Memorandum

To:	**Reinvestment Working Group, City and County of San Francisco**
From:	HR&A Advisors, Inc.
Date:	February 10, 2023
Re:	Assessing the Viability of a Joint Green-Public Bank in San Francisco – **DRAFT**

DISCLAIMER

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Introduction

HR&A Advisors, Inc. (HR&A) prepared this memorandum on behalf of the San Francisco Reinvestment Working Group (RWG) to evaluate the viability of establishing and operating a municipal green bank alongside or as part of a future municipal finance corporation (MFC) or public bank. A green bank is generally defined as a mission-driven financial institution that provides capital for projects that mitigate greenhouse gas (GHG) emissions, reduce pollution, or otherwise contribute to positive environmental outcomes. The City is interested in exploring whether such an entity could be established to support implementation of its 2021 Climate Action Plan (CAP), whose goal to reach net-zero emissions by 2040 could cost an estimated $21.9 billion. More specifically, the City would like to better understand the feasibility of operating such an entity as part of an MFC or public bank, which would be similarly tasked with providing low-cost loan capital to finance various community improvements.

This memorandum provides an overview of green banks, their deployment across the country, and how they can support the City's policy objectives within the planned MFC and public bank framework. In order to retain access to critical federal funds, HR&A recommends that a green bank entity be established as part (or a subsidiary) of an MFC. Should the City seek to establish a regulated public bank, we recommend that the MFC remain separate from, but potentially subordinate to, the public bank. More research is needed to explore what types of legal structures could enable such an arrangement.[1]

Local Context

The City of San Francisco has a long history of climate action, having reduced local GHG emissions by 41% since 1990. The City is building on these achievements by committing to net-zero emissions by 2040 through its 2021 CAP, specifically highlighting five primary emitting activities to prioritize: Responsible Production & Consumption, Transportation & Land Use, Energy Supply, Building Operations, and Healthy Ecosystems.

The 2021 CAP advances several strategies in support of these ambitious goals, whose implementation will require significant funds. Summarizing costs for initiatives like electrifying the housing stock, expanding the transit system, and others, the University of California, Berkeley's Center for Law, Energy, and the Environment (CLEE) estimated in November 2022 that implementing the Climate Action Plan could require up to $21.9 billion.[2]

This indicates a significant need for financing that a new local lending institution could address to complement and channel federal, state, and private funds committed to this effort. To help implement the ambitious goals of the CAP, the CLEE report proposes the establishment of a San Francisco green bank that could "[commit] public funds to one or more financing mechanisms […] to attract private capital to clean energy technologies and upgrades." The report identifies the Inflation Reduction Act's Greenhouse Gas Reduction Fund (GHGRF)[3] as a potential source of funding for this entity.

Overview of Green Banks

A green bank is a mission-driven financial entity that uses public funds to make and incentivize green investments. Like other mission-driven financial institutions, green banks typically place public and/or philanthropic capital in a "first-loss" position[4] to encourage additional private investment.[5]

There is no single "blueprint" to establish a green bank: green banks share a common mission but may differ in terms of their legal structure, services, and means of capitalization. A green bank could be a public, quasi-public, or nonprofit entity that exists as a standalone institution or as part of an existing agency or organization, with each model presenting unique funding and governance implications. For example, a public entity would be under direct government control and could have direct access to local, regional, or state funding sources. Some such entities receive a one-time appropriation—such as the New York Green Bank, which received $1 billion in initial seed funding[6]—while others could receive annual allocations from a variety of state and regional sources. [7] Green banks provide distinct types of products. As a wholesale-focused institution, the Connecticut Green Bank issues loan-loss reserve funds that enable local lenders (e.g., credit unions, etc.) to provide low-interest, long-term loans for homeowners to implement energy efficiency improvements. By contrast, retail institutions like the New York City Energy Efficiency Corporation issue direct loans to building owners seeking to invest in energy efficiency upgrades.[8]

The City could establish a green bank by choosing among the multiple structures and funding and lending approaches available to green banks. The City would need to confirm whether applicable state or local laws constrain its ability to pursue its desired structure and approach.

Viability Assessment & Recommendations for a Joint Green-Public Bank Institution

Two obstacles can constrain the viability of operating a green bank within a public bank. First, California Assembly Bill 857 (AB 857) requires public banks to partner with local financial institutions in the provision of lending services. In other words, a public bank must strictly be a "wholesale" entity unless it can prove that a lack of retail products exists in the private market.[9] In practice, this presents only a minor challenge since many green banks already operate primarily as wholesale lenders. This is consistent with the envisioned approach for an MFC or public bank.

The second—more substantive—hurdle pertains to legal form. Depository institutions—such as a regulated public bank—are ineligible to participate in the Greenhouse Gas Reduction Fund, which the UC Berkeley CLEE report cited as a primary source of funding for an eventual green bank.[10] (Experts we interviewed did not know of any depository, chartered green bank in the United States.) Without access, the City would have to seek alternative funding sources at the federal, state, and local level for which a depository institution could be eligible.

Though a San Francisco public bank would be ineligible for GHGRF funding, an MFC could still apply for it given its non-depository status. Given the alignment of objectives between the proposed MFC and a potential green bank, HR&A therefore recommends that—if the City seeks to establish a green bank—the City consider making the MFC, or a structure within the MFC, the green bank entity for San Francisco. This achieves multiple objectives: it reinforces the MFC's role on green investments and environmental justice; it potentially brings additional funds for the MFC to deploy; and it avoids creating separate entities (an MFC and a green bank) with the redundant costs and lending programs that might entail.

Should the City ultimately seek to transform the MFC into a regulated public bank, we recommend that the City explore legal structures that could allow the green bank component of the MFC to remain separate from—but potentially subordinate to—the public bank to preserve the green bank's ability to access GHGRF funds while remaining within the single umbrella structure of the public bank.

References

[1] This memo was also informed by interviews with a green finance expert who helped to establish the Connecticut Green Bank and with experts at an impact investment advisory and management firm with extensive knowledge of green banks.
[2] University of California at Berkeley, Center for Law, Energy, and the Environment. Funding San Francisco Climate Action: Strategies for Revenue, Implementation, and Equity, 2022
[3] The Greenhouse Gas Reduction Fund provides competitive to entities that finance projects that reduce or avoid greenhouse gas emissions.
[4] "Catalytic first-loss capital refers to socially- and environmentally-driven credit enhancement provided by an investor or grantmaker who agrees to bear first losses in an investment in order to catalyze the participation of co-investors that otherwise would not have entered the deal." Council on Foundations, Catalytic First Loss Capital
[5] As of 2022, the Connecticut Green Bank leveraged $322.4 million in public funds to attract $1.95 billion in private investment. Connecticut Green Bank. 2022 Annual Report
[6] New York Green Bank. Impact Report 2022
[7] The Connecticut Green Bank receives $27 million in annual funding from the state's Clean Energy Fund. Connecticut Green Bank. Comprehensive Plan Fiscal Years 2017 through 2019
[8] Environmental Protection Agency. Clean Energy Finance: Green Banking Strategies for Local Governments
[9] California Assembly Bill No. 857, 2019-20
[10] Request for Information - Greenhouse Gas Reduction Fund