



New Jersey State Development Bank Policy Brief
By the New Jersey Citizen Action Education Fund

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This paper was prepared under the aegis of the New Jersey Citizen Action Education Fund (NJCAEF). The paper is the property of the New Jersey Citizen Action Education Fund. It is intended to be a policy brief to educate New Jersey advocates, policymakers, stakeholders, and, more generally, the public-at-large about the need for establishing a public bank in New Jersey. This paper is not intended to be a comprehensive research project, but rather provides an overview of the concept of a public bank in New Jersey. It also attempts to address key and important questions most likely to be raised with respect to its content and our call to establish the NJ State Development Bank (NJSDB). NJCAEF will conduct additional research, hold focus groups, staff a Leadership Team, and convene a series of roundtable discussions on the proposals outlined in this policy brief. NJCAEF will also continue to work with and expand its broad based coalition of New Jersey advocates and stakeholders who are committed to developing a public bank concept and establishing the NJSDB. NJCAEF expects this process to promote extensive discourse with elected officials, government administrators and staff, as well as advocates and experts from a wide range of relevant fields. Citations of the paper should read “New Jersey Citizen Action Education Fund – New Jersey State Development Bank Policy Brief—October 2018.”

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Executive Summary

This policy brief calls for the establishment of a New Jersey State Development Bank (NJSDB) within the Department of Treasury. The NJSDB should be accountable to the State Treasurer and a representative Board of Trustees, providing policy direction to a full-time director and small staff on ways to ensure greater access to capital at competitive rates for creditworthy, socially beneficial projects.

This document is not a complete plan or design for establishing the NJSDB. This paper is a first and crucial step in the process of creating the bank. It includes discussion about the factors which its contributors deem most important for consideration in establishing the bank, and which must be more fully researched. The paper provides some recommendations and poses some questions that still have to be answered in order to create a bank that will serve the people of New Jersey. The paper's authors and contributors have begun to address many of these questions: *What is the need for the bank? How would it benefit the state? How would it operate, be governed, and be funded?* One of the most significant questions to research and answer is, *how would a public bank in New Jersey add to and enhance the existing state entities that have some bank like functions, such as the Economic Development Authority, the Redevelopment Authority, the Housing and Mortgage Finance Agency and the New Jersey Water Bank?* The challenge is to create a structure for the bank that compliments the functions of these entities and that will result in an additive and synergistic approach to filling the many unmet social and economic needs that persist in the state today.

We will begin to invite the appropriate expert stakeholders from the public and private sectors in government, academia, advocacy, and industry experts as we convene roundtable discussions to review and debate each point raised in this paper. The first convening of a stakeholder roundtable will take place after the release of this paper. At the first convening, members of the Leadership Team will outline a plan for and schedule a series of additional roundtables throughout the state meant to address the many proposals outlined in this paper. These discussions will also help inform what further research, focus groups, and meetings are needed to fully develop the NJSDB.

Interest in the concept of public banks is growing and generating great debate in cities, counties, and states across the country. Many efforts have failed when the magnitude of the endeavor has been taken too lightly and/or legislation proposed was far too vague or incomplete. Some efforts have died in the scrap heap of "feasibility studies." If we are to succeed at becoming the first state to create a public bank that serves the people, above all else, it is important that we not underestimate the challenge. Legislation has already been proposed in the state Legislature to create a public bank in New Jersey. This policy brief is meant to compliment the work of the Administration and the Legislature to create a state public bank. With this document, and with the stated commitment from the Governor and some legislators to create a public bank, we will set the table and invite the best and the brightest experts and advocates to join us, roll up their sleeves, and get to work on this difficult and worthwhile endeavor.

Why We Need a New Jersey State Development Bank (NJSDB)

The primary mission of the NJSDB would be to expand access to capital at competitive rates for creditworthy projects that fall within socially beneficial categories and are currently not funded, or not funded adequately. The NJSDB would manage risks wisely by adhering to best practices and lending standards. Initially, the NJSDB would be organized to address the most pressing unmet financial service needs experienced by New Jerseyans across market segments in the state today.

We believe that these needs fall into the following categories:

- **Public Infrastructure**, specifically related to transportation, environment/climate change, renewable energy and energy efficiency, and more generally with respect to the still unfolding “smart cities” concept;
- **Affordable Housing & Neighborhood Revitalization**, specifically, affordable housing and neighborhood revitalization that lack sufficient funding and investment;
- **Economic Development and Micro-lending**, especially in the underserved small business sector, where access to credit is limited;
- **Student Loans and Debt Obligations**, specifically loans that are neither affordable to nor manageable, thus leaving borrowers with crippling debt; and
- **Retirement Savings Accounts**, which currently are not available to all private sector employees, and are desperately needed for retirees to have a minimum level of financial security.

Benefits of the NJSDB

The NJSDB would go beyond the obvious benefit of meeting needs of underserved consumers and markets. The bank would also mitigate the impact of business cycle swings, federal government policy shifts and natural disasters; finance public priorities in more responsive, efficient and effective ways; promote enhanced cooperation and collaboration among existing public finance entities; provide direct and indirect multiplier impacts with beneficial effects on the state’s economy and quality of life; and employ the state’s access and control of a portion of its public funds to support proven financially sound investments that benefit New Jersey communities and their residents.

The NJSDB would also reduce the “financial leakage” that currently takes place because of New Jersey’s over-reliance on national and international banks, which use, lend, and invest New Jersey dollars outside of the state or country. The NJSDB would redirect investments and lending of New Jersey dollars back into New Jersey’s economy.

In her recently released policy brief “Exploring a Public Bank for New Jersey: Economic Impact and Implementation Issues,”¹ Stockton University Economics Professor, Dr. Deborah M. Figart suggests that “state-owned banks may be able to reduce the cost of public investment by lending at lower interest rates and avoiding asset bubbles with more evened out debt cycles. Some portion of the revenue (surplus) may be returned to supplement the state budget and enable more spending and/or reduce tax rates.” While we agree with Dr. Figart that further analysis should be done regarding potential impact, her findings are positive and suggest specific economic benefits a public bank could bring to New Jersey.

The NJSDB Would Build on Existing Assets

The NJSDB should be tailored to address New Jersey’s unique needs and build on the state’s existing assets, such as its rich public finance and community-banking environment. We should not create a state bank from scratch as a new stand-alone silo institution. Instead, the formation of a NJSDB would best involve an integration and coordination of our state’s existing public financing with institutions that have missions to and track records of investing in public needs, such as, community banks, credit unions, community development corporations (CDCs) and community development financial institutions (CDFIs).

¹ <https://stockton.edu/hughes-center/documents/2018-0326-exploring-a-public-bank-for-new-jersey-economic-impact-and-implementation.pdf>

Funding the NJSDB

Ultimately, we recommend drawing on multiple funding sources to capitalize and fund the NJSDB. This approach would ensure that the bank does not rely on any single source. Below are some potential recommended funding sources. They are intended to be a starting point for discussion about capitalizing and funding the NJSDB. Specific amounts of capital needed to fund the bank in its entirety or any portion of the bank's operations will be determined with further research. Research and further investigation will also determine how much any one of the proposed funding sources below (or any proposed funding source going forward) would provide for the bank:

- 1. A Percentage of State Public Deposits** – The state could capitalize a portion of the NJSDB's reserves with a percentage of the deposits now held in banks;
- 2. A State Legislative Appropriation** – The Legislature could make an initial appropriation to fund the NJSDB;
- 3. Private Bank Contributions** – Private banks could be encouraged to contribute to or invest in the NJSDB's "social benefits" fund and apply for Community Reinvestment Act (CRA) credits;
- 4. Existing Public Finance Entities** – Existing public finance entities, such as the New Jersey Housing and Mortgage Finance Agency, the Economic Development Authority, and New Jersey Redevelopment Authority, among others, could be required to set aside and pool a percentage of their tax exempt bond funding to fund the NJSDB. Constraints on the bond funding would have to be taken into account in order to do this;
- 5. A Baby College Fund** – The State of New Jersey could contribute \$50 to a college fund for each newborn and adopted child in New Jersey whose parents are income eligible;
- 6. Landlord/Tenant Security Deposits** – All or a portion of tenant security could be deposited in the NJSDB, and funds could be dedicated to relevant projects;
- 7. Private Philanthropic Funding** – the NJSDB could seek donated funds from private foundations to fund projects in line with their missions;
- 8. Federal Government Program Funding** – The NJSDB may seek federal government funding from relevant and appropriate federal programs;
- 9. Recycled Loan Proceeds** – Funds from loan repayments would be recycled and used for more lending;
- 10. Voluntary Contributions** – The State of New Jersey could promote voluntary contributions to the NJSDB Fund;
- 11. Imposing State User Charges** – User charges could be directed to fund the NJSDB bank, e.g., state licensing fees, motor vehicle charges, or environmental permit fees, etc.; use of these fees could be limited to NJSDB projects related to the sources of the fees and charges; and
- 12. Legalized Marijuana Tax** – Should marijuana be legalized in the state, a portion of the revenue derived from the marijuana tax could be dedicated to the NJSDB, and used for appropriate social benefit projects.

Operations

The NJSDB would not operate as a retail bank with branches throughout the state. Instead, it would work with and through local banks, credit unions, CDCs, and CDFIs that provide a range of retail products and services to the public. The NJSDB would also coordinate with existing state financial institutions to increase efficiency and expand the reach of state financed projects. The NJSDB would lend to creditworthy projects that are public policy priorities that are often less attractive to conventional private large bank investors for a variety of reasons, including the potential for lower returns on investment.

Governance

We recommend that the NJSDB be of, but not necessarily located in, the New Jersey Department of the Treasury. The State Treasurer and the Commissioner of the New Jersey Department of Banking & Insurance would sit on the State Development Bank's Board of Trustees, with the Treasurer serving as its Chairperson. The Director of the NJSDB would report to a Board of Trustees. The Board would set policy for the State Development Bank.

Risk Management

The NJSDB would apply conventional and prudent bank lending criteria, professional risk management, pre-existing funding supply constraints, conventional and regular audits, and operations reviews, among others. The NJSDB would also devise and apply a set of developmental banking criteria to promote the concept of a "triple bottom line" to encourage financing that would be sensitive to environmental and social equity public policy concerns, as well as traditional fiscal concerns.

The Green, Sustainable, and Smart Overlay: Bringing New Jersey into the 21st Century

While focusing on current unmet needs is important, the NJSDB would drive its investment and finance strategies and its policies by implementing a forward thinking and "green" overlay to move the state toward climate change resilience, more efficient use of resources and state of the art technological innovation.

Acknowledgments

The New Jersey Citizen Action Education Fund (NJCAEF) would like to thank **Governor Phil Murphy** for making the establishment of a public bank a key part of his economic agenda. We would also like to thank **his policy team** for making themselves available to us for consultation and support. Additionally, NJCAEF thanks New Jersey **Senators Nia H. Gill (NJ-34)** and **Richard J. Codey (NJ-27)** for introducing the State Bank of New Jersey Act at the beginning of the 2018 legislative session. We look forward to working with the Administration and Legislature to create the NJSDB.

Finally, we must thank the following members of the **Public Bank Project Leadership Team** for their assistance and contributions to the development of this policy brief.

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Introduction: Precedent, Concept, and Background for Public Banking

When the topic of a “public bank” is discussed, the Bank of North Dakota (BND), the only publically run state bank in the United States, is the example most often raised. The Bank of North Dakota² was established in 1919 to collaborate with community banks and credit unions to provide a secondary mortgage market and liquidity support for the state’s businesses and financial institutions when out-of-state financial institutions denied North Dakota businesses sufficient credit. The BND was initially funded by the state, but those funds were subsequently leveraged by other in-state funds for the benefit of North Dakota’s economy. BND transfers about half of its surplus funds (profits) to the Legislature, and the usage of bank earnings remains at the discretion of the Legislature.³

While we acknowledge that New Jersey’s current economic situation is very different from North Dakota’s economy at the time of its state bank’s establishment, there are lessons to be learned from the long-term North Dakota experience. Chief among them is the nature of the relationship that developed between the BND and local banks. That relationship provided a way to leverage limited state funds to re-lend and re-invest them at the state and local levels. The BND optimized multiplier effects and kept capital flowing and available in North Dakota even when the large national banks would neither lend nor invest in the state.

The BND fostered a relationship whereby it purchased sound residential mortgages from local banks while it also partnered with those banks on large commercial loans. At the same time, the North Dakota State Bank avoided most retail banking functions, and therefore did not compete with established retail operations of local banks. The Associated Press reported that in 2017 the NDSB recorded its 14th consecutive year of record profits.⁴

Although cross-international comparisons are difficult, there are, nevertheless, other examples of public banking institutions in other countries that New Jersey might emulate. For example, national banks and state development banks have been established by member nations of the European Union.

The German public bank, KfW⁵ is an important financial institution for individuals, business enterprises, local governments, and non-governmental organizations. It is often cited as a strong model. It holds a wide-ranging loan portfolio while working through existing private banks to finance diverse municipal projects and services from schools to industrial parks. It also finances affordable housing development, with special focus on those projects that address energy efficiency and climate change issues. With respect to non-governmental organizations, the German public bank lends money to nursing homes and childcare facilities.

New Jersey today is neither North Dakota in the 1920s nor Germany in the 21st century. The NJSDB should be tailored to the state’s specific economic environment and needs. New Jersey’s economy is also more

² <https://bnd.nd.gov/the-bnd-story/>

³ <https://stockton.edu/hughes-center/documents/2018-0326-exploring-a-public-bank-for-new-jersey-economic-impact-and-implementation.pdf>

⁴ <https://www.usnews.com/news/best-states/north-dakota/articles/2018-04-18/state-owned-bank-of-north-dakota-has-record-profits-again>

⁵ https://www.kfw.de/PDF/Download-Center/Konzernthemen/KfW-im-%C3%9Cberblick/GP_2014_deutsch_112014_final-2.pdf

diverse and its existing public finance sector presents a much more complicated terrain than existed in North Dakota a century ago.

Especially important, New Jersey's public finance sector is substantial and already supports multiple state agencies in promoting a wide range of state government priorities. A public bank in New Jersey cannot simply be "bolted on" to the current state public financing infrastructure. A public bank should be integrated into, complement and improve upon the existing public finance sector.

The contemporary New Jersey state public finance sector consists of a variety of entities organized by public policy function. Examples include but are not limited to economic development, education, environment, housing, small business, transportation, urban redevelopment and casino reinvestment. In addition, numerous New Jersey counties employ improvement authorities that operate more generally as public finance entities on the local government scene.

It is understood that in many ways the state, through these entities, is already acting like a bank. The intention of establishing a public bank is not to duplicate what is already being done. A significant part of the process of creating the bank is to clarify what these entities, as well as private financial institutions, actually do and do not do in order to identify what needs are not being met. In this way, the public bank proposed could successfully fill significant "needs gaps."

New Jersey's public finance sector evolved incrementally over the past several decades to address unmet needs in which the private banking sector was either less interested in or incapable of addressing. Public financing followed predictable functional furrows, relying primarily upon tax-exempt bonds to provide below market interest rate loans. Nonetheless, New Jersey and its people continue to face many persistent and serious problems that require much more financial support. Establishing a public bank would ensure that financing is made available for successful solutions to persistent social and economic problems in New Jersey.

Establishing the New Jersey State Development Bank

What is the Mission of the New Jersey State Development Bank?

The primary mission of the New Jersey State development Bank (NJSDB) is to expand access to capital at competitive rates to creditworthy and socially beneficial projects in ways consistent with the expressed priorities that may otherwise have difficulty in gaining access to such capital and/or are required to pay higher interest rates, while at the same time managing risk. Additionally, the NJSDB would also provide the state with a valuable financial tool to achieve the following objectives:

1. Provide greater access to capital to address unmet financial needs of underserved people and market segments while also prudently managing risk;
2. Expand and strengthen the role of community banks, credit unions and CDFIs in terms of New Jersey's financial institutional terrain;
3. Mitigate the impacts of business cycle swings, federal government policy shifts and disasters;
4. Finance state government public policy priorities in more responsive, efficient and effective ways;
5. Promote enhanced cooperation and collaboration among the existing public finance entities to generate new synergies leading to more creative financial problem-solving;
6. Provide direct and indirect multiplier impacts to increase the state's gross domestic product, income and employment in ways that enhance New Jersey's competitive position with respect to the national and global economies and improve the quality of life for New Jersey residents;
7. Employ the state's access and control of at least a portion of its public funds to support proven financially sound investments that benefit New Jerseyans and the communities in which they live; and
8. Reduce economic leakage by reinvesting local dollars from state deposits back into the state's economy and to prevent capital from leaving New Jersey.

What are the unmet needs and the main public policy areas in which the State Development Bank could add value?

We recommend that the New Jersey State Development Bank concentrate on projects with respect to the following pressing unmet needs in these substantive public policy areas:

- **Public Infrastructure**, specifically related to transportation, environment/climate change, renewable energy and energy efficiency, and more generally with respect to the still unfolding "smart cities" concept;
- **Affordable Housing & Neighborhood Revitalization**, specifically, affordable housing and neighborhood revitalization that lack sufficient funding and investment;
- **Economic Development and Micro-lending**, especially in the underserved small business sector, where access to credit is limited;
- **Student Loans and Debt Obligations**, specifically loans that are neither affordable to nor manageable, thus leaving borrowers with crippling debt; and
- **Retirement Savings Accounts**, which currently are not available to all private sector employees, and are desperately needed for retirees to have a minimum level of financial security.

New Jersey currently has funds set aside to provide financing for some aspects of the needs outlined above. However, the structure of various streams of funding and the amount of the funding have not

adequately covered projects needed to address and solve significant social and economic problems in these areas:

Public Infrastructure

New Jersey's infrastructure suffers from delayed repair and lack of maintenance. In 2016, the American Society of Civil Engineers gave the state infrastructure a "D" grade⁶, citing significant and serious deficits in "capacity, condition, funding, future need, operation and maintenance, public safety, resilience, and innovation for bridges, dams, drinking water, energy, hazardous waste, levees, parks, ports, rail, roads, solid waste, transit, and wastewater."

According to New Jersey Department of Health statistics from 2014, 11 cities in the state have dangerously elevated levels of lead in their drinking water⁷. Lead poisoning in New Jersey's drinking water is found in urban, suburban, and rural areas. However, older cities with the least amount of resources are the most seriously affected. Newark Mayor Ras Baraka estimates it will cost billions to remediate the lead problem detected in half of the City's 67 schools.⁸

Every year at least 23 billion gallons of untreated raw sewage are dumped into New Jersey's rivers, mainly the Hudson, Passaic, Hackensack, Raritan, and Delaware rivers. As little as a twentieth of an inch of rain can send dangerous mix of bacteria and pollutants straight into many of New Jersey's rivers.⁹

Remediating these serious health and environmental crises is going to be an expensive undertaking. Private sector financing of water and sewage system infrastructure projects can be too costly to ensure the desired return on investment for lenders. Trends in private public partnerships, and complete privatization of water systems are very costly and passed on directly to the utility customers through exorbitant rate hikes.¹⁰ Through the NJSDP, local governments could access cheaper financing and improve their ability to compete for federal and state grants needed to upgrade and maintain affordable public water systems.

Affordable Housing Development and Neighborhood Revitalization

New Jersey has significant deficits and inequities in affordable housing. A study by the National Low Income Housing Coalition (NLIHC) found that New Jersey is the sixth most expensive state in the U.S. for renters.¹¹ The hourly housing wage in New Jersey for a two-bedroom apartment at fair market rent is \$27.31. At minimum wage — \$8.44 an hour — a New Jersey resident would have to work 129 hours per week to afford a two-bedroom apartment at fair market rent. New Jersey also has the distinction of having the highest residential foreclosure rate in the nation in 2018.¹² The federal programs to help homeowners avoid foreclosure and to stay in their homes are subject to unpredictable political winds.

⁶ <https://www.infrastructurereportcard.org/state-item/new-jersey/>

⁷ https://www.nj.com/news/index.ssf/2016/02/11_cities_in_jersey_have_more_lead-affected_kids_t.html

⁸ https://www.nj.com/essex/index.ssf/2016/03/baraka_says_it_could_cost_billions_to_fix_newark_w.html

⁹ <https://www.njfuture.org/wp-content/uploads/2015/03/New-Jersey-Combined-Sewer-System-by-the-Numbers-New-Jersey-Future.pdf>

¹⁰ https://www.foodandwaterwatch.org/sites/default/files/qa_public_private_water_fs_june_2009.pdf

¹¹ <http://nlihc.org/oor/new-jersey>

¹² <https://www.attomdata.com/news/market-trends/foreclosures/foreclosure-starts-jump-153-percent-in-houston-increase-in-43-percent-of-local-markets/>

At the same time, recent federal government tax cuts will reduce the supply of low-income housing tax credits as interest rates have begun to rise.¹³ This means that the private real estate and development sectors may have fewer incentives to provide affordable housing despite the acute demand.

Capital investment by the NJSDB through CDCs and CDFIs would expand investment in affordable housing by preserving existing homes and building new affordable rental housing. It would also increase the affordable capital CDFIs need to purchase foreclosed properties, provide affordable terms for owners to keep their homes, or make the properties available for affordable homeownership, and revitalize neighborhoods hit hard by the foreclosure crisis.

Economic Development and Micro Lending

When the largest banks reduce access to capital during financial downturns¹⁴, small business lending is hit the hardest and is usually the last to recover.¹⁵ From the start of Great Recession in 2008 through 2012, FDIC data showed a 19.1 percent decrease in loans to small businesses across the country.^{16 17} In contrast, loans to midsize and large companies rose by 12 percent in the same period.¹⁸ Without access to affordable credit, small businesses across the country laid off workers, stopped buying from suppliers, and many went out of business.

Based on a 2016 small business credit survey conducted by the New York Federal Reserve Bank,¹⁹ small businesses with annual revenues of \$1 Million or less reported trouble with making ends meet and accessing credit. Too often the larger commercial banking sector is not interested in lending less than \$100,000 because smaller loans are not as profitable.²⁰ Many small businesses do not need or qualify for such large loans. The 2016 survey also reported higher approvals for smaller-revenue firms at community development financial institutions (CDFIs), credit unions, and small banks than for large banks. Borrower satisfaction among all applicant firms is highest at small banks, credit unions, and CDFIs.

The NJSDB would strengthen the locally based and nonprofit-lending sectors by investing in CDFIs, other micro lenders, credit unions, and smaller local banks, which are willing to provide small loans in the \$5,000 to \$35,000 range that many small businesses need. With an emphasis on investment in the financial needs of underserved small businesses, the NJSDB will drive economic development across the state.

Student Loans and Debt Obligations

In late 2017, the Consumer Financial Protection Bureau (CFPB) reported that the total outstanding student loan debt balance was \$1.4 trillion nationally and \$41.6 billion in New Jersey.²¹ On average, New Jersey student loan borrowers owed \$30,000. Debt and loan obligations are affecting a range of important life decisions the borrowers make. Student loan debt affects everything from career paths, to housing choices, to buying a car, as well as to life decisions about marriage and having children. The more these borrowers

¹³ <https://www.reuters.com/article/us-usa-housing-tax/u-s-tax-cuts-will-reduce-incentive-to-build-affordable-housing-campaigners-idUSKBN1EHONJ>

¹⁴ http://www.people.hbs.edu/shanson/BigBankSmallBiz_paper_20170317_FINAL.pdf

¹⁵ https://www.hbs.edu/faculty/Publication%20Files/15-004_09b1bf8b-eb2a-4e63-9c4e-0374f770856f.pdf

¹⁶ https://www.huffingtonpost.com/joe-driscoll/what-to-do-with-all-those_b_4293336.html

¹⁷ https://www.sba.gov/sites/default/files/files/sbl_12study.pdf

¹⁸ <https://www.cnbc.com/id/101009116>

¹⁹ <https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf>

²⁰ http://www.hbs.edu/faculty/Publication%20Files/15-004_09b1bf8b-eb2a-4e63-9c4e-0374f770856f.pdf

²¹ https://files.consumerfinance.gov/f/documents/cfpb_student-loans_50-state-snapshot_complaints.pdf

are limited by debt to make traditional middle class financial investments, the less they will be able to participate in the wider economy.

Most New Jersey loan borrowers hold federal loans, but many also have NJCLASS loans. With policy shifts in the federal government, including an ever-changing position on student loan forgiveness and the stated intention by the current administration and Congress to cut in funding for student lending²², the need for NJCLASS loans is not likely to go away anytime in the near future.

The New Jersey Higher Education Student Assistance Authority (HESAA) originates NJCLASS loans that are underwritten with private sector bonds. Underwriting for private sector bonds determines rates and payment terms on these loans. This structure limits HESAA's ability to offer lower rates and more flexible repayment term options, particularly in rehabilitating loans in default. Without the constraints of profit-driven underwriting, the NJSDB has the potential to provide its own loans, or back HESAA loans with lower rates and more flexible payment and rehabilitation terms. Lower rates, more flexible terms, and better default rehabilitation options could potentially provide student loan borrowers with significant relief from the heavy debt caused by the current system.

Retirement Savings Accounts

AARP estimates that roughly 1.7 million private sector workers in New Jersey do not have access to a retirement savings plan through their employers.²³ The National Institute of Retirement Security describes this as a growing consumer crisis, because the average working household has saved only \$2,500 for their retirement.²⁴

The New Jersey Legislature has introduced the New Jersey Secure Choice Savings Program Act (A4134/S2891)²⁵, which would provide a retirement savings vehicle for private sector employees in New Jersey. The program is intended to provide enrollees with an efficient savings tool and investments that would be "individualized, simple, inexpensive, and secure." The program, which includes financial education and guidance, would help more New Jerseyans avoid financial distress and poverty in retirement and old age. The NJSDB should be structured to offer products as well as fund management services to this much needed program.

What would be the key benefits of the State Development Bank?

1. ***Addressing People's Real Needs*** – By responding to projects that have been prioritized in terms of their recognized economic and social needs, the NJSDB would be addressing real needs, such as housing and retirement savings and easing their pain at a time that the federal government is paring back the social safety net.
2. ***Optimizing Economic Impacts*** – In financing public infrastructure, promoting small businesses, lending to affordable housing development projects, easing the student debt crisis while forging an expanded and strengthened role for community banks, credit unions and CDFIs, the NJSDB would have enhanced measurable multiplier effects that add to the state's Gross Domestic

²² https://ticas.org/sites/default/files/pub_files/ticas_stmt_on_fy19_house_budget.pdf

²³ <https://action.aarp.org/site/Advocacy?cmd=display&page=UserAction&id=5449>

²⁴ <https://www.nirsonline.org/reports/the-continuing-retirement-savings-crisis/>

²⁵ https://www.njleg.state.nj.us/2018/Bills/A4500/4134_11.PDF

Product, income and employment, with the ultimate impacts depending upon the amount of capital that the NJSDB can raise, the reserves that it is required to keep, and the amount of money that it would be permitted to lend.

3. **Managing Risk Wisely** – By adhering to professional best banking practices through effective checks and balances, and strict oversight, the NJSDB would manage its risk wisely by maintaining adequate reserves, sticking to prudent loan-to-value ratios, abiding by funding source restrictions, and following the professional guidance provided by its director and board of trustees in transparent ways as demonstrated by professional periodic audits.
4. **Contributing to Sustainable Development** – The NJSDB would strike a balance among economic development, environment and natural resource protection, and social equity concerns thereby contributing to the idea of “sustainable development.”
5. **Mitigating Economic Volatility** – Through its operation as a financial policy tool, the NJSDB would provide an effective instrument to counter the volatility of recurrent business cycles, provide a means to mitigate abrupt federal policy changes, and address disaster recovery efforts, thereby providing New Jersey with a competitive edge over other states.
6. **Generating New Synergies** – By more thoroughly integrating existing public finance institutions that are currently structured in terms of their respective functional silos or geographical jurisdictions, the opportunity for re-arrangement provided by the introduction of the NJSDB would generate new synergies that would lead to enhanced problem-solving capacity.
7. **Reducing Leakage and Bringing New Jersey Dollars Back to New Jersey** – “Leakage” occurs when capital exits the economy rather than remaining in it. By funneling deposits from state agencies back into the state’s economy, a NJSDB would prevent capital from leaving New Jersey. Local small and community banks alone do not generally going to have the capacity to manage the state’s large deposits. Rather than putting the state’s public deposits in large nationally chartered too-big-to-fail banks, which are likely to be used and loaned out of state or even this country, the NJSDB would hold and use those same deposits for local state investments and loans.
8. **Positive Economic Impacts** – In her recently released policy brief “Exploring a Public Bank for New Jersey: Economic Impact and Implementation Issues,”²⁶ Stockton University Economics Professor, Dr. Deborah M. Figart suggests that “state-owned banks may be able to reduce the cost of public investment by lending at lower interest rates and avoiding asset bubbles with more evened out debt cycles. Some portion of the revenue (surplus) may be returned to supplement state budgets to enable more spending and/or reduce tax rates.” In the brief, Dr. Figart also states: “Using the customary empirical methodology (multiplier analysis), I estimate the potential impact of the proposed State Bank of New Jersey, calculating the effects on State Gross Output, Value- Added, Earnings, and Employment. Every \$10 million in new lending by the State Bank of New Jersey would yield an additional \$16 million - \$21 million in state output (Gross State Product), raise state earnings by \$3.8 million to \$5.2 million, add 60 –93 new state jobs, and increase state value-added

²⁶ <https://stockton.edu/hughes-center/documents/2018-0326-exploring-a-public-bank-for-new-jersey-economic-impact-and-implementation.pdf>

by roughly \$9 million –\$12 million.” Further analysis is required. However, Dr. Figart provides data that suggest significant economic returns to the state from a public bank.

What are the State Development Bank’s Potential Funding Sources?

Ultimately, the NJSDB should draw on multiple funding sources without negatively affecting any one source. The list of additional potential funding sources that follows is intended to be a starting point for capitalization. These suggestions require additional research and exploration to more fully understand their feasibility along with their consequences, both intended and unintended. They are not intended to be exhaustive. Further discussion will be centered on expanding the list. Specific amounts of capital needed to fund the bank in its entirety or any portion of the bank’s operations will be determined with further research. Research and further investigation will also determine how much any one of the proposed funding sources below (or any funding sources proposed going forward) would provide for the bank. Capitalization for the NJSDB could come from:

- 1. A Percentage of Public Deposits** – Could be made available or set aside in some way to be used to capitalize a portion of the NJSDB. It is estimated that the bulk of the State of New Jersey’s average cash balances are with large national commercial banks. There are no assurances that monies deposited by the state into banks is invested in or lent in New Jersey. Dedicating public deposits to the NJSDB, will prevent leakage of capital and ensure that New Jersey dollars are invested back into the state’s economy and into projects designed to address the state’s unmet needs;
- 2. A State Legislative Appropriation** – Could be dedicated to the NJSDB’s coffers. With consideration of New Jersey’s budget challenges and the status of the state’s credit rating, the Legislature and Administration would determine the appropriate level of an initial appropriation to cover a portion of the bank’s start-up costs;
- 3. Private Bank Contributions** – Private banks could be encouraged to contribute to or invest in the NJSDB’s “social benefits” fund and to designate these funds as Community Reinvestment Act (CRA) investments when they report to their federal regulators. In general, the state and local jurisdictions in New Jersey should adopt responsible banking policies to encourage greater local community investment on the part of the big banks. The establishment of the NJSDB provides a significant opportunity for large banks to engage in much more robust commitments to CRA than is currently the case;
- 4. Existing Public Finance Entities** – Existing public finance entities, such as the Housing and Mortgage Financing Agency, Educational Facilities Authority, Higher Education Student Assistance Authority, Transportation Trust Fund Authority, Environmental Infrastructure Trust, Economic Development Authority, New Jersey Redevelopment Authority, and the Casino Reinvestment Development Authority, could be required to set aside a specified percentage of their tax exempt bond funding to be pooled more broadly into a “social benefits” fund to be lent by the NJSDB in ways that are consistent with its mission. Some bond condition adjustments may have to be made in these regards going forward;
- 5. A Baby College Fund** – The State of New Jersey could establish a fund to which it would contribute \$50 at the time of newborn birth or adoption of children whose parents are income eligible.

Parents could also contribute until such time that the child begins to attend an in-state post-secondary educational institution when those funds can be accessed after remaining on deposit and accumulating interest in the NJSDB;

6. **Landlord/Tenant Security Deposits** – Tenant Security deposits are legally required to be kept by landlords in escrow accounts with interest paid to tenants. These funds could be deposited in the NJSDB perhaps dedicated to loans for rental affordable housing developments. The bulk of these funds remain stable with only limited turnover. Tenants could still be assured that they would continue to be paid interest on security deposits and their security deposits returned at the appropriate time pursuant to New Jersey law. Landlords would continue to collect annual administrative expenses of one percent of the deposit as provided for under current law;
7. **Private Philanthropic Funding** – Private foundations may donate funds to the State Development Bank for purposes that overlap between the missions of the private foundations and the mission of the NJSDB;
8. **Federal Government Program Funding** – In addition to the initial set-aside, the NJSDB may seek federal government funding from relevant and appropriate federal programs. The existing public finance entities may already have access to some of these loans and grants that may be eligible for deposit in the NJSDB;
9. **Recycled Loan Proceeds** – Once the NJSDB is adequately “seeded,” recycled funds from loan repayments would continue to sustain the NJSDB in perpetuity and in fact generate additional wealth;
10. **Voluntary Contributions** – the State of New Jersey could promote voluntary contributions to the NJSDB Fund. A voluntary check-off on the state’s income tax return may be the easiest vehicle. Other possible voluntary contributions need to be considered;
11. **Dedicate Existing State User Charges** – The State of New Jersey has numerous existing user charges that could fund the NJSDB. The examples that follow are illustrative and are not intended to constitute an exhaustive list. User charges could be limited based on use:
 - a. State license fees for small business permit charges, dedicated to micro lending;
 - b. Motor vehicle charges to traffic violation summonses and/or vanity license plates dedicated to transportation infrastructure improvements;
 - c. Water charges to be dedicated for clean water including wastewater, drinking water and storm water management improvements;
 - d. Sewer charges to address combined sewer overflows and storm water management infrastructure;
 - e. Utility charges to be dedicated to energy efficiency and alternative energy sources; and
 - f. Environmental permit fees related to lead clean-ups and other site remediation.
12. **Legalized Marijuana Tax** – The State Legislature is currently considering the legalization and taxation of marijuana. A portion of revenue derived from a marijuana tax could be dedicated for the NJSDB’s purposes. Any monies secured for the NJSDB through a marijuana tax could be dedicated to appropriate social projects that benefit communities disproportionately and most negatively impacted by historically unjust policies related to prohibition.

How would the State Development Bank Operate?

The NJSDB would not be a retail bank with brick and mortar branches and ATMs operating throughout the state. Instead, it would tap capital from a variety of public and private sources and work with and through community banks, credit unions, CDCs and CDFIs. The bank would lend to creditworthy projects that are public policy priorities, which are often less attractive to conventional private large bank lenders for a variety of reasons, including lower returns on investment.

The NJSDB would provide an “umbrella” to existing New Jersey State public finance entities, requiring them to interact in ways that they have not in the past; and require them to employ their respective bonding capacities to contribute some portion of their capital to the State Development Bank’s supply of funds. Other public and private sources of funding would also be tapped. Once the NJSDB is operational, recycling loan funds would provide a substantial amount of its working capital on a continuous basis.

In many ways, the state already acts like a bank through a variety of public finance entities. The establishment of a public bank is not intended to duplicate what these public finance entities are already doing. By defining what these entities, as well as private financial institutions, actually do and do not do, we can identify what needs are not being met. In this way, the public bank proposed will fill significant unmet needs.

Much of the State Development Bank’s lending activity would occur through partnerships with community banks, credit unions, CDCs, and CDFIs that typically lend to small businesses and to homeowners for residential mortgages. This is particularly important when natural disasters, like “Superstorm Sandy” occur, and when there are economic downturns with fallout on the scale of the persistent foreclosure crisis in New Jersey. The non-profit banking and financial sector offers a number of advantages including and most importantly that financial decision-makers are familiar with the communities in which they work.

The NJSDB would significantly expand the lending capacity of these local financial institutions. By providing additional services that go beyond what traditional lenders offer, the NJSDB will be able to identify and finance creditworthy projects historically overlooked. These additional services might include technical assistance to those receiving loans and additional capacity to vet the credit worthiness of socially beneficial projects which traditional banks are not able or willing to vet.

- **Additional Vetting Capacity:** The NJSDB would take into account criteria that extend beyond conventional loan eligibility criteria and apply relevant environmental and social equity criteria. For this reason, the NJSDB expects to partner with private sector banks and avoid competing directly with them. Multiple decades of socially responsible investing and lending have demonstrated the profit potential for such lending activity while implementing ways to manage risks prudently.
- **Technical Assistance:** The NJSDB expects to provide a level of service, including technical assistance and consumer counseling that the private sector frequently fails to provide. The track record for non-profits like New Jersey Citizen Action in this regard is instructive and was documented in a study by Federal Reserve Bank of Philadelphia.²⁷

²⁷ <https://www.philadelphiafed.org/-/media/community-development/homeownership-counseling-study/2014/homeownership-counseling-study-042014.pdf>

How would the State Development Bank be governed?

A threshold decision would have to be made as to the most appropriate location for the State Development Bank. Ideally, the NJSDB would be of but not necessarily in the New Jersey Department of the Treasury. The State Treasurer and Commissioner of the New Jersey Department of Banking and Insurance would sit on the State Development Bank's Board of Trustees, with the Treasurer serving as its Chairperson. The Director of the NJSDB would report to a Board of Trustees. The Board would set policy for the State Development Bank. Such policy would include, but not be limited to lending eligibility criteria.

In addition to the State Treasurer and Department of Banking Commissioner, the Board of Trustees would be comprised of the directors of the various existing state public finance entities, a representative for the Attorney General, and public members drawn from the private banking community and consumer banking advocates. The State Development Bank's Trustees would devise a set of policies to guide the Bank in terms of required reserves, setting interest rates, establishing liquidity requirements, and draft an investment policy that is consistent with its social responsibility requirements. In addition, the Board should approve a staff-developed business plan submitted by the Director that would at minimum serve as a guide to relationships with existing public finance entities, state departments and agencies, local jurisdictions and private financial institutions.

The NJSDB would be appropriately staffed by a Director appointed by the Governor, as well as a small professional staff with adequate experience in banking, public finance, and sustainable development.

How would the State Development Bank manage its risk?

The NJSDB we propose would carefully manage its risk with respect to its lending in the following ways:

- **Conventional Bank Lending Criteria** – The NJSDB would apply “Conventional Bank Lending Criteria,” e.g., prudent lending criteria, professional risk management; pre-existing funding supply constraints, conventional audits, etc. In the first instance, the NJSDB would manage the risk of its lending activities through the application of these eligibility criteria;
- **Developmental Banking Criteria** – The State Development Bank would also devise and apply a set of developmental banking criteria to promote the concept of “sustainable development” applied in ways to encourage financing that would be sensitive to environmental and social equity public policy concerns rather than limited to just traditional fiscal concerns. These criteria are sometimes referred to as the “triple bottom line.” It would use these criteria to prioritize its lending activities after projects meet conventional bank lending criteria; and
- **Additional Risk Management Safeguards** – Other checks and balances would be provided by constraints from funding sources, e.g., bond conditions, subject to review by the State Development Bank's Board of Trustees and subject to periodic audits and operations reviews.

Green, Sustainable, & Smart Future Overlay: Bringing NJ into the 21st Century:

While focusing on current unmet needs is important, the NJSDB should drive its investment and finance strategies and its policies by implementing a forward thinking and “green” overlay to move the state toward climate change resilience, more efficient use of resources, and state of the art technological innovation. The NJSDB should focus on projects that address energy efficiency and climate change issues, and projects that incorporate “sustainable development” and “smart cities” best practices in public infrastructure as detailed in the next section.

Financing 21st Century Public Infrastructure Investments

Conventional financing may too often undervalue long-term public infrastructure needs. In other situations, large national financial institutions may apply lending formulae designed to optimize bank profits when taken from a long-distance perspective that remains oblivious to local needs and opportunities.

The NJSDB should assist in identifying and lend to “smart cities” initiatives by exploring innovative financing arrangements that may encourage expedited permitting and procurement requirements, employ policy guidelines to encourage co-innovation and sharing among neighboring jurisdictions while simultaneously promoting innovative finance frameworks that would draw upon multiple capital sources. In these ways, the NJSDB would address the inefficiencies that emanate from both the private and public sectors to provide New Jersey with a competitive edge from which the state’s economy and its residents would benefit. Examples of public infrastructure investment projects that may be financed by the NJSDB include, but are not limited to the following:

- **Broadband Infrastructure Investments** – to develop, manage, and disseminate data through decentralized data hubs with open sources to improve transparency and public participation while simultaneously expanding social networks to connect and share lessons learned across local jurisdictions throughout the state, nation and internationally;
- **Redevelopment** – to develop and manage a database to identify and support strategic planning and investment with respect to vacant parcels, land assembly, and redevelopment opportunities that would positively affect local neighborhoods by encouraging reinvestment and mitigating displacement that results from gentrification, while identifying and acting upon innovative land use approaches, e.g., land value capture;
- **Affordable Housing Development** – to support affordable housing development and encourage residential integration, especially those developments associated with non-profit sponsors in the face of the demise of New Jersey’s Council on Affordable Housing (COAH) and the recent reduction of federal low-income housing tax credits and other federal public subsidies;
- **Education & Student Debt** – to promote digital literacy by closing the “digital divide” through school systems by targeting low-income and racially and ethnically segregated neighborhoods, while alleviating the current and growing crisis related to post-secondary student debt and loan obligations;
- **Small Business/Micro Lending** – to support the development of a small business eco-system and micro-lending opportunities by providing digital access to valuable information related to small business start-ups and adequate financing to support this underserved sector of the economy;
- **Transportation/Traffic Improvements** – to provide financing to upgrade transportation information management systems, to encourage electric and hybrid vehicles, to improve roads for autonomous vehicles, to explore the potential for and finance aspects of congestion pricing where warranted and feasible, and to finance other unanticipated urban transportation impacts;
- **Environmental Justice/Climate Change/Renewable Energy** – to finance addressing mobile air pollution source hot spots, vulnerability analyses related to sea-level rise, the impacts of more frequent extreme storm events and flood hazards, and energy efficiency & renewable energy measures;
- **Public Works** – to identify, address, and finance a range of public works projects and related equipment associated with local sanitation, street cleaning, snow plowing, solid waste disposal, recycling, etc.

Findings & Conclusions

This paper is a starting point for creating the NJSDB. The process for creating a public state bank will require much more research and the involvement of many more expert stakeholders. The next step in the process is to convene the Leadership Team and appropriate expert stakeholders from the public and private sectors in government, academia, advocacy, and industry to a series of roundtable discussions to review and debate each point raised in this paper.

Proposed Action:

The New Jersey Legislature should establish a New Jersey State Development Bank within the Department of Treasury with the State Treasurer as Chairperson of its representative Board of Trustees. The Board will provide the full-time Director and staff with policy direction on ways to provide greater access to capital at competitive rates for creditworthy, socially beneficial projects. The NJSDB should work in partnership with community banks, credit unions, CDCs, and CDFIs with respect to priorities that include public infrastructure investments, non-profit sponsored affordable housing developments, small business & micro lending, student debt & loan obligations, retirement savings, the environment, and climate change.

- The concept of a public bank is not new in the United States or abroad. The record of accomplishment for successful management and operations, and the social benefits of publically owned banks exist. The best practices of successful public banking institutions should be studied, replicated, and emulated to establish a New Jersey State Development Bank;
- New Jersey currently has funds set aside and systems in place to finance projects needed to address and solve significant social and economic problems in the state. However, the structure of various streams of funding and the amount of the funding for many aspects of these projects are not adequately covered and leave the state with substantial unmet social and economic needs;
- The primary mission of the NJSDB would be to expand access to capital at competitive rates for creditworthy projects that fall within socially beneficial categories and are currently not adequately funded or financed. The NJSDB would manage risks wisely and adhere to best practices and lending standards. Initially, the NJSDB could be organized to address the most pressing unmet financial service needs experienced by certain consumers and market segments in the state today. These financial service needs fall into the following categories:
 - Public infrastructure
 - Affordable housing developed by nonprofit organizations, urban redevelopment, neighborhood revitalization
 - Small business and micro-lending
 - Student loans and debt obligations
 - Retirement savings accounts

The benefits of the NJSDB would go beyond the obvious benefit of meeting needs of underserved consumers and markets. It would also mitigate the impacts of business cycle swings, federal government policy shifts, and natural disasters; finance public priorities in more responsive, efficient, and effective ways; promote enhanced cooperation and collaboration among existing public finance entities; provide direct and indirect multiplier impacts with beneficial effects on the state's economy and residents' quality

of life; and employ the state's access and control of a portion of its public funds to support proven financially sound investments that benefit New Jersey communities and their residents.

Further, the NJSDB would:

- Build on the state's public finance and community banking environment and cultivate innovative financing to achieve the following benefits:
 - Addressing People's Real Needs
 - Optimizing Economic Impacts
 - Managing Risk Wisely
 - Contributing to Sustainable Development
 - Mitigating Economic Viability
 - Generating New Funding Synergies
 - Bring New Jersey Dollars back to New Jersey
- Receive its initial funding from formerly untapped public and private sources to be combined and enhanced in innovative ways and then recycled on a self-sustaining basis. Although this brief offers some suggestions for funding, specific amounts of capital needed to fund the bank in its entirety or any portion of the bank's operations will be determined with further research;
- Not operate as a retail bank with brick and mortar branches and ATMs operating throughout the state. The NJSDB would extend and strengthen the operations of existing public financing with institutions interested in and which have a track record of investing in public needs, including and especially, community banks, credit unions, community development corporations (CDCs) and community development financial institutions (CDFIs). The NJSDB should not directly compete with them, thereby reducing concerns formerly raised in those regards;
- Be governed by a Board of Trustees. The Director of the NJSDB would report to a Board of Trustees. The Board would set policy for the bank. Such policy would include, but not be limited to lending eligibility criteria. The NJSDB would be of, but not necessarily in the New Jersey Department of the Treasury. The State Treasurer and Commissioner of the NJ Department of Banking & Insurance would sit on the NJSDB's Board, with the Treasurer acting as its Chairperson;
- Carefully manage its risk through the application of a dual set of lending criteria, e.g., conventional lending, development lending; with multiple built-in safeguards as well. These safeguards could include: adherence to best professional practices, its representative Board of Trustees, capital-supply constraints, and the application of an expanding body of knowledge related to socially responsible lending;
- Establish additional risk management safeguards. Checks & balances would be provided by constraints from funding sources, e.g., bond conditions, subject to review by the State Development Bank's Board of Trustees and subject to periodic audits and operations reviews; and
- Impose an environmental and climate change overlay, which takes into account climate change and incorporates "climate resilience," "sustainable development" and "smart cities" best practices and innovations to combat the negative impact caused by of climate change and inefficient use of resources.