity	41%	54%	+/-4
Non-U.S. Equity	15	15	+/-2
Emerging Markets Equity	3		+/-1
Private Equity	5	1	
Equity Real Estate	6		
Total Equity	**70%**	**70%**	**+/-5**
Fixed Income Securities			
Core+5 Fixed-Income	22%	25%	+/-4
Enhanced Yield	5	5	+/-1
TIPS	3		+/- ½%
Total Fixed Income	**30%**	**30%**	**+/-5%**

Source: NYCERS Investment Policy Statement 2004, 7.

The asset allocation policy is so central to the investment strategy process that pension funds engage consultants to provide advice on the asset mix as well as counsel in their selection of an investment advisor (investment management firms)[3]. Asset allocation is a responsibility of the pension plans' Board of Trustees. They hire consultants to assist them and their staff in this function. An example is Pension Consulting Alliance, Inc. (PCA), a company that offers insight to pension plans on their asset allocation policy. A PCA research brief summarized the findings of 15 pension funds and trends in their strategic portfolio structure. The research highlights how plan sponsors need to continually evaluate their asset allocations and delete or add asset classes to the mix. PCA identifies the challenge posed to pension funds in reaching the optimal number of asset classes that:

(i) offers a high likelihood of producing attractive risk-adjusted return benefits and
(ii) is not too burdensome in terms of complexity and actually putting the investment structure in place (Pension Consulting Alliance 2002, 2).

[3] There is a wide range of terminology for the different players in the investment universe. With reference to the players in institutional real estate, which we would argue can be used for other sub-groups of investment, Kaiser defines (2005, 17), "(1) the investors, which include public and private pension plan "sponsors", endowment funds and foundations; (2) the investment management firms, referred to as "advisors"; and (3) the "consultants" who advise the sponsors [pension plans] on asset allocation issues, portfolio strategy, and coordinate the search and selection of advisors. General consultants typically advise on all asset classes in the client's fund, while real estate specialty consultants focus only on the real estate portion."

The survey showed that the ideal number of asset classes for strategic asset allocation purposes ranged between four and eight. The research further reflected that to navigate the complexity of the Fund's most important investment decision it is preferable to keep the number of asset classes at a manageable level. The PCA research notes the importance of these findings given that with the latest investment product innovations the industry is continually introducing new asset classes and/or asking plan sponsors to "slice-and-dice" their portfolios.

While outside consultants are retained to assist the Board in the pension plan's portfolio strategy, ultimately the Board of Trustees takes the deciding role in determining the Plan's investment objectives. As Litvak (1981) emphasizes in a discussion of asset types and investment strategies, trustees are not only committed to diversification of investment vehicles but also to take on an active management policy for a portion of the portfolio. "There is a continuum of portfolio management strategies ranging from 'passive' at one extreme to 'active' at the other" (p. 132). There are some very efficient sectors of the capital market with inactive board management while similar examples can be found with active board management. Litvak notes, "Combining a core passive portfolio with active peripheral holdings is quite consistent with what a pension portfolio with *development-oriented investment* [emphasis added] might look like" (p. 133). Whether actively or passively managed, the Board responsibility is to identify the best mix of assets to meet liabilities while also controlling risk. An asset mix encompasses both conventional and traditional investment products that can involve *development-oriented* investments.

3.2 Conventional investment products

Conventional investments, either through fixed income or real estate asset classes, are one form of urban economic development. The New York City and State retirement systems spread their urban investments across both asset classes. In the case of real estate investments, a pension fund will either allocate the assets to their traditional real estate portfolio or as part of alternative assets (private equity real estate). "Core", "Value-added", and "Opportunistic" are the basic "style box" definitions for investment possibilities in real estate. Kaiser (2005, 6) articulates what has emerged as a "fuzzy consensus" around the terms:

> Core…has traditionally involved investments in generally fully leased, multi-tenant properties more than $5 million in size, in major metropolitan areas, owned with little or no mortgage debt.
>
> Value-added approaches generally involve relatively substantial redevelopment or leasing of a property to increase its potential value at a rate in excess of general market trends.
>
> Opportunistic originally involved the purchase of distressed properties at rock-bottom prices and their redevelopment, but has evolved to other aggressive forms of investing such as new property development and heavily leveraged property ownership.

The New York investments will provide examples of the above styles together with a discussion of their investment return objectives against established benchmarks.

Within conventional investment products, urban economic development can also take the form of fixed income affordable housing products that include: commitments for long-term permanent financing (at the start of the construction phase), mortgage backed securities, and short-term construction loans. These investment products are often backed by a state mortgage insurance agency as detailed in section 4.1.

The economic development impact through conventional real estate and fixed income investments is substantial, yet it is often not the first investment style thought of when referring to pension funds and urban revitalization. The more recognized products in this arena are known as alternative assets and encompass various investments that can offer higher risk and return rewards.

3.3 Alternative investment products

Alternative investment products (AIPs) have captured the attention of institutional investors. These investments make a significant impact in urban economic development through the different asset classes. Alternatives used in urban revitalization usually fall within the following categories: 1. equity real estate[4] 2. private equity (business expansion and special situation funds that invest in specific industries) and 3. venture

[4] While establishing a common language in the real estate industry has been a challenge, the investment styles or themes for investing private equity real estate include: core (low risk/low return), value-added (moderate risk/higher returns) and opportunistic (high risk/high return). J. Baczewski, K. Hands and C.R. Lathem, "Real Estate Investment Styles: Trends from the Catwalk" (white paper, NCREIF, 2003).

capital (new business development). These investments impact urban revitalization through residential and commercial development and business job growth.

Today both private and public sector pension funds are very much into ‘alternatives’. According to data from Greenwich Associates Inc.’s annual survey (Pensions & Investments, April 4, 2005), U.S. institutional investors allocated close to $500 billion to alternatives in the year ended June 30, 2004. Pensions & Investments highlighted the top 50 pension investors in alternative assets as illustrated in appendix table 8-2 (Pension funds in alternative assets). We find the top three institutional investors are public pension funds (CalPERS, CalSTRS and New York State Common) followed by a mix of both public and private funds. While a portion of alternatives are in hedge funds, the table shows the bulk is in equity real estate and private equity. Also noteworthy is that as a percentage of total assets the average total alternative asset allocation is 11.8%.

The trend of institutional investors towards alternative assets continues to grow. AIPs are regarded as an investment opportunity as Clark (2000, 258) points out:

> Perhaps the crucial difference between ETIs and AIPs is the fact that AIPs are chosen for their contribution to a portfolio of investments, irrespective of their contribution to other social or community objectives like long-term economic development and the growth of tax revenue. In this respect, urban and regional development may be thought of as an investment opportunity, just as other investment products compete for assets.

The use of the words ‘investment opportunity’ is significant as it characterizes the third generation of investments in urban economic development. This third generation is guided by a strategic asset allocation policy. Pension funds engage in urban investments as they offer needed diversification as part of their overall asset allocation policy. The following section will detail specific New York projects that support the argument for successful urban investments based on a sound asset allocation policy and market rate returns.

4 Revitalizing New York City and State

The New York case illustrates local economic development projects (through alternative assets, real estate and fixed income assets) and identifies the achieved market-rate risk-adjusted returns against an established benchmark. The material is drawn from semi-structured interviews and pension fund internal documentation from the New York City and State retirement systems.

In the case of New York City the work focuses on the New York City Retirement System (NYCERS) being the largest of the five pension systems within New York City, with total assets of $42.7 billion as of June 30, 2004 and total investments at fair value at $41.1 billion (NYCERS Comprehensive Annual Financial Report 2004).[5] NYCERS has grown into the largest retirement system within New York City with over 200,000 active members, approximately 120,000 retirees and beneficiaries and about 7,000 terminated vested members who are not yet receiving benefits. NYCERS is a defined benefit retirement plan and the amount received at retirement is defined by law and is generally based on a member's years of service, age, and highest compensation. The New York City Comptroller is the custodian and investment advisor to NYCERS and its operating arm is the New York City Bureau of Asset Management (BAM). The system is governed by an 11 member Board of Trustees with an Executive Director (New York City Retirement System).

The New York State and Local Retirement Systems (NYSLRS) covers two different systems, the Employees' Retirement System (ERS) and the Police and Fire Retirement System (PFRS) with a total overall membership of more than 970,000. This figure includes 641,721 members and 328,357 retirees and beneficiaries (of which *78% remain New York State residents*). ERS and PFRS provide coverage in the form of service retirement, disability, and death benefits to police, firefighters, and uniformed services personnel. Total assets under management are $134.4 billion (second largest public

[5] NYCERS covers all city service employees not eligible in the other four New York City plans: New York City Board of Education Retirement System (BERS), New York City Fire Department Pension Fund (FIRE), New York City Police Pension Fund (POLICE), and New York City Teachers' Retirement System (TRS) www.nyc.gov (accessed May 2, 2005). Collective assets of the five pension funds total $88,676 million as of December 31, 2004 (NYSLRS Annual Report 2004).

pension fund in the United States) and total investments of $119.2 billion as of March 31, 2004. Comptroller Alan G. Hevesi is the sole trustee and steward of the Common Retirement Fund (CRF) and advised by a 23 member advisory council (NYSLRS Annual Report 2004).

4.1 Expanding affordable housing

NYCERS has taken an active role in financing housing stock in New York City, primarily through fixed income products. The initiative is part of the ETI program adopted by the Board of Trustees in April, 1982. The resolution adopted states:

> …WHEREAS, to the extent such targeted investment program is successful it can reasonably be expected to contribute further to the security of retirement income through its impact on economic activity in New York City… (NYCERS 1982)

The program spurs economic activity and finances affordable housing through agreements with private lenders and housing partners[6]. The pension fund makes a capital commitment without which additional capital from private lenders would not get placed in the market. The program buys loans for the renovation and/or construction of affordable housing and retail spaces in low-moderate income areas throughout the five boroughs of New York City. City residents can benefit from increased access to housing and the economic impact of new construction jobs. The majority of NYCERS employees are required to live within the City limits (Manhattan, Brooklyn, Bronx, Queens, and Staten Island). Civic employees also benefit by living near their place of work where affordable housing is at a premium. Therefore targeted investing benefits the city in which beneficiaries both live and work.

The Public-Private Apartment Rehabilitation (PPAR) Program is NYCERS largest active program. As of March 2005 the program (for both of its lenders—J.P. Morgan Chase & the Community Preservation Corporation) has financed 11,012 affordable apartments (cost of $208 million) and committed to an additional 3,073 units (cost of $123 million). The majority of the financing (30 year fixed-rate mortgages) are 100% guaranteed by the

[6] Private lenders and affordable housing partners include, among others, the Community Preservation Corporation (CPC), J.P. Morgan Chase, Bank of America, NYC Department of Housing Preservation and Development, Neighborhood Housing Services of New York City, the New York State Housing Finance Agency, and the New York State Division of Housing and Community Renewal.

State of New York Mortgage Agency (SONYMA) or the New York City Residential Mortgage Insurance Corporation (REMIC). The program is part of NYCERS' ETI program that seeks to achieve a target allocation of 2% of assets to ETIs that may cross several asset classes. NYCERS recently approved 2005 ETI policy seeks to move beyond guarantees and expand into private equity and real estate (K. Martino, pers. comm.).

Within the PPAR program NYCERS makes forward-rate commitments (commits to buy a loan up to 24 months at a long-term lock-in interest rate) to the originator, a private lender such as the Community Preservation Corporation (CPC)[7]. CPC then has the certainty to make the construction loan as the guaranteed take-out financing is in place, and after construction CPC converts the loan to permanent financing and sells it at par to NYCERS. CPC is the entity that has the track record and understands the neighborhood, developers, rent regulations and operating costs of the project. NYCERS makes the commitment subject to the State of New York Mortgage Agency (SONYMA) committing to insure the loan (ratings: Aa1 Moody's, AA- Fitch), see appendix 8.2 (SONYMA guarantee) for a detailed background on the Agency and its Mortgage Insurance Fund. SONYMA will declare the 100% insurance effective when the project is complete, "certificate of occupancy" is in place and the minimum "rental achievement level" has been met (M. Friedman, pers. comm.). Appendix figure 8-2 (Public-private partnership) illustrates the process and financing partners of the NYCERS PPAR program. In this model pension funds are able to commit the long-term permanent financing needed at the start of the construction phase and stimulate other banks and private mortgage lenders to make short-term construction loans. Appendix figure 8.3 (NYCERS-Harlem project) illustrates a NYCERS financed mixed-use building in Harlem with commercial space on the first floor and affordable housing above.

[7] CPC is a private, not-for-profit, mortgage lender specializing in financing low-moderate income housing throughout New York and New Jersey. Established in 1974, CPC is sponsored by banks, insurance companies, pension funds, and Freddie Mac and Fannie Mae. The Community Preservation, http://www.communityp.com.

Another similar pension fund leveraged loan is NYCERS investment in the Cathedral Parkway Towers building of the Mitchell-Lama Program[8]. NYCERS, the Teachers' Retirement System, and the NY Police Fund made a $35 million commitment to provide the permanent take-out financing for a construction loan provided by CPC. The loan (100% guaranteed by SONYMA) was used to repair the deteriorating outer brick walls of the two-tower complex, a 309 unit building on Cathedral Parkway in upper Manhattan. In June 2005 the pension funds celebrated the completion of the apartment complex rehabilitation.[9] In this example, buildings were rehabilitated that would have been neglected if not for the pension funds' commitment to provide the permanent long-term mortgages. The loan was contingent on the buildings remaining in the Mitchell-Lama affordable housing program, 90% of the tenants of the Cathedral Parkway Towers qualify for Section 8 housing[10] (J. Greene, pers. comm.).

Similarly the New York State Common Retirement Fund (CRF) purchases permanent mortgages for multi-family housing, revitalization of deteriorated or obsolete housing units, and special housing for senior citizens. As of 2004 CRF increased its program to purchase mortgages from CPC from $300 million to $400 million. Since the inception of the program in 1991, 5,876 units have been completed with 3,054 in the works. To date, the Fund has invested $175 million in mortgages and committed an additional $150 million to the CPC program (NYSLRS Comprehensive Annual Financial Report 2004, 49).

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[8] Mitchell Lama affordable housing program was created in 1955 for the purpose of building affordable housing for middle-income residents. The program was created through legislation sponsored by former Manhattan State Senator MacNeil Mitchell and former Brooklyn Assemblyman Alfred Lama. (NY State Division of Housing and Community Renewal, http://www.dhcr.state.ny.us/ohm/progs/mitchlam/ohmprgmi.htm).

[9] New York City Comptroller's Office, "Pension funds celebrate renaissance of cathedral parkway towers," press release, June 23, 2005.

[10] Section 8 housing vouchers is a program of the U.S. Department of Housing and Urban Development that subsidizes low-income families and individuals with housing vouchers to be able to purchase or lease decent and affordable housing in the private market (Knowledgeplex, http://www.knowledgeplex.org).

Another way for pension funds to expand affordable housing is through investments in mortgage related products. NYCERS invests (owns shares) in the AFL-CIO Housing Investment Trust (HIT, $3.6 billion union pension)[11] that in turn primarily invests in mortgage-backed securities. As of March 31, 2005 New York City's four pension funds total investment in HIT is $146.6 million, with NYCERS investment of $54.3 million. While HIT is a national Fund, the systems investment in HIT helped leverage a HIT direct investment in New York City. As a condition for the funds, HIT committed to invest $500 million directly to the City in affordable housing over a period of five years (NYC Bureau of Asset Management).[12] Part of the trust's aim is to increase the supply of affordable housing for working families in the United States. The portfolio strategy has an overweight in multifamily mortgage backed securities that are agency-insured or guaranteed by government sponsored enterprises (AFL-CIO Housing Investment Trust Annual Report 2004).

CRF similarly provided affordable housing opportunities for more than 62,300 New York State residents through the mortgage pass-through program. Since 1981 the Fund has purchased close to $6.6 billion in New York State mortgages backed by Fannie Mae and Freddie Mac. (NYSLRS Comprehensive Annual Financial Report, 49).

4.2 Acquiring commercial real estate

Real estate investments have become increasingly attractive to institutional investors. Investments are made through core, value-added and opportunistic real estate throughout the five boroughs of New York. Pension funds are engaged as these investments stimulate the local economy (through releasing, repositioning, and upgrading of property) while providing for portfolio diversification and competitive returns.

[11] AFL-CIO Housing Investment Trust finances the development of multi- and single family residential real estate projects through the purchase of mortgage backed securities. Fannie Mae serves as a secondary market intermediary to package the loans into investment-grade securities that the Trust can buy (AFL-CIO Housing Investment Trust, http://www.hithome.org). HIT HOME initiative has been active in New York City as part of the Trust's New York City Community Investment Initiative with 460 participants in 2004 being New York City union or municipal employees (AFL-CIO Housing Investment Trust Annual Report 2004).

[12] New York City Comptroller's Office, "New York City pension systems invest $135 million in AFL-CIO Housing Investment Trust," press release, October 7, 2002.

NYCERS announced in 2003 that it would invest up to $100 million through Tishman Speyer/Travelers NYC Real Estate Venture V, LP[13]. The Fund focuses on value-added acquisitions. Based on NYCERS $100 million commitment, the Fund will commit $50 million to New York City projects.[14] Other real estate projects include a joint venture with Tishman Speyer Properties to acquire the MetLife building. In a real estate article Michael Stoler (New York Sun, April 14, 2005) mentions NYCERS and the Teachers' Retirement System contract to pay $1.72 billion to Metlife for the 58-story MetLife Building in Manhattan. These current real estate investments are not considered part of NYCERS ETI program. However NYCERS ETI strategic policy is to now expand into real estate and private equity (K. Martino, pers. comm.).

In December 2003 CRF invested $25 million of equity financing in the first phase of the mixed-use apartment building 'Avalon Chrystie Place' on Manhattan's lower east side (East Houston Street, between Chrystie and Bowery), the first of a four-building complex[15]. The building includes 360 rental apartments (80% market-rate and 20% low-income housing – families earning 50% or less of the area median income) commercial retail space including a Whole Foods supermarket and community center. University Settlement and the YMCA of Greater New York will jointly own and operate the community center. Phipps Houses Group, an established not-for-profit housing developer in New York City will develop one of the four buildings. The entire four-building complex will include 178 apartments for low-income households[16].

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[13] The "US Fund V" is a closed end fund with approximately $300 million in equity commitments. Its strategy is "value-added" with a primary focus on office buildings located in a select number of first-tier urban Central Business Districts in U.S. metropolitan target markets. As of June 30, 2004, the Fund had made 11 investments. Tishman Speyer, www.tishmanspyer.com/fundmanagement/funds.

[14] New York City Comptroller's Office, "New York City pension fund to invest $100 million in commercial space," press release, October 17, 2003.

[15] The Fund was advised in the transaction by JPMorgan Fleming. The developer, Chrystie Ventures LLC, lead by AvalonBay Communities, Inc. is a publicly traded national real estate investment trust, and providing over $6 million of equity. The New York State Housing Finance Agency will lend $117 million that comes from the sale of tax-exempt bonds. The City received $13.5 million from AvalonBay Communities Inc. for the land.

[16] New York City Department of Housing Preservation and Development, "$150 million building to bring jobs, rental apartments, stores and a new community center to Manhattan's Cooper Square," press release, February 23, 2004.

CRF and the five city retirement systems are also diversifying into real estate as Stoler points out (The New York Sun, April 21, 2005) through the New York City Investment Fund LP[17]. The City Investment Fund was established in 2004 to pursue value-added and opportunistic real estate investments within the five boroughs.

4.3 Growing businesses

Thus far the discussion has focused on urban investments through fixed income and real estate assets. Private equity is an asset class that can provide high returns that come with increased risk and volatility. Pension funds are involved in private equity given their ability to invest for the long-term and simultaneously address capital needs overlooked by the traditional market.

While Comptroller of NYC (1993 – 2001) Alan Hevesi promoted investing in urban economic development throughout the five boroughs. Now in his capacity as New York State Comptroller (2002 – present) and sole trustee of the Common Retirement Fund (CRF), he continues to advance a similar model for in-state investing for the state of New York. CRF has seen the potential in funding businesses both upstate (Buffalo, Rochester, and the Capital Region) and downstate (New York City, Long Island and Westchester). Private equity investments make up the majority of their alternative investments and generally invest in partnerships that are not publicly traded. CRF looks for private equity investors to partner with and be long term sources of investment capital in the State. The in-state private equity program was created in November 1999 in response to the Jobs 2000 Act adopted in August 1999. The legislation recognized that CRF is first guided by their fiduciary responsibility and the prudent person principle. After the close of fiscal year 2003-2004, NYSLRS commitment under the program totaled $298 million, surpassing the legislature's target of $250 million (NYSLRS Comprehensive Annual Financial Report 2004, 51). Table 4-1 captures some of the investments and their location.

[17] The City Investment Fund is an investment vehicle designed to pursue opportunistic real estate investment activities exclusively within the five boroughs of the City of New York. The Fund is co-sponsored by Fisher Brothers and the Morgan Stanley Real Estate Fund IV, LP, an affiliate of Morgan Stanley & Co. (collectively, the "Sponsors"). The Fund is structured as a limited partnership and is managed by City Investment Management Co., L.L.C. (the "Management Company") (The City Investment Fund, www.cityinvfund.com).

Table 2 Companies in NYSLRS private equity portfolio

Company	Location
The NewsMarket	New York City
Concentrix	Pittsford
Latham International	Latham
Reichert	Buffalo
Q-RNA	New York City
Acorda Therapeutics	Hawthorne

Source: NYSLRS Comprehensive Annual Financial Report 2004, 50.

CRF's both private equity and real estate opportunity portfolio includes investments in 198 New York businesses with a value of $502 million. This amount represents only the Fund's share of these investments; the total value of New York companies held by the Fund's partnerships was $5.7 billion as of December 31, 2003 (NYSLRS Comprehensive Annual Financial Report 2004, 50-51).

The above sections have provided a sampling of the economic development projects pension funds are engaged in through conventional or alternative investment products. It is worth noting that pension funds currently involved in such urban investments are not questioning whether to continue this strategy but rather how to broaden their program. In the case of NYCERS the trustees often struggle with how to expand their ETI program and the number of deals through fixed income and private equity asset classes (M. Musuraca, pers. comm.).

5 The myth of low returns

As a pension fund's primary aim is to meet their fiduciary duty, investments in either conventional or alternative assets through a strategic asset allocation policy are driven by risk-adjusted market-rate returns. In order for a retirement system to grow its assets and meet its liabilities the fund must achieve a competitive return set against an established benchmark. In the case of public pension funds (versus other institutional investors engaged in community investing—banks with CRA obligations, insurance companies, and foundations) the collateral benefits come secondary to the returns. The aim of this section is to analyze the economic returns, which are the pension fund's first objective.

It is important to address how the returns are measured and against what benchmarks. The English Dictionary defines a benchmark as "a standard against which something can be measured or assessed". Indices are benchmarks that fund managers use to compare themselves against the industry standard. They provide a measurement of performance relative to investments with similar degrees of risk and liquidity. Table 5-1 lists some of the most popular benchmarks and what they measure:

Table 3 Investment benchmarks

Benchmark[18]	Measures
Dow Jones Industrial Average	30 largest cap stocks
S&P 500	500 of the approx. 7,000 publicly traded stocks in the U.S.
Nasdaq Composite	value-weighted listing of nearly 5,000 stocks
Russell 2000	tracks 2,000 smaller company stocks
Wilshire 5000	all publicly traded stocks in the U.S.
Lehman Brothers Aggregate Bond Index	gov't and investment grade corp. bonds-maturities of one to ten years
MSCI-EAFE	Morgan Stanley Capital Int'l-Europe – approx. 1,000 of largest stocks in Europe & Pacific Basin
Solomon Brothers	World Bond Index (tracks fixed income investments)
NCREIF Property Index (NPI)	maintained by National Council of Real Estate Fiduciaries (NCREIF) measures historical performance of income-producing properties

Some indices such as the S&P 500 are value-weighted since the large cap companies have a bigger impact on the index return than small cap companies. These indices often do not have a third party monitor but have a long track record. They are continually used for statistical measuring, not selling, and as such tend to be self-regulated. In the case of public pension funds and urban investments, advisors choose an index according to their own methodology. The asset classes of fixed income, real estate and alternatives have different benchmarks and are included in Table 5-1.

In the case of the NYCERS CPC portion of the PPAR program described in section four (i.e. Cathedral Parkway Towers forward-rate commitment) the benchmark used is the Lehman Brothers Aggregate Bond Index (the "Aggregate"). While these forward-rate commitments are fully insured by SONYMA (see appendix 8.2, SONYMA guarantee) they are measured against the Aggregate. The Aggregate is an unmanaged independent third party benchmark that does not reflect fees, for comparison purposes the NYCERS

[18] TurnKey Financial Systems, "Choosing the Right Investment Benchmarks," http://www.turnkeyfs.com/library/art0402b.htm.
Russell, http://www.russell.com/us/glossary/indexes/ncreif_classic_property_index.htm.

returns listed in Table 5-2 is net of any fees. The benchmark covers U.S. securities including government securities, mortgage-backed securities, asset-backed securities and corporate securities (Investopedia.com). Since inception (11/30/84) NYCERS investment in the CPC portion of the PPAR program has yielded a net rate of return of 10.85% (K. Martino, pers. comm.). Net returns in Table 5-2 illustrate that the program has consistently outperformed the benchmark. In the case of the AFL-CIO Housing Investment Trust, the Trust also uses the Aggregate as their benchmark and has outperformed it for the time period shown (except for the year ending 12/31/04).

Table 4 NYCERS net returns on housing investment products

Time Period	Net return CPC portion of PPAR Program	Benchmark Lehman Brothers Aggregate	Net return AFL-CIO HIT Fund	Benchmark Lehman Brothers Aggregate
Year ended 12/31/04	**6.24%**	**4.34%**	**4.20%**	**4.34%**
Three year	**N/A**	**6.19%**	**6.48%**	**6.19%**
Five year	**8.19%**	**7.71%**	**7.97%**	**7.71%**
Ten year	**9.33%**	**7.72%**	**8.20%**	**7.72%**

Source: NYC Comptroller's Office (K. Martino, pers. comm.). AFL-CIO HIT 2004 Annual Report, 3.

In the case of New York State, NYSLRS real estate portfolio for fiscal year 2003-2004 provided a total return of 26.04 percent and continues to enhance overall investment returns, while providing a level of diversification to equity investments (NYSLRS Annual Report 2004). Returns on private equity investments are more difficult to measure as the life of the fund is usually between ten and twelve years. Funds are invested over a five or six year "investment period" then during the remaining five to six years of the fund's term the general partner focuses on selling the investments (New York State Common Retirement Fund In-State Private Equity Investment Program 2004). As the in-state private equity investing program began in 1999 it is too early to measure the performance results. Private equity is higher risk and thus has higher potential returns. Venture capital invests in start-ups and companies at the early stage of development. Such investments are the riskiest with the greatest return potential. An example from the Common Retirement Fund's core portfolio is a "$53.7 million investment made by Warburg Pincus in BEA Systems; since 1995, BEA Systems has generated $6.8 billion in returns, a multiple of 126 times cost (CRF's share is 6.2 percent)" (Office of the New York State Comptroller In-State Private Equity Program 2004, 8).

6 Conclusion

The objective of this study was to show that pension fund targeted investing is based on sound investment practices driven by market-rate returns. The discussion started with the debate surrounding ETIs then moved to the importance of a strategic asset allocation policy in making urban investments, and finally the actual projects and their economic returns.

We found that public pension fund investing in urban revitalization is guided by a strategic asset allocation policy and competitive returns, with the social benefits being secondary. Investments in urban economic development include traditional investments, in the form of real estate and fixed income, and alternative assets, in the form of equity real estate, private equity, and venture capital. The NYCERS case showed that investments were based on strategic asset allocation, calling for 2% of assets to ETIs that can cross asset classes. The policy included both a geographic target and a requirement to fill a capital gap and reach an underserved market. We found that pension funds provide the finance commitment, without which additional capital would not be placed in the market. In this model there is often a finance partner who makes the projects possible considering the pension fund's need for scale. The economic returns showed that the investments consistently outperformed the chosen benchmark or industry standard. These investments were often supported by government guarantees although with an initiative to move beyond guarantees and expand into the emerging third generation of investments.

The implications of the findings show that pension fund urban investments can produce competitive returns with the community benefit being a spillover effect. In the New York example such investments make formerly distressed communities bankable and economically viable. The investments also leverage direct investments into New York City as in the case of HIT (leveraged a HIT $500 million direct investment to NYC affordable housing over a five year period) and the Tishman Speyer/Travelers NYC Real Estate Venture V Fund (will commit to $50 million to New York City projects).

The ideas and arguments presented in this study can now be taken to another level. We believe the next step in the research is to stimulate pension fund targeted investing in other states. The candidate states are those who have shown a clear interest in using targeted investing to further their goal of creating working communities. Given the characteristics of individual states, the New York example may not be replicated in its exact forms. However, the model could generate ideas to create individual models having the same goal of competitive economic returns and revitalized communities.

Figure 1 Efficient frontier

Source: Investopedia, http://www.investopedia.com/terms/e/efficientfrontier.asp

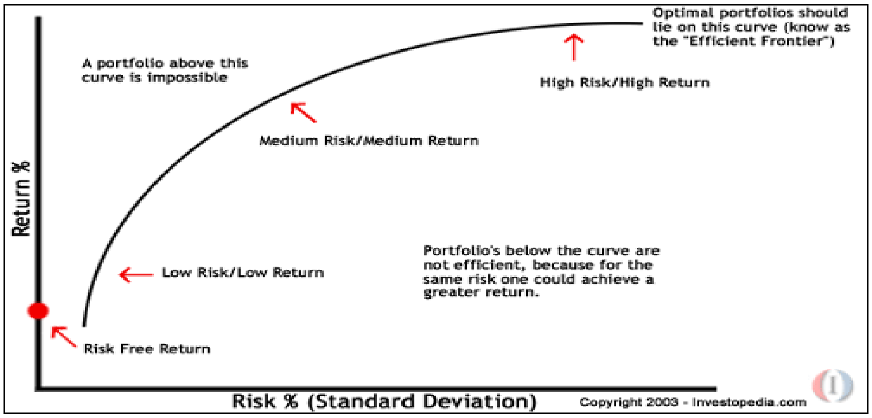

Table 5 State Mortgage Insurance Funds

Source: Moody's Investor Service Special Comment, "Moody's approach to evaluating state-sponsored mortgage insurers", May 1999, p. 3.

What Types of Loans Do State Mortgage Funds Insure?

California Housing Loan Insurance Fund	Single Family Primary
Florida Affordable Housing Guarantee Fund	Single Family Primary Single Family Pool Multi-Family Primary
Maryland Housing Fund	Single Family Primary Single Family Pool Multi-Family Primary
Massachusetts Mortgage Insurance Fund	Single Family Primary
New York State Mortgage Insurance Fund	Single Family Primary Single Family Pool Multi-Family Primary Project Finance Primary
Pennsylvania Housing Insurance Fund	Single Family Primary
Vermont Home Mortgage Guarantee Board	Single Family Primary Consumer Loans

Note: Vermont is no longer active as of approximately the year 2000 (F. Zeman, pers.comm.).

Table 6 Pension funds in alternative assets

Top 50 pension investors in alternatives ranked by total invested, in millions, as of Sept. 30.
Source: Arleen Jacobius and Christine Williamson, "The Capacity Problem", Pensions & Investments, April 4, 2005, p.16.

RANK	FUND	TOTAL ALTERNATIVE ASSETS	% OF TOTAL ASSETS	HEDGE FUNDS/ FUNDS OF FUNDS	EQUITY REAL ESTATE	VENTURE CAPITAL	PRIVATE EQUITY
1	**California Public Employees**	$20,743	12.40%	$834	$11,900	$1,689	$6,320
2	**California State Teachers**	$10,775	9.20%		$5,375	$1,305	$4,095
3	**New York State Common**	$9,677	8.20%		$3,186	$773	$5,718
4	**General Motors**	$9,392	10.80%	$1,677	$4,940	$910	$1,865
5	**Washington State Board**	$9,337	22.60%		$3,890	$876	$4,571
6	**Pa. State Employees**	$9,067	36.40%	$4,800	$1,699	$747	$1,821
7	**Michigan Retirement**	$8,432	17.90%	$359	$3,260	$1,000	$3,813
8	**Florida State Board**	$7,438	7.30%		$4,005	$73	$3,360
9	**General Electric**	$7,045	16.00%	$1,453	$2,885		$2,707
10	**Verizon**	$6,256	17.50%	$1,343	$1,380	$1,026	$2,507
11	**Pa. School Employees**	$6,022	12.60%		$2,584	$370	$3,068
12	**New York State Teachers**	$5,927	7.40%		$4,351	$194	$1,382
13	**Ohio State Teachers**	$5,443	10.00%	$23	$4,239	$395	$786
14	**Oregon Public Employees**	$5,391	11.90%		$1,890	$250	$3,251
15	**Massachusetts PRIM**	$4,561	13.80%	$1,311	$1,326	$524	$1,400
16	**Colorado Public Employees**	$4,533	15.40%		$1,743	$694	$2,096
17	**IBM**	$4,464	10.80%		$1,341	$66	$3,057
18	**Los Angeles Co. Employees**	$4,408	15.10%		$2,959	$210	$1,239
19	**Virginia Retirement**	$4,348	10.90%	$1,094	$1,535	$355	$1,364
20	**Lucent Technologies**	$3,974	12.70%		$1,798	$1,007	$1,169
21	**Wisconsin Investment Board**	$3,551	5.50%		$1,855	$156	$1,540
22	**Illinois Teachers**	$3,430	11.00%		$2,594	$230	$606
23	**AT&T**	$3,132	17.90%		$1,596	$311	$1,225
24	**Ohio Public Employees**	$3,017	5.00%		$2,689	$46	$282
25	**Boeing**	$2,827	7.30%	$823	$1,080	$89	$835
26	**BellSouth**	$2,795	19.10%		$905	$537	$1,353
27	**Minnesota State Board**	$2,736	7.30%		$798		$1,938
28	**Louisiana Teachers**	$2,644	22.00%		$464	$40	$2,140
29	**Alabama Retirement**	$2,636	10.70%		$1,575		$1,061
30	**Texas Teachers**	$2,552	3.00%	$1,151	$345	$160	$896
31	**SBC Communications**	$2,518	9.00%	$720	$541	$762	$495
32	**New York City Retirement**	$2,086	2.50%		$1,148		$938
33	**San Francisco City & County**	$2,041	17.10%		$959	$318	$764
34	**DuPont**	$1,943	13.00%		$577	$20	$1,346
35	**Connecticut Retirement**	$1,936	9.70%		$350	$114	$1,472
36	**Iowa Public Employees**	$1,894	10.90%		$901	$218	$775
37	**World Bank**	$1,752	16.60%	$802	$350	$38	$562
38	**DaimlerChrysler**	$1,737	9.10%		$808	$85	$844
39	**Alaska Investment Board**	$1,700	14.10%	$300	$977		$423
40	**Delta Air Lines**	$1,492	7.80%	$200	$504		$788
41	**Teamsters, Western Conference**	$1,230	4.60%		$1,230		
42	**Episcopal Church**	$1,186	17.20%	$413	$429	$222	$122
43	**National Electric**	$1,080	11.40%		$997		$83
44	**Missouri State Employees**	$1,057	17.80%	$866	$100		$91
45	**Utah State Retirement**	$1,025	6.90%		$1,025		
46	**Illinois State Board**	$971	9.70%		$599	$112	$260
47	**Maryland State Retirement**	$935	3.10%		$823	$40	$72
48	**Nevada Public Employees**	$930	5.80%		$930		
49	**United Parcel Service**	$897	8.60%	$164	$453	$77	$203
50	**Kansas Public Employees**	$865	8.30%		$398	$96	$371
	TOTAL	**$55,044**	**11.80%**	**$4,616**	**$94,286**	**$16,135**	**$77,074**

Figure 2 Public Private partnership

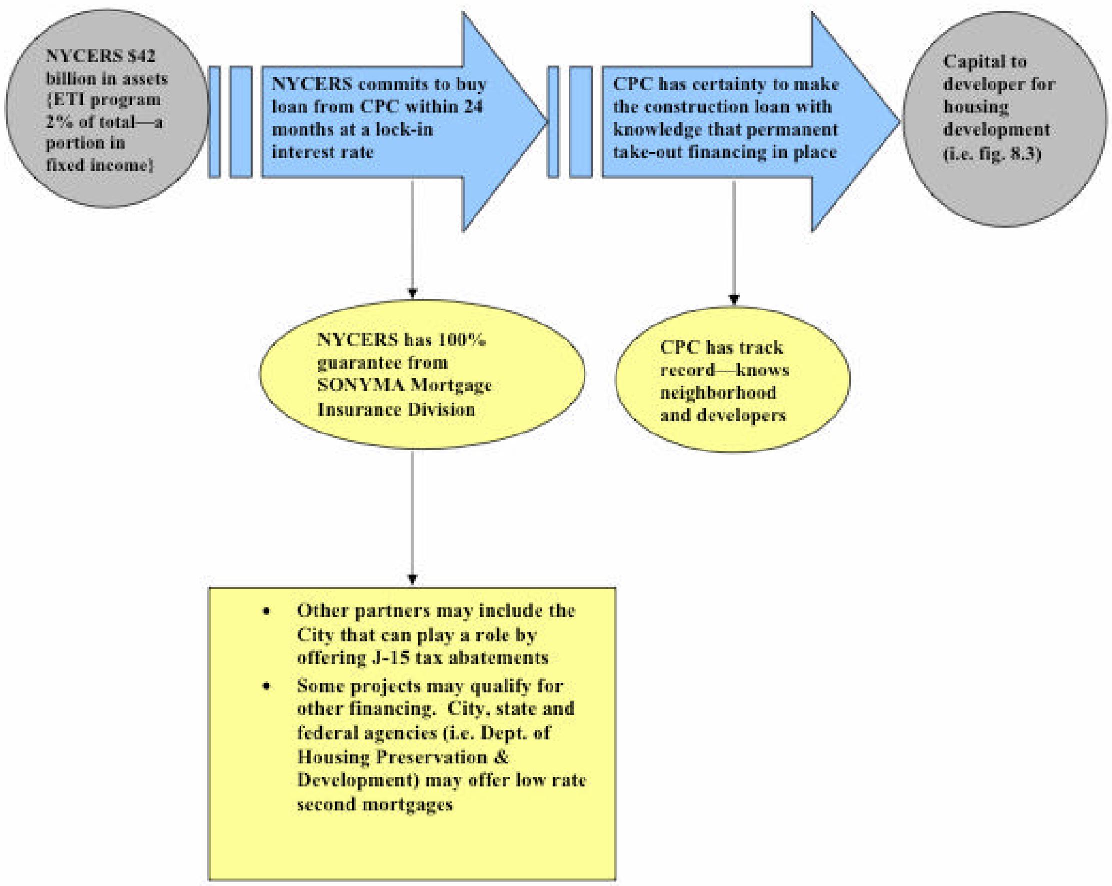

Figure 3 NYCERS – Harlem project (commercial + affordable housing)

Source: Office of the Comptroller, NYC, Economically Targeted Investment Program

Before **After (artist's rendering)**

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8 Appendices

8.1 SONYMA guarantee

State of New York Mortgage Agency (the Agency) is a public-benefit corporation of the state of New York created by statute in 1970. The agency creates affordable housing opportunities for low- and moderate-income first-time and other qualifying homebuyers, and provides mortgage insurance for qualifying real property loans. The Agency issues taxable and tax-exempt bonds and uses the proceeds to purchase low-interest rate mortgage loans. In 1978 their mission was expanded to include the issuance of mortgage insurance to advance neighborhoods throughout the state. The Agency has two divisions, the Single Family Mortgage Finance Division and the Mortgage Insurance Division. The Mortgage Insurance Division provides insurance on mortgage loans for residential, mixed residential, commercial and community service-related properties throughout New York (State of New York Mortgage Agency).

The insurance is backed by the New York State Mortgage Insurance Fund (the Fund). The Fund's operating expenses come from a surcharge on the mortgage recording tax. The mortgage recording tax surcharge is 25 cents per $100 and applies throughout the state. As of May 1987 there was a shift in a portion of the Fund's revenues as surcharge receipts from mortgage recordings (1-6 family homes) in Eerie County and the 12 downstate counties were diverted to the Niagara Frontier Transportation Authority and the New York Metropolitan Transportation Authority respectively. The Fund today receives tax surcharges on all other mortgage recordings throughout the State such as apartment and office buildings (M. Friedman, pers. comm.).

The Fund gets no direct state funding and uses approximately $60 million per annum from the mortgage recording tax surcharge for new commitments and new claims**.** Insurance reserves are funded from interest income and premiums as well as application fees. For the fiscal year ending March 31, 2005 the Fund earned interest income of $25.7 million and premiums of $7.5 million. The Fund has an established loan criteria selection process and requires on all insured mortgage loans a ratio of total income over total operating expenses (including debt service) equal to 1.05. With an outstanding track record since 1978, the Fund has paid only five claims on loans outside of New York City that were purchased by the New York State Common Retirement Fund. The total claim amount since 1978 is $1.7 million (Friedman, Michael, e-mail message to author, August 2, 2005).

Similar models, although on a smaller scale with no locked in funding source, exist in California, Florida, Maryland, Massachusetts, and Pennsylvania. Appendix table 8-1 (State Mortgage Insurance Funds) details the loan types insured by the respective state mortgage insurance funds. The insurance funds are self-funded aside from some initial seed money. In the case of Florida the Guarantee Fund was supported by the state until the mid-1990s through an allocation of the Documentary Stamp tax (F. Zeman, pers. comm., Moody's Investors Service Special Comment 1999).

8.2 List of interviews

Adam Blumenthal, Partnership Equity, Former First Deputy Comptroller and CFO, Office of the Comptroller, NYC

Michael Friedman, SVP/Director, State of NY Mortgage Agency/Mortgage Insurance Fund

Adam Freed, Director of Economic Development and Policy Analysis, NY Comptroller's Office

Deborah Gallegos, Chief Investment Officer, Office of the Comptroller, NYC

Jack Greene, SVP/Chief Loan Officer, Community Preservation Corporation

Michael Lappin, President & CEO The Community Preservation Corporation

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