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DEPARTMENT OF BANKING AND INSURANCE
OFFICE OF THE COMMISSIONER
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JUSTIN ZIMMERMAN
*Acting Commissioner*

February 2, 2024

The Honorable Philip D. Murphy
Governor of New Jersey
Office of the Governor
PO Box 001
Trenton, NJ 08625

RE: Recommendations for Implementing a Public Bank in New Jersey

Dear Governor Murphy,

As Chair of the Public Bank Implementation Board (the Board), I am pleased to submit the attached report with recommendations on the implementation of a Public Bank in New Jersey as required by Executive Order 91. On January 30, 2024, the Board unanimously supported the transmission of the report as presented. Since its creation, the Board has worked together to develop suggestions and gather public input that can further the State's goal of establishing a public banking entity.

While the Board considers its charge, as defined by Executive Order 91, fulfilled, it remains ready and duly constituted to assist with related duties going forward.

Thank you for your confidence in the Board and for your consideration of the report.

Respectfully submitted,

Justin Zimmerman
Acting Commissioner

# Recommendations for Implementing a Public Bank in New Jersey

Report to the New Jersey Public Bank Implementation Board, January 2024

next street

# 1. Executive Summary

This report seeks to inform recommendations from the New Jersey Public Bank Implementation Board (PBIB) on developing a public banking entity in the state of New Jersey in response to Governor Phil Murphy's Executive Order 91 (Executive Order). The Executive Order tasked the PBIB with exploring how public banking models can expand access to below-market rate capital for socially impactful projects in the state of New Jersey. Building on three years of work by the PBIB to evaluate numerous options, the State engaged Next Street, an independent mission-driven advisory firm, to perform research into the design of a public bank and the opportunity for an interim Bridge Entity to facilitate progress toward this goal. Included in this report is a summary of work completed and ultimate recommendations.

Next Street divided its initial research into two main foci. The first investigated the scale and areas of need for new forms of socially beneficial investment capital in New Jersey. This research revealed no shortage of need for low-cost, patient, and creative investment capital across several sectors of interest. More than a dozen unmet financing gaps in under-resourced communities of New Jersey in small business support, student debt solutions, affordable housing, and better infrastructure emerged from the research.

The second focus was the applicability of various public banking models for the specific needs of New Jersey. Over thirty public banking models were reviewed, identifying crucial and necessary tradeoffs in the areas of a given institution's mission, economic model, investment activity, and legal structure. At the heart of these distinctions was the question of whether a public bank should optimize profits to provide market-rate financial returns to government investors, or whether it should maximize its social impact at the cost of reduced or non-existent profits. Based on the stated intention of Executive Order 91, this report recommends that the State implement a public bank designed to prioritize social impact over profitability to achieve the primary goal of expanding access to below-market rate capital for socially beneficial uses.

Based on these initial findings the PBIB developed a framework for an initial Bridge Entity structure that would lay the groundwork for a public bank by more quickly addressing areas of need for investment through a temporary, easier-to-implement structure. The recommendation of this group resulted in the creation of the New Jersey Social Impact Investment Fund (SIIF), which was formed through the passage of S3977/A5670, an act of the Legislature that Governor Murphy signed into law in June 2023 (P.L. 2023, c-67), along with $20M in appropriated seed funding for the SIIF to address three market gaps for impact capital. The SIIF will deploy below-market-rate capital for critical investments in affordable housing, infrastructure, and early childhood education facilities and will be managed by a private fund manager that will blend public and private investment.

From this starting point Next Street and the PBIB conducted additional research and collected feedback on how to build to a public bank in New Jersey. Through iterative feedback Next Street and the PBIB compiled a comprehensive list of considerations, made narrowing decisions, and aligned on the following set of recommendations:

> New Jersey's public bank should be developed as a State-funded and partially State-controlled community development bank that is designed to play multiple roles in accelerating the investment of impactful capital in underserved New Jersey communities.

> Structured as a private entity and overseen by a combination of State appointees, private sector representation, and community members within the state, the public bank entity should operate independently of existing State agencies.

> To maximize the socially beneficial impact of the public bank's investments and below-market rate lending, it should not operate at a profit initially, and should rely instead on patient capital supplied by State and philanthropic investors that accept returns on these investments which may fall below risk-adjusted market rates. However, the public bank should be required to leverage State funds to attract private capital and reduce its reliance on State funding over time.

> The public bank entity should not be a depository institution but should seek funding from a diverse range of investors and non-depository investment vehicles to avoid bank regulations specifically focused on liquidity requirements that could reduce its opportunity to fulfill its mission.

> The public bank's core mission should be to work through and with existing financial institutions as much as possible, neither competing with nor replicating existing efforts.

As described in this report, this type of entity could be a multi-faceted player in community development by embracing multiple roles as a direct investor (potentially with a separate CDFI certification), a backstop for other financial institutions, and a convener or facilitator of investment in the community development industry in New Jersey. It should actively avoid competing with existing financial institutions and state agencies, but rather should support them through financial tools that will help them expand their impact, scale, and operational capabilities.

The State should maintain a voice in the governance of a public banking entity through representation on a Governing Board but should not retain majority control to insulate from fluctuating political will, while still representing the public interest of the state and its residents. Representatives from existing financial institutions and non-profits should be selected for the Governing Board via a Community Advisory Board made up of local stakeholders from communities that stand to benefit from funding deployed through a public bank. Nonetheless, the public bank entity should be accountable to the State and the public through transparent practices, detailed annual public disclosure, and an annual audit prepared by an independent public accounting firm.

Implementation of a public bank should build on the work of the SIIF by embracing its successes and avoiding its challenges, while simultaneously preparing for potential absorption of the SIIF into the eventual entity. Growing the SIIF, implementing a transition of the SIIF into a public bank, identifying permanent leadership, and fundraising will likely take several years. However, the gaps in New Jersey's community development ecosystem and the opportunities to significantly improve the lives of New Jersey residents are not temporary, and the vehicle outlined in this report has the potential to be a significant long-term catalyst for expanding access to below-market rate capital for socially beneficial projects.

# 2. Introduction and Project Context

## 2.1 Overview of Executive Order

In November 2019, Governor Phil Murphy signed Executive Order 91 forming a Public Bank Implementation Board (PBIB) to develop recommendations for a plan to create a public banking entity in New Jersey. As set forth in the Executive Order, the primary goal of this public banking entity is to expand access to below-market rate capital for creditworthy and socially beneficial projects, including those in public infrastructure, affordable housing, small business lending, and higher education financing. Additional goals and perceived benefits included:

- Strengthening capacity of local financial institutions and non-profit entities, including community and minority-owned banks, credit unions, community development corporations (CDCs) and community development financial institutions (CDFIs).
- Blending public and private capital to finance and support sustainable projects to benefit the public interest.
- Reducing "economic leakage" by retaining institutional investment capital in the State of New Jersey.
- Better coordinating State authorities and commissions as they work cooperatively on investments in these areas.

The Executive Order directed the formation of a Public Bank Implementation Board (PBIB), to be composed of "fourteen members consisting of key government official across relevant sectors as well as four public members appointed by the Governor". The stated responsibilities of the PBIB were to:

1. Assess the capital needs of New Jersey small businesses, students, infrastructure building, and affordable housing projects.
2. Seek input from the public on unmet capital needs, emphasizing low-income and minority populations.
3. Consult with experts in the field of public banking.
4. Develop a proposal for a public bank including capitalization needs and outlining its governance and operational structure.

## 2.2 Work of the Public Bank Implementation Board

The PBIB was officially formed in 2020, and despite the impact of the COVID-19 pandemic pursued ongoing activities for the several years following. The PBIB met with both public and private stakeholders on capital needs and thoughts on a public bank, surveying State agencies on the potential benefit of public bank, taking input from the general public at a virtual hearing hosted online in April 2022, and developing a short list of potential public banking structures based on an initial market scan. Through this process the PBIB decided on the following strategies to guide the future development of a public banking structure:

| | |
|---|---|
| **Start with a Bridge Entity.** | To quickly begin this work in earnest, the PBIB should recommend pursuing an interim "Bridge Entity" that could be a precursor to a public bank. The PBIB proposed that this entity could provide a smaller range of capital products to facilitate the proposed social impact of a public bank. The Bridge Entity was envisioned as an impact investment fund to attract long-term capital from outside "impact investors" with the goals of developing a track record and honing the capacity of existing State authorities, to prove the value of a public bank. |
| **Exclude retail deposits as a funding source.** | To meet the Executive Order's goal of avoiding competition with existing community banks and credit unions, the PBIB determined that the public bank should not operate as a retail bank that would accept deposits and provide personal banking services. The PBIB still considered whether the public bank should accept deposits from State entities and municipalities. However, as detailed below, this report does not recommend seeking deposits as a primary funding source for a public bank. |
| **Do not pursue the purchase of an existing bank.** | Purchasing an existing private bank to shape it into a State-owned entity was determined to pose unwarranted competitive risks to current New Jersey financial institutions, and therefore this concept was eliminated from consideration |
| **Seek alternative capitalization sources rather than the State's Cash Management Fund.** | The PBIB initially considered the concept of funding the public bank via deposits from the State's Cash Management Fund (CMF), which holds most of the liquid capital of the State. However, upon reviewing the liquidity requirements of State deposits, as well as the high variability in the amount of capital in the fund at any given time, the Board determined that the CMF is not a suitable financing vehicle of a public bank or Bridge Entity, and that other funding sources should be pursued instead. |

*Table 2.2.1 – Initial PBIB Guiding Decisions*

After narrowing the scope of what to consider in its final recommendations, in February of 2022 the PBIB advised the State of New Jersey as it issued a Request for Quote (RFQ) for consulting services associated with the design of the New Jersey Public Bank – specifically to create an operating plan for the Bridge Entity, an Implementation Plan for a public bank, and a final summary report including research performed, key findings, and recommendations.

## 2.3 Next Street Project Plan

The State selected Next Street's bid in response to the RFQ and began work in September 2022. Next Street, a mission-driven advisory firm and certified B Corporation, outlined a four-phase approach to this work as follows:


1. Fact Finding: Market research and analysis on the supply and demand of capital in key impact sectors to determine gaps that the Bridge Entity and public bank could address, taking input from desk research as well as

interviews with experts in community development investing, public banking, and impact investing to inform structural options.

2. Bridge Entity Business Plan: Development of options for the structure of the Bridge Entity; assessment of the capitalization requirements and options for capital sources for the Bridge Entity.
3. Public Bank Options Assessment: Development of strategic options for an overall public bank including governance, activities, and capitalization; evaluation of narrowed options based on feasibility and potential impact on mission; alignment on a go-forward strategy for the public bank.
4. Final Recommendations & Public Bank Implementation Plan: Development of final vision and operating plan for public bank; development of roadmap to execution of a public bank.

After Next Street first met with the Public Bank Implementation Board on September 19, 2022, the consulting team worked with the PBIB and smaller subgroups across all four of these phases, as follows:

| | |
|---|---|
| **Fact Finding** | Next Street's initial research included:<br>> Interviewing PBIB members and local stakeholders to understand the ongoing context in the state of New Jersey and opportunities for a public bank.<br>> Identified and analyzed over thirty investment gaps in student lending, small business support, affordable housing, and municipal finance that the public bank could potentially fill.<br>> Interviewed national and international experts on public banking structures to inform key design criteria and implementation options.<br>> Identified and analyzed over thirty national and international public banking models to identify key learnings, considerations, and opportunities.<br>Key findings are summarized in Section 3, and Next Street delivered findings from this research to the PBIB on December 19th, 2022. |
| **Bridge Entity Business Plan** | Next Street then identified, evaluated, and narrowed options for the Bridge Entity's structure, presenting a final recommendation to the PBIB on April 14th, 2023. The PBIB endorsed the recommendations which aligned with the Governor's FY 2024 budget proposal for a Social Impact Investment Fund (SIIF) to serve as the Bridge Entity with $20 million in initial funding. The Legislature built on this initial concept by approving this funding and by passing a new law authorizing the SIIF, which Governor Murphy signed into law on June 30th, 2023 (, P.L. 2023 c. 67). |
| **Public Bank Options Assessment** | Next Street subsequently developed, evaluated, and narrowed operational options for a public bank with ongoing input from the PBIB. Next Street presented an initial recommendation to the PBIB on July 5th, 2023, with request for comment. A final recommendation was presented to the PBIB on July 27th, 2023. |
| **Recommendations & Implementation Plan** | Next Street then developed an implementation plan for the proposed structure of the public bank, in addition to summarizing research, findings, and strategic recommendations in this report. |

*Table 2.3.1 – Research & Design Process*

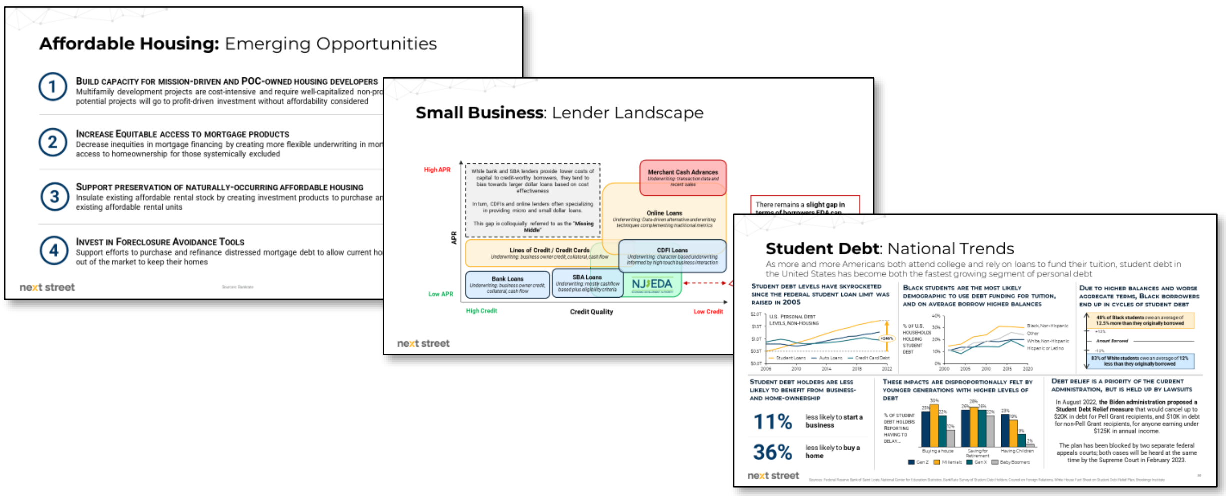
# 3. Research

## 3.1 Research into Market Gaps

Next Street researched opportunities for investment in the student lending, small business, affordable housing, and municipal infrastructure sectors, to identify and evaluate market gaps that the Bridge Entity and public bank might address. Factors reviewed included feasibility, potential impact, supply trends, demand trends, and market size in the state.

This process leveraged previous research by the PBIB, interviews with State agencies and local stakeholders, secondary research in market trends, and analysis of publicly available data to identify and evaluate gaps and gauge the size of markets.

Next Street identified and analyzed more than 30 investment opportunities across the four target sectors identified in Executive Order 91 and worked to identify the most promising potential investments. Through market research and data analysis Next Street narrowed the list to 14 potential investment gaps that a publicly owned or controlled financial institution could address, within these four broad categories.




Graphic 3.1.1 – Illustrative Research Slides

As noted in section 5 of this report, after the conclusion of Next Street's initial research, New Jersey legislative leaders identified early childhood education facility development as a fifth category of potential investment that was not initially identified in Executive Order 91.

In addition to narrowing the range of potential investment opportunities, Next Street also identified several key overarching themes for consideration in the next phases of work.

First, there is not one gap to solve for. There is a wide range of investment opportunities in New Jersey through which a public bank could deploy capital towards public good. A future public bank should be strategic when undertaking investment opportunities based on the mission, goals, and investment criteria finalized by its leadership team, but the scale of opportunity for gap-filling capital across all four sectors is significant.

At the outset, the SIIF and an eventual public bank should focus on investments where there is direct opportunity to complement or collaborate with existing state agencies and private partners. The most attractive gaps will be those that unlock further capabilities of existing impact-oriented institutions yet cannot be filled today due to current restrictions. Longer term, there will be opportunities to have higher impact outcomes from investments by working to expand the scope of existing institutions, but those should not be considered initially.

New Jersey is a high-cost state, and affordability has been a key focus of the Governor's, especially as New Jersey, like most of the country, faces a persistent shortage of affordable housing. As high-cost burdens disproportionately impact New Jersey's low-income residents, gap-filling capital enabled through a public bank can help address this issue. Similarly, there are significant gaps in the financing of public infrastructure, as public market dynamics combined with the low credit profiles of certain New Jersey municipalities limit the ability of the conventional market to invest in modern infrastructure that could improve the quality of life and achieve environmental justice for residents of New Jersey's poorest communities.

Thus, affordable housing and municipal infrastructure financing are excellent candidates for the initial investments of a public bank or Bridge Entity in collaboration with the New Jersey Housing and Mortgage Finance Authority (HMFA) and the New Jersey Infrastructure Bank (IBank). Both state agencies face structural restrictions that limit their abilities to take on specific high-impact gaps, based on higher perceived risk, creating a clear opportunity for an unstructured public financing vehicle.

By contrast, postsecondary student lending is a less opportune area for initial investment, due to the scale of funding required to have a meaningful impact in support of distressed student borrowers. The New Jersey Higher Education Student Assistance Authority (HESAA) currently effectively maximizes borrower benefits within the constraints of its non-State funding sources, by efficiently deploying the proceeds of bond to offer supplemental student loans with relatively low financing costs. Interest rates of HESAA's loans are based on public bond market demand. To further reduce the finance charges for a significant number of student borrowers in New Jersey would require pools of capital outside of the scope of the SIIF or initial public bank. As such, an initiative to address student debt would yield a lower immediate impact opportunity.

Similarly, small business lending should not be a starting priority. The New Jersey Economic Development Agency (EDA), in collaboration with CDFI partners, administers significant investments in New Jersey's small businesses. While this sector may become a longer-term priority for a public bank to add value in the future, EDA's successful programs, the recent influx of small business support funding made available by federal agencies in response to the COVID-19 pandemic (including the State Small Business Credit Initiative that is currently rolling out), and the EDA's strong current balance sheet, all suggest that a public bank's initial focus should be in other areas.

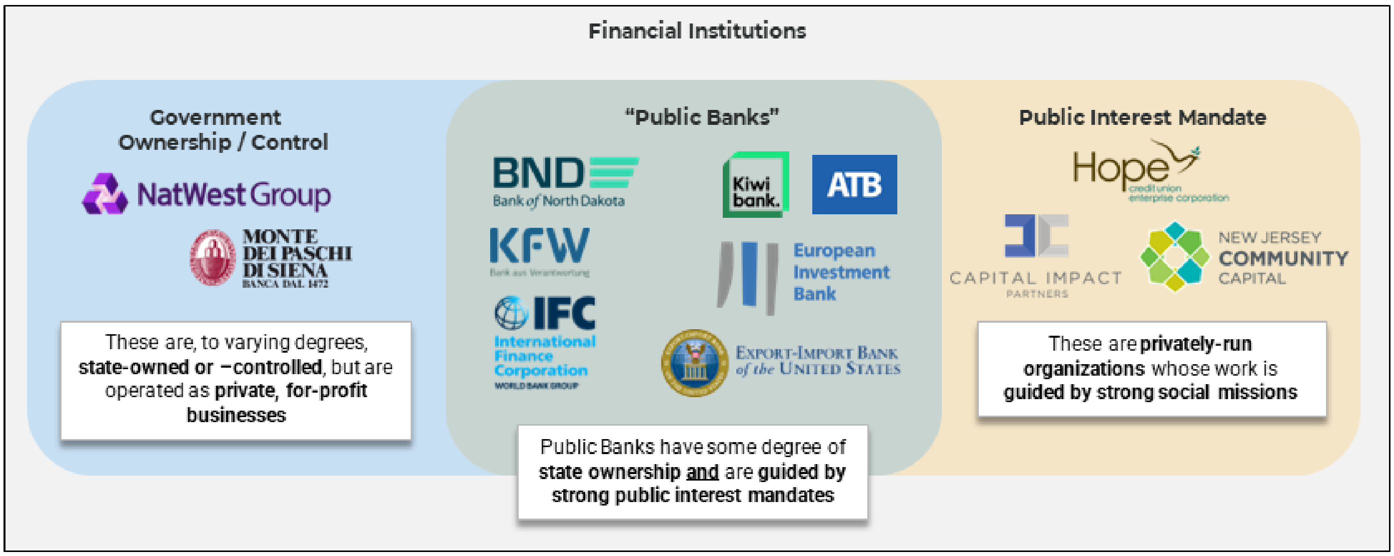
In all, the scale of need across these four investment areas underscores the potential impact of a public bank in New Jersey. While several select areas are immediate priorities for short-term funding through the SIIF, Next Street's research indicates that a future public bank should have a broad mandate with the ability to work across sectors on a wide range of high impact opportunities given the rapidly changing landscape of community development needs and investment.

## 3.2 Public Banking

Next Street also researched national and international history, as well as current context of public banking, to identify key learnings and best practices to apply to a public bank in New Jersey.

## Key Definitions

> *"Public Bank"* – While there are many varying definitions of public banks, for purposes of this report public banks are defined as **financial institutions with at least partial government ownership or governance that operate with a public interest mandate.**



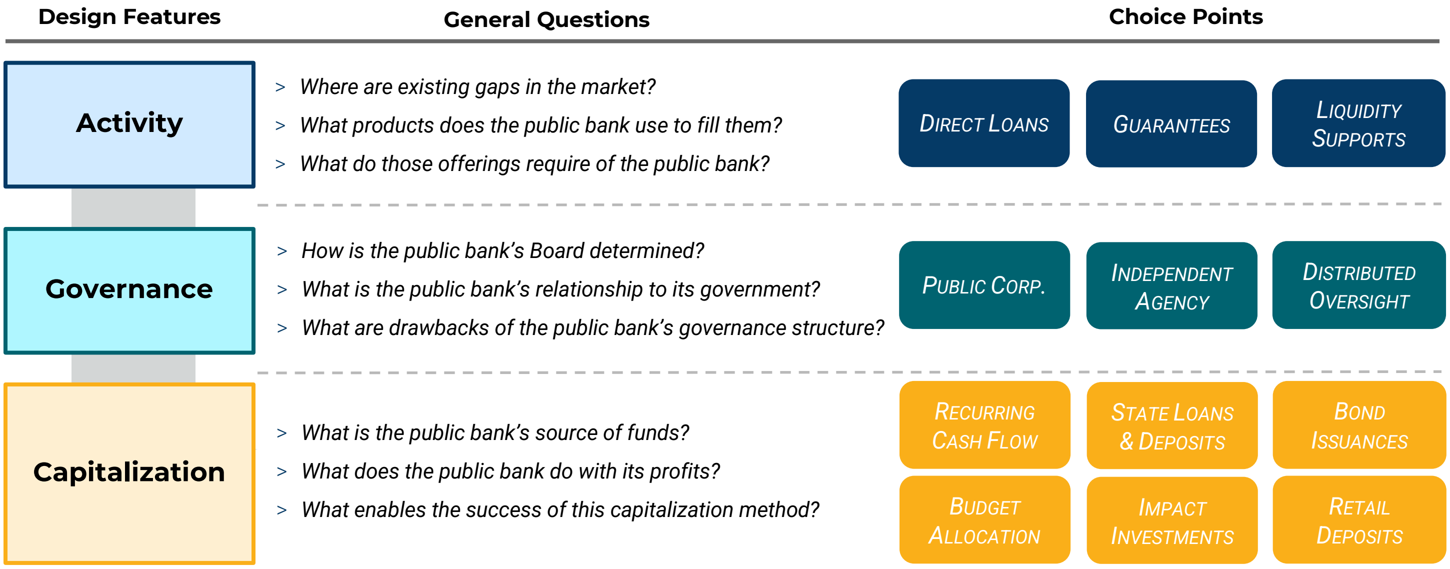

*Graphic 3.2.1 – Public Bank Definition*

> Segmentation – This report refers to several models of banking, defined as follows:

| | Makes Loans | Accepts Deposits | Branded as a 'Bank' |
|---|---|---|---|
| Central Banks<br>*Banks responsible for monetary policy* | Only to Commercial Banks | Only from Commercial Banks | Yes |
| Development Banks<br>*Banks that finance economic and community development* | Yes – Project Finance, Trade Finance | Sometimes | Sometimes |
| Investment Banks<br>*Banks that issue securities* | No | No | Yes |
| Commercial Banks<br>*Banks that serve commercial enterprises* | Yes - Corporate Loans | Yes | Yes |
| Retail Banks<br>*Banks that serve individuals and smaller businesses* | Yes – Mortgages, Auto Loans, Student Loans, Personal Loans | Yes | Yes |

*Table 3.2.2 – Banking Segmentation*

> <u>Analysis Framework</u> – In order to analyze various public banking models, this report defines public banks by three key design features: Activity, Governance, and Capitalization.




*Graphic 3.2.3 – Model Segmentation*

## Public Banking Background

Public banking as a concept has existed for millennia, but first appeared in the United States in 1791 when Alexander Hamilton introduced a plan to create a national bank to act as the government's fiscal agent. In the 1800s, roughly a dozen states created financial institutions in which the state government owned majority or minority stakes, but financial hardship and legislation supporting federally chartered private banks caused most of these state-owned banks to close toward the end of the 19th century.

The Bank of North Dakota (BND) is the last remaining state-owned bank in the Unities States established under this earlier model. BND opened in 1919 to bolster agricultural and economic development and has remained active ever since, mostly making or participating in commercial, agricultural, student, and residential loans. It plays an important role in stabilizing financial institutions in North Dakota through liquidity supports and backstops, and operates like a private commercial bank, remaining profitable and having returned $1B in dividends to the State since 1945.

In addition to BND, many other federal and statewide entities in the United States, such as the Small Business Administration (SBA), Export-Import Bank, and local economic development organizations meet the working definition of a "public bank," although most are not discussed as such, despite leveraging publicly funded balance sheets to provide financial tools intended to create public good.

Globally, different public banking models gained significant popularity during the 19th and 20th centuries. Currently, over 500 public banks globally control more than $18T in total assets. Most have a narrow focus around a specific role or type of financial intervention, although roughly one-third have a flexible mandate to promote social good.

Over the past several decades in the United States, there has been an increased interest in public banks at both the state and municipal level. Supporters cite a range of potential benefits of public banking models, including:

> Deployment of Flexible Capital – Leveraging both public funding and backing to introduce new forms of investment that are not feasible in private markets.
> Investments in Socially Beneficial Projects – Using the power of a publicly owned bank to invest strictly for public good.
> Expanding Access to Banking Services – Extending banking services and lending to unbanked and underbanked communities that are not effectively served by the private sector.
> Recycling Local Capital – Ensuring that locally-held capital deposits are invested in local communities rather than being deployed to generate investment returns for non-local entities.

Different public banking models emphasize some of these goals more than others. However, these values require trade-offs, and no single type of public bank can fully achieve all four of these goals simultaneously and equally. Recent initiatives have made varying amounts of progress on establishing entities that prioritize one or more of these goals, but to date no state has formed a new depository State bank that follows the BND model.

### Research Findings

Next Street researched more than 30 existing public banking models and interviewed national and international public banking experts to identify key design choices, considerations, and best practices. These efforts generated several key takeaways:

| | |
|---|---|
| *Activity* **The best public banks are solutions to clear and specific problems.** | > Public banks should be founded with a mandate to fill a specific purpose in a financial ecosystem that existing institutions are not equipped to address; the mission/goal of a public bank should be clear and specific.<br>> The goals of a public bank should dictate its structure; well-designed public banks identify their mandates and products first, and then develop capitalization strategies to fund that activity.<br>> Public banks offer a specialized set of products tailored the gap they wish to address. This gap can either be a product gap, causing a bank's specialization to focus on specific end borrowers, or a market inefficiency where a bank can specialize in interventions that can be broadly applied to a range of sectors. |
| *Activity* **Public banks should complement rather than compete with private financing institutions.** | > Successful public banks solve challenges for existing private financial institutions and community lenders by creating mechanisms that encourage higher impact lending.<br>> A public bank should not replicate existing structures and functions, but rather should solve for market gaps; public banks are established in response to specific gaps in financial markets that private institutions cannot or will not fill.<br>> A public bank must clearly define how its activities fit into the financial services market in which it sits. |

| | |
|---|---|
| *Activity*<br>**There is a tension between offering "high impact" loans and being profitable.** | > Public banks that seek to be profitable without subsidy need to generate sufficient revenue to cover expenses and repay their debts, which can be difficult if they focus heavily on higher-impact activities.<br>> High-impact activities can and often do entail higher levels of risk, which restrict access to financial markets and require government subsidies to absorb losses.<br>> Profit-maximizing public banks, such as the Bank of North Dakota, often focus on higher returning investments with lower perceived social impact. |
| *Capitalization*<br>**There are no easy ways to fund a public bank; each strategy has its trade-offs.** | > Public banks that rely on bond markets as a funding source tend to avoid making higher-impact (i.e., riskier) loans, to maintain their credit ratings and access to affordable capital.<br>> Government deposits often earn lower interest rates at public banks than at private commercial banks and since public banks rarely benefit from deposit insurance, these deposits are at risk in the event of severe loan losses or mismanagement.<br>> Impact investors report being less likely to directly invest in a public bank, although they may be interested in co-lending with a public bank or purchasing its below-market rate social impact bonds. |
| *Capitalization*<br>**Public banks nearly always require early funding from the State to reach full operating potential.** | > Public banks are initially formed via a direct public sector budget appropriation or a bond issuance that is backed by a government entity's guarantee or credit enhancement; in either event, demonstrating "skin in the game" on the part of the government sponsor is crucial to launching a public bank.<br>> Public banks are not always expected to maximize profits but should still generate revenue intended to minimize reliance on subsidies while still fulfilling their overall mission.<br>> The longest-lasting public banks decrease the need for ongoing one-off capital from their government sponsors by solidifying their operating model over time, securing ongoing government-sponsored financing, accessing additional funding, and creating efficiencies as they scale. |
| *Governance*<br>**Rigorous risk management policies and experienced leadership are crucial to public bank execution.** | > Many public banks have failed because they were established and run by governmental entities without deep experience in private sector risk management. This is especially true of those banks making direct loans and investments without maintaining a strong balance sheet and access to liquidity.<br>> Leadership from professional bankers and management professionals is critical to ensuring a public bank can sustainably and safely deliver on its objectives. |
| *Governance*<br>**Public banks must be transparent and have checks and balances to guard against political interference.** | > Public Banks are operated and led by financial professionals but ultimately governed at least partially by governmental leaders via a Governing Board; the oversight and independence of this Board is critical to eliminating political interference or corruption.<br>> Public banks are rarely regulated by outside authorities; rather, their governance structures are designed to be regulated through oversight and governance by the State, elected officials, and the public itself.<br>> Transparent processes and public oversight by legislators reduce risk but can also expose banks to disruptive political dynamics.<br>> A public bank should be ultimately beholden to the public it serves; creating mechanisms for public oversight and accountability are crucial to a public bank keeping the faith of its people. |

*Table 3.2.4 – Key Research Takeaways*

## Implications

These findings provide several implications for the next phases of work in implementing the Bridge Entity (now launched as the New Jersey SIIF) and designing a public banking entity.

First, there is a clear need to coherently define the core goal(s) and role(s) of the public bank. In designing a public bank, the fundamental decisions around the problem the public bank seeks to solve should drive downstream decisions around profit maximization, governance, structure, and capitalization sources. The final plan must carefully consider the role the bank can play in the market and who its potential partners could be. Avoiding competitive concerns from both political forces and peer financial institutions are crucial to the success of a public bank, so it is important to design the bank with these institutions in mind.

The delicate balance between profitability and impact is at the core of designing a public bank. From the outset, it is crucial to understand the market gap(s) that a public bank sets out to fill, as well as available funding sources both public and private. The form of initial State funding and the sources of public and private investment capital available to a public bank are directly tied to its economic model and goals. To balance competing priorities, a public bank can pursue diversification strategies in its mix of product and business lines, developing non-loan or investment-based revenue streams.

Finding the correct balance of public and private sector actors in the oversight of a public bank is another important design factor. Management of a public bank must have the requisite skill set to successfully manage and grow a financial institution yet must work in concert with public sector officials and agency heads to design and execute investment programs. Board representation should balance the State, the private sector, the general public, and communities served.

## 4. Bridge Entity Design

While the above considerations were incorporated in the public bank design process, Next Street and the PBIB also worked to develop a conceptual framework for a Bridge Entity structure that could be launched more expeditiously and be funded with a smaller initial investment while still having meaningful impact and demonstrating a proof of concept for public bank funding. Based on these discussions, the State established an impact investment fund vehicle that will blend public and private investment and be managed by a private fund manager. The New Jersey Social Impact Investment Fund (SIIF) was formed through an act of the Legislature that Governor Murphy signed into law in June 2023 (P.L. 2023 c. 67), along with $20M in appropriated seed funding for the SIIF to address three market gaps for impact capital by deploying below-market-rate-capital for critical investments in affordable housing, infrastructure, and early childhood education.

The design work on this Bridge Entity investment vehicle is summarized below:

Process Goals

| Outcome | | Description | Implications |
|---|---|---|---|
| **Feasibility** | **Secure Initial State Funding** | *To effectively attract additional outside capital to fund a Bridge Entity, State seed funding is imperative* | > The scope of the Bridge Entity's **activities** and **governance** must be **designed to achieve Governor and Legislature's approval for funding** |
| | **Raise Additional Outside Funding** | *To demonstrate the potential scale of a Public Bank, the Bridge Entity must attract non-State investment* | > The scope of the Bridge Entity's **activities** and **governance** must be **designed considering private investor interests and opportunities for outside funding.** |

| | | | |
|---|---|---|---|
| | | | > The **investment terms** of the Bridge Entity must have an **exit strategy that bridges to a future Public Bank structure.** |
| **Setup** | **Operationalize Quickly** | *To **continue the momentum** from authorizing legislation, the Bridge Entity must be stood up quickly* | > The **structure** of the Bridge Entity must be as **straightforward** as possible and **avoid implementation risks.** |
| | **Minimize Cost** | *To facilitate funding and prove concept, cost of implementation should be minimized* | > Where possible **governance** and **administration** of the Bridge Entity should strive for **operational efficiencies** and **avoid high-cost implementation** efforts. |
| **Proof of Concept** | **Deploy Capital Quickly** | *To **continue the momentum** from authorizing legislation, the Bridge Entity must be stood up quickly* | > The **deployer(s)** of the Bridge Entity must have the **operational capacity to deploy and manage target products and programs** quickly. |
| | **Demonstrate Unique Impact** | *To demonstrate the potential **impact** of a Public Bank, the Bridge Entity must effectively deploy new forms of impactful investment* | > The **deployer(s)** of the Bridge Entity must be **willing to deploy new and innovative products and programs** that require something like the Bridge Entity to be effective. |

*Table 4.1.1 – Bridge Entity Target Outcomes*

Key Design Considerations & Decisions:

The PBIB and Next Street evaluated three high-level tactics for standing up the Bridge Entity:

1) Execute within an existing state agency.
2) Execute with a private partner.
3) Create a new state agency.

Due to short timelines for implementation combined with anticipated operating costs, limited initial earnings streams, and the regulatory challenges of creating a new state-owned entity, the PBIB determined that building a new operational organization for the Bridge Entity should be ruled out.

Explorations of the remaining structural options centered on the following questions:

1) How will the State oversee the Bridge Entity?
2) Who will manage the Bridge Entity?
3) Who will deploy the Bridge Entity's capital?

While oversight, management, and deployment all from an existing state agency would be easiest to implement, it was determined that no single existing entity could serve all these roles. However, both the New Jersey Department of Treasury and the Economic Development Authority (EDA) were identified as able to serve an oversight role while engaging other private and public partners to serve in management and deployment capacities.

To evaluate private partners, Next Street compiled a list of organizations that could serve as either a manager or deployer of capital based on each entity's experience in community development investing, impact investing, and fund management in New Jersey and the broader region. This list included:

> NJ Local Partners
   - Community Development Loan Funds

  - Credit Unions and Community Banks
- Regional / National Partners
  - Regional / National CDFIs
  - Impact Investment Managers
  - General Investment Managers

From this market scan, it there was clearly a sufficient set of high-quality partners, enabling pursuit of designing the Bridge Entity with a private investment deployer or manager subject to oversight by a state agency.

## Investment Opportunities:

Based on the research into market gaps in key impact sectors, Next Street and the PBIB identified concrete investment opportunities for both the Bridge Entity and a public bank. These opportunities in turn were evaluated for fit with the goals of the Bridge Entity by Next Street, the PBIB, and relevant state agencies.

Two high-potential opportunities emerged in the affordable housing and municipal infrastructure space:

| Collateral Enhancement for Infrastructure Projects in cooperation with the IBank | Capacity Building for Emerging Developers in cooperation with HMFA |
|---|---|
| **Problem**<br>Because of risk management requirements, the IBank is currently unable to extend funding to certain New Jersey municipalities with low credit ratings for infrastructure projects. | **Problem**<br>Early-stage affordable housing developers struggle to access predevelopment loans to help them take on larger-scale projects and grow their capacity. |
| **Solution**<br>The Bridge Entity can provide credit enhancement to distressed areas such that vital infrastructure projects can qualify to receive IBank financing and meet critical community needs. | **Solution**<br>The Bridge Entity can provide predevelopment capital to mission-driven developers to help them expand their activities so that they can become investment-ready to build affordable housing and be positioned to participate in HMFA funding programs. |
| **Impact**<br>Enabling these transactions in low-credit areas could not only upgrade water infrastructure to improve residents' health and quality of life, but also increase the feasibility of general redevelopment projects that depend on renovated systems. | **Impact**<br>Building capacity for these developers can increase the overall affordable housing development capacity in the state of New Jersey, thus enabling more affordable housing to be built. |

*Table 4.1.2 – Bridge Entity Investment Opportunities*

## Bridge Entity Proposal

Next Street recommended that the Bridge Entity should take the form of an impact investment financing vehicle capitalized by both State funds and private investments, overseen by the State, managed by an outside private sector fund manager, and deployed via local New Jersey community development investors and State agencies. The financing vehicle should fund targeted investment projects that can demonstrate the social impact of such a vehicle as well as a public bank. The PBIB helped recommend that the role of the State should be:

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| **Funding** | The Bridge Entity should be capitalized initially with seed capital and build funding from the State, which can then be leveraged by attracting additional outside investments. |
| **Oversight** | Initially, the State should maintain sole oversight of the Bridge Entity through an existing State agency to expedite approval of funding and process execution. |
| **Management** | The Bridge Entity should be managed by an outside party given the lack of a logical current management capacity among existing State agencies. |
| **Deployment** | State agencies should comprise some of the capital deployers investing the Bridge Entity's capital, but private community-based investors should also be considered as potential deployers for relevant opportunities. |

*Table 4.1.3 – SIIF Fund Parameters*

The PBIB approved this recommendation in April 2023.

## 5. Social Impact Investment Fund (SIIF) Legislation

Based on this recommendation, the Governor's Fiscal Year 2024 budget proposed the creation of a "Social Impact Investment Fund" (SIIF) seeded with a $20 million State appropriation to create a new instrument that would deploy below-market rate loans, guarantees, or other financial tools to advance socially beneficial projects and programs. Specifically, the proposal included the following key actions related to creation of a Bridge Entity:

> Form a new publicly controlled entity to make gap-filling, impactful investments in New Jersey.
> Raise outside private capital to fully leverage the State's initial investment.
> Focus specifically on opportunities determined to be market gaps with high potential social impact.
> Work with the local financial ecosystem, potentially deploying loans through local and regional CDFIs.
> Provide multiple forms of investment to demonstrate the potential impact of a wide range of capital solutions that a public bank could provide.
> Work with existing State agencies to maximize their impact without duplicating their programs.

Key aspects of the SIIF's Governance, Management, and Capitalization are as follows:

| | |
|---|---|
| **Governance** | **State Treasury** will have oversight of the SIIF with guidance from an informal **steering committee** made up of representatives from HMFA, EDA, and the IBank. Responsibilities include:<br>> **Issuing a Request for Proposals (RFP)** for the Fund Manager of the SIIF and selecting an initial manager<br>> **Investing initial capital** from the State appropriation into the SIIF<br>> **Monitoring the Fund Manager** through audits and progress/impact reports |
| **Management** | The **selected Fund Manager** will manage the operations of the SIIF with responsibilities including:<br>> **Establishing a Special Purpose Vehicle** (SPV) which will form the legal structure of the SIIF<br>> **Identifying private capital** to leverage State investment in the SIIF either through direct investment or co-investment |

| | |
|---|---|
| | > **Invest in permissible uses of the SIIF** by either lending capital to private lenders and State agencies, or by purchasing loan participations |
| **Capitalization** | The SIIF's operating costs and capitalization will be funded by:<br>> **Initial State investment** which will cover both the SIIF's operating expenses seed capital for investment<br>> **Private investment** from philanthropic and impact investors, sourced by the Fund Manager<br>> **Repayments to the SIIF** from its investment activities<br>> **Earnings and interest paid to the SIIF** from investment activities<br>> **Additional State appropriations** that may become available in the future |

*Table 5.1.1 – SIIF Summary Parameters*

Senate Majority Leader M. Teresa Ruiz and Assemblyman John F. McKeon sponsored legislation, S3977/A5670, to establish a SIIF based on the principles outlined above. The bill passed through both chambers of State legislature on a bipartisan basis and was signed into law by Governor Murphy on June 30, 2023. Under the terms of this new law, P.L. 2023, c.67, three (3) permissible uses of the SIIF are initial target investment opportunities:

- Enabling water infrastructure financing in low-credit municipalities.
- Enhancing capacity for affordable housing development through pre-development loans; and
- Financing the development of early childhood education centers for new center operators.

The third item on the statutorily authorized list of the SIIF's initial activities – supporting childcare center development – was proposed and championed by Senator Majority Leader Ruiz. This welcome addition, identified during the legislative process, received strong support from community members, advocates, PBIB members, and legislators.

In the coming months, the State will issue a request for proposals to procure a private fund manager to be overseen by the State Treasury. Relevant State agencies will identify potential first investments for the SIIF in target areas, and the State Treasury will work with the steering committee to implement oversight procedures.

## 6. Public Bank Design Process

While the SIIF legislative initiative moved forward, Next Street and the PBIB simultaneously focused on design principles to include in a final recommendation for a public bank to address and further the goals set forth in Executive Order 91, while building on the progress of the SIIF.

To iteratively include feedback from the PBIB, the Next Street team led several phases of work to narrow down the potential solution set. This process included initial proposals from Next Street, ongoing design and working sessions with the PBIB, requests for comment from all PBIB members on an initial draft proposal, and final collective review of the overall recommendation presented here.

Design decisions from this process were narrowed to three main questions:

1. Core Focus – As emphasized in Next Street's research, identifying the specific market gaps and goals of a public bank is a crucial first step in its design. The Next Street team worked with the PBIB to collectively prioritize goals and define the recommended vision for a public bank.
2. Economic Model - A core tension in designing a public bank is the trade-off between making a positive social impact and being a self-sustaining (or profitable) financial institution. Next Street identified and presented to the PBIB its evaluations of several potential economic models for a public bank based on peer examples and industry best practices.
3. Governance Model - The group focused on key guiding questions regarding governance that surfaced in research into public banking models including:
    - What is the public bank's relationship with its government sponsor? In New Jersey, what would be a public banks relationship with the Executive and Legislative branches?
    - Who should be selected for the Public Bank Governing Board? How are they chosen? What are their term limits?
    - How is the public bank accountable to the public?

### Core Focus

The PBIB determined that the core focus of a public bank in New Jersey should align with the primary goal of deploying sub-market rate and patient capital that addresses market gaps in key impact areas to improve the lives of marginalized populations. While positive social impact should be the top priority, other secondary goals should be considered to determine potential impact and feasibility. While members of the PBIB expressed strong support for other secondary goals, ultimately the group decided that the social impact goal must take first precedence in determining how to deploy capital and how to measure the future public bank's success in remedying market gaps.

### Economic Model

To evaluate potential economic models, Next Street surfaced and evaluated the potential viability of a range of investment vehicles currently implementing impactful investing or banking strategies. These models included:

> Depository Banks & Credit Unions – Regulated depositories are required to be profitable and to implement strong safeguards that require conservative lending standards. Lending capital derived from customer deposits is subject to further limits on risk taking due to required strong liquidity and interest rate risk management policies and practices that prevent or constrain lending to less traditionally creditworthy projects and people. Limiting credit risk and providentially managing liquidity risk is core to the sustainability and scalability of these institutions, but it makes them a poor model for a public bank that has an exclusively

social impact mission. As such, depository banking was ruled out because while it could achieve several of the secondary goals of a public bank, it cannot support the socially beneficial investments that are the core mission of the public bank described in Executive Order 91 of providing the impactful capital.

> Impact Investing Funds – An impact investment fund that leverages private philanthropic investment and deploys blended capital or credit enhancement is well suited for the goals of the Bridge Entity, as is now underway with the establishment of the SIIF. However, this model does not fully accomplish the goals of a public bank given scale and funder limitations. The SIIF is an important starting point to prove the feasibility of investment concepts that can inform the activities of a future public bank, but staying within narrow definitions of impact funds would limit the ability for a public bank to grow to a robust operational scale. Traditional impact investing fund models were deemed too limited for the goals of the public bank.

> State Agency Model / Ongoing State Funding Sources – Public banking models depend on funding from a government sponsor to provide funding for initial operations and investment. However, there is no certainty of consistent and ongoing State funding for a public bank in New Jersey. Next Street and the PBIB reviewed options for tying an ongoing State revenue stream, such as cannabis funding, to financially sustain a public bank on an ongoing basis. However, the PBIB noted that, other than through an arduous Constitutional amendment process, no State funding set-aside can ever have true multi-year security; pledges to dedicate funding in any given year can be, and frequently are, overturned in subsequent annual budgets. Therefore, ongoing State appropriations were deemed the most feasible State funding source, despite questions around long-term sustainability, and should be strongly advocated as the cornerstone of public bank development.

> Community Development Financial Institution (CDFI) Loan Fund Status: The CDFI model is a proven option for impactful financial investing. Currently New Jersey's CDFI market is underperforming, as CDFIs in the Garden State receive lower percentage of federal CDFI funds than New Jersey's overall share of the national economy. Increasing CDFI presence through certifying a public bank as a CDFI entity could help address these issues, but Next Street recommends that a public bank focus on enhancing the existing CDFI ecosystem in New Jersey. As such, if certifying a public banking entity as a CDFI could negatively impact existing CDFIs in the state, it should not be pursued. If the public bank pursues CDFI status, it should seek the input of the existing CDFI community in New Jersey to ensure that it strengthens rather than detracts from their current operations.

➢ Endowment or Diversified Investment Fund – The PBIB considered models such as large-scale endowments or diversified investment funds that make impactful investments or grants from their corpus. While these investments can be very impactful, they simultaneously require investing large amounts of capital in traditional market-rate vehicles to subsidize a very small amount of funds used for grants or impact investments. The below-market rate activities made possible by such a model would be so marginal that they would not achieve the scale envisioned for a public bank. Thus, this option was ruled out.

### Governance Model

Among the areas investigated by Next Street, the PBIB helped in provided input on the following key questions:

> Role of the Governor's Office - The Governor's office is seen as central in advocating for the development of a public bank, but the public bank needs to be insulated to make individual investment selections free from political influence. The public bank should have a broad statutory charter tasking with achieving clearly defined positive social impacts. While the public bank's board should have some gubernatorial appointees, they should not make up a majority, and their terms should be staggered to prevent any one Governor from entirely overhauling the institution.

> Role of the Legislature - A public bank will require ongoing support from the Legislature and should be structured for reasonable ongoing legislative oversight to establish a system of accountability while insulating individual investment selections and lending decisions from political influence. To maintain ongoing accountability to the legislature however, a number of members of the Governing Board should appointed at the recommendations of legislative leadership.

> Governing Board - The public bank Governing Board should be made up of representatives appointed by a wide range of stakeholders that reflect interests across several priorities of the public bank. The Board membership should include experts in banking/investment, community development, and state and local government. Some Board members should be appointed by the Governor, some at the recommendation of legislative leadership, and others by the Board members themselves, including those selected from among a Community Advisory Board. Initial representatives to these positions may be determined by the Governor initially and then become self-perpetuating long-term.

> Additional Public Accountability – A public bank should be accountable to the public both through required reporting to the Legislature and Governor, and through reporting to a Community Advisory Board. In both cases, the public bank should be required to submit annual reports documenting its activities and how successfully it is meeting the social impact criteria spelled out in its legislative charter.

After considering its original research, the design process that ultimately led to the establishment of the SIIF, and feedback from the PBIB, Next Street formulated a high-level concept for designing a public bank that meets New Jersey's specific goals. This proposal was presented in high-level summary form to the PBIB in July 2023, and upon receiving the PBIB's conceptual approval, Next Street further built it out as a recommended implementation plan as described in the next section.

## 7. Recommended Public Bank Implementation Plan

To achieve the goals of Executive Order 91, New Jersey should develop a State-funded and partially State-controlled public bank focused on community development that will have multiple roles in accelerating the investment of impactful capital in the state. Structured as a private entity, it should have a Governing Board composed of State appointees, private sector representatives, and community members, but it should operate independently of existing State agencies. To maximize the socially beneficial impact of the entity's investments and below-market rate lending, it should not seek to be profitable initially. The public bank should not be a depository institution but instead should be capitalized by a diverse range of investors and investment types, including State funds and philanthropic donors, that agree to supply patient capital with the expectation that the returns on these investments may fall below risk-adjusted market rates. As it expands, the bank's activities may reach financial self-sufficiency, but attaining that goal should not be the focus of growth. Its core mission should be to work through and with existing resources as much as possible, neither competing with nor replicating existing efforts.

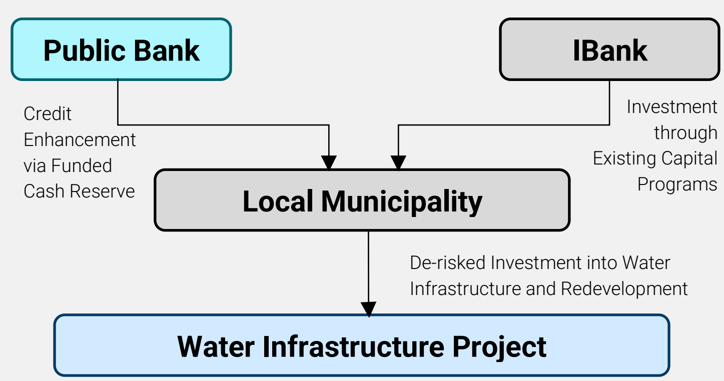
### Activity

The primary focus of a public banking entity should be to drive investment benefiting social good by solving unmet gaps in the community development market. This can take several different forms including as a catalytic investor, providing financial reassurance to existing institutions, and facilitating additional investment in target community development goals:

1. Catalytic Investor - The public bank provides catalytic investments into impactful opportunities to increase the flow of capital to communities in need. By investing in these opportunities that provide a below-market rate of return to the bank, it can attract additional outside investment that previously may not have been possible, unlocking capital access for communities and borrowers that are not served by current financial systems.

Example: IBank Water Infrastructure

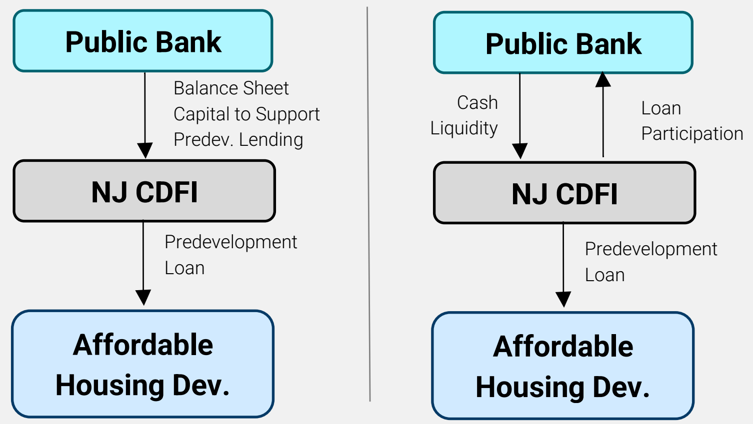
The public bank provides credit enhancement to low-credit municipalities that currently are unable to access funding via the IBank to fund water infrastructure and redevelopment projects in low-wealth areas.



2. Government Backstop – The public bank supports local CDFIs and community banks by providing direct investment, risk-sharing support, and liquidity functions to support these entities and their impact. By serving as an additional financial support to the local community development ecosystem, a public banking entity can grow financial support for low-wealth communities from the ground up.

Example: Predevelopment Housing Loans

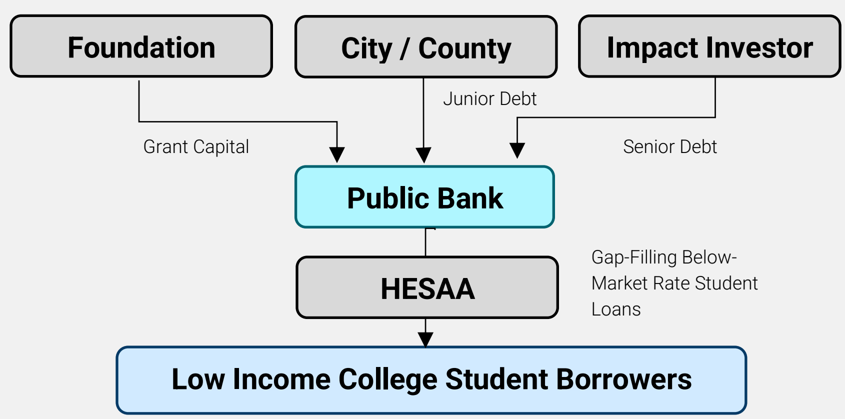
The public bank either directly funds, or purchases either participations in loans, or whole loans from lenders providing pre-development financing solutions to affordable housing providers operating in the State of New Jersey




3. Investment Facilitator – The public bank works with a range of public and private funders to structure bespoke investment opportunities that deliver impactful capital in New Jersey at below market rates. By being a coordinating entity the public bank can drive impactful investment in the state in ways it does not today, and build the foundation of a coordinated community development investment ecosystem.

Example: Local Low-Income College Fund

The public bank works with public and private funders to initiate new student debt offering for low-income borrowers at better terms than the existing student loan programs made available to them.




> Additional Detail:
  - Direct Lender / Investor: Initially, the entity should not directly lend or invest capital in local projects and organizations due to the implementation effort of creating those capacities in-house. Instead, it should invest in partnership with state agencies, CDFIs, MDIs, and community banks that have seasoned deployment infrastructure. Investments with these partners could take the form of balance sheet investments, loan purchases or participations, subordinated or "at-risk capital," or guarantees.

Once the public bank is established with an appropriate level of capitalization, it could build out direct investment capabilities, but only if there are no trusted local investors to originate said transactions. This tenet should reduce the perception that the public bank poses a competitive threat to local CDFIs and Community Banks.

- Catalytic Investments: The public bank should focus on providing catalytic investments that extend the impact of current state agencies and private lenders by leveraging additional private investment and facilitating non-traditional deal structures.
- Innovative Solutions: The public bank should support the sourcing, structuring, and execution of innovative transactions that blend State and private capital for social good; these pilots will build infrastructure for future public/private investment in New Jersey.
- Relationship to State Agencies: While the public bank will invest in and alongside existing state agencies, it should operate independently of them and have no legal or regulatory requirement to work with them on any investment program. Investment decisions should be made by the entity's management as approved by its Governing Board (details below), to avoid becoming "guarantor-of-last-resort" for state agencies.
- Relationship to MDIs, CDFIs, and Community Banks: A primary goal of a public bank in New Jersey should be to strengthen the existing economic ecosystem in underserved communities. It should provide tools to help existing MDIs and CDFIs fulfill their missions and increase their impact, rather than competing with them or private community banks. A new public banking entity should explore all potential avenues of investment to support these organizations, including direct investment, co-investment, asset purchases, and more.

## Capitalization

The organization will need to attract direct investment and co-investment capital from a range of investors including State appropriations, philanthropies, and impact investors, among others. State appropriations will be critical to building the initial track record and investment profile of the organization. Private capital will be key to maximizing the public bank's overall impact and helping it scale.

> Additional Detail:
  - State Funding: State appropriations should comprise the core of any public banking entity's initial capital base. Appropriations will require budget allocations over multiple years to cover start-up costs and initial operating deficits, and to serve as risk capital to absorb loan and investment losses. Without at-risk capital from the State, private funding will be difficult or impossible to attract. Additionally, without a strong multi-year State funding commitment, private investors could be deterred by the risk of changing State government priorities, which would significantly undermine the likelihood of success and limit a public bank's impact. Reliance on State funding should decrease as

the organization builds its capital base and reinvests capital reflows, but if State funding is withdrawn too early in the growth process it would limit the scale of the impactful investment possible.

- Private Funding: The public bank should seek additional philanthropic investment, co-investment, and debt funding from foundations, banks, and impact-motivated accredited and institutional investors. The initial focus for private partnerships should be funders that have a stated mission aligned with that of the public bank and can provide flexible capital. Over time, as the public bank grows, it should seek to attract more traditional market investors through blended financial structures. Non-accredited investors could be considered in the future if the appropriate securities exemptions can be obtained, and only if the Board deems it prudent to do so.
- Deposits: As noted above, the entity should not be a depository institution. Deposits would be an inappropriate funding source due to their high-liquidity nature, need for a market rate return, and the absence of an insurance mechanism. These constraints make funding via deposits antithetical to the mission of the public banking organization envisioned. Instead, the entity should secure grant capital from the State, along with low-cost patient investments from municipalities and private investors. Additionally, the regulatory requirements of becoming a depository institution would pose difficult operational challenges without a deposit insurance mechanism in place. It should be noted that this decision has several key implications:
    - The entity proposed here would be distinct from the Bank of North Dakota (BND) model of a for-profit depository institution that uses its capital base to fund loans and provides liquidity support to other North Dakota financial institutions. The reason for this distinction is mainly that the Bank of North Dakota is constrained by its mission to maximize profitability and thus does not underwrite the perceived "high-risk", impactful investments a New Jersey public bank is designed to offer. As such, BND charges mostly market rates for its financing options, while truly impactful investments occur on the margins of its activity, if at all, making it not an appropriate template for a public bank in this context.
    - The BND model relies on deposits of publicly owned capital, thus retaining investment capital in-state. While in theory this could be accomplished via public mandate for state agencies and municipalities to participate with a public bank, the hurdles to imposing such a policy would detract from support of a public bank.

  Ultimately, despite these trade-offs, focusing on non-deposit funding is necessary to fund the socially beneficial, low-yielding, high-risk investments that are the primary goal of New Jersey's future public bank.

> CDFI Certification: The public bank should explore the feasibility and benefits of seeking CDFI certification once the bank is established and has a proven track record. This will allow the entity to access a wide range of both federal grant and private debt capital including the Bond Guarantee Program, Capital Magnet Fund, and CRA financing from relevant banks. Any future CDFI application should be made in coordination with existing

CDFIs in New Jersey, to maximize New Jersey's share of federal funding available through U.S. Treasury's CDFI Fund and relevant funders.

### Governance

While the State should maintain a role in the governance of the public bank to ensure that its programs are in line with the public interests of the state, governance should largely be controlled by the nonprofit and community investment communities in New Jersey to ensure that the key goals of the bank are met regardless of periodic changes in governmental leadership. While shifts in the political realities in the state of New Jersey will impact any eventual governance structure, Next Street proposes the following preliminary suggestions in managing the governance of a public banking entity:

> Mandate / Mission: The public bank should have a broad mandate (in terms of sectors and types of investments) to make investments with positive impact on the social and economic welfare of underserved communities throughout the state, allowing for opportunistic investment in innovative opportunities as they arise.

> Community Advisory Board: To ensure that the voice of the communities that stand to benefit from the creation of a public banking entity is reflected in its governance initial leadership should appoint a Community Advisory Board made up of no more than 15 members from across key sectors to provide guidance on investment activities. In turn, five (5) members of the Governing Board should be nominated by the Community Advisory Board to ensure that their oversight and participation is not just ceremonial. The Community Advisory Board should be selected by the Governing Board in consultation with the Governor's Office, the Legislature, and the public.

> Governing Board: In addition to local community stakeholders, the Governing Board should include representation from other institutional stakeholder groups including the Office of the Governor, State legislative bodies, and industry groups in the field of community development finance. As such Next Street recommends that the Board be made of up around 15 members appointed by a range of parties:

- If the public bank were to seek CDFI status in the future, current CDFI regulations limit government appointees to be no more than 33% of the Governing Board. Consequently, the Governing Board should consist of no more than five state-appointed members: three appointed by the Governor with staggered terms, and one each recommended to the Governor by leadership of the State Senate and Assembly.
- The remaining two-thirds of the Board should be appointed by non-government entities, including:
    - Elected representatives from the Bankers Association, Credit Union Association, and CDFI community to ensure collaboration and limit competition between the public bank and existing financial institutions in the state.
    - Two members made up of members of the management team or appointed by members of the management team.

  - Five members selected by the Community Advisory Board from amongst its members, as noted above.

> Management Team: The Governor should appoint the first CEO and CFO, but the Governing Board should oversee their employment thereafter and select their successors. The initial CEO and CFO should have strong experience in private sector finance and risk management, as well as knowledge of the community development finance industry.

> Accountability: The public bank should prepare and present publicly available financial statements and impact reports to be formally presented to State legislators and the Governor annually. If the entity were to become a CDFI it would be separately subject to the federal reporting and impact requirements defined by the CDFI Fund, which can be found on the U.S. Treasury Department's website.

A summary of the intent of the Board was reviewed at a public hearing held on the 13th of December 2023, during which public comments were recorded on the scope and intention of the envisioned public bank entity. Comment was heard on the opportunities for investment that this entity could help address across a range of sectors, and considerations for implementation including having strong labor procurement standards for projects funded by the public bank. These considerations will play a key role in the next stages of implementation planning for a public banking entity.

## 8. Next Steps and Implementation Process

A significant effort will be required to implement this vision, which should not be underestimated. There will be unforeseen obstacles and questions and any implementation process should be flexible to account for these, but should generally follow a phased approach:

Pre-Legislation (approximately 2 to 4 years) – As the SIIF is deployed and grows, the next major milestone should be to pass authorizing legislation. This legislation would create the structure of the new public banking entity and provide the broader authority to fund different types of investments beyond those allowed in the SIIF law. In the years leading up to that milestone several work streams should be undertaken in parallel:

1) Stand up the SIIF – Ensuring successful launch and deployment of the SIIF is a crucial first step in building to the establishment of a public bank. Failing to execute on initial investments and failing to grow the SIIF will likely set back or end the public bank approval process. Supporters of the public bank should support the SIIF's launch, pipeline development, marketing of investments, and continue to advocate for the eventual public bank.
2) Grow the SIIF – Since the bank could be built on the balance sheet of the SIIF, the best way to support ongoing development of the public will be to scale up the SIIF, which can happen in several ways:

- Increasing Activities within Current Areas of Investment – If initial SIIF investments are successfully deployed, additional private or public capital should be able to be raised expand SIIF investment in these areas (*see above for currently-approved SIIF investments*).
- Expanding Approved Areas of Investment – In future legislative sessions emerging market failures in underserved communities should be considered for additional lines of investment for the SIIF. If identified, appropriations from Legislature should be sought to expand the SIIF's mandate.

3) Cultivate Partners & Funders - The proposed approach to creating this new entity relies heavily on convincing a range of partners across New Jersey to partner with the SIIF and the eventual public bank on transactions and in funding. These partners, including the banking community, credit unions, philanthropic funders, public advocates, and more should be brought into the development of the SIIF and forming the vision for the organization.
4) Milestone 1: Pass Authorizing Legislation

Post-Legislation (approximately 1 to 2 years) – Once the new entity is authorized in a state statute, the next phases of activity include:

1) Appoint CEO and CFO – A crucial first step will be to identify executive leadership of the organization. These leaders will hire a staff team and develop a transition plan. Selection of candidates for these two positions should be treated with appropriate significance, as they will be key to role the launch of the bank. While the organization is in this initial incubation phase, the CEO and CFO will be employees of the State, and authorizing legislation should account for this.
2) Develop Transition Plan – One of the most important parts of transitioning from the SIIF to the secondary banking entity is creation and implementation of a transition plan. Contents of this plan will depend on a variety of factors including the performance of SIIF investments, the range of these investment types, the amount and types of private capital raised by the SIIF, and more.
3) Hire Key Staff – An initial leadership team will need to be broader than just a CEO and CFO, starting at a minimum with a Chief Risk Officer and a Chief Investment Officer.
4) Fundraise – Once the transition plan is determined, fundraising for the public bank can begin as informed by the needs of the transition strategy. Public awareness from the enactment of authorizing legislation should be used to cultivate an initial potential investor base.
5) Form the Governance and Advisory Boards – Having both the Governing Board and the Community Advisory Board identified will greatly help with fundraising efforts and partner cultivation and will be needed once the organization starts operations.
6) Operational Standup – Create loan, investment, and operating policies, procedures, and manuals to fully codify operations of the bank.
7) Milestone 2: Transition to public bank operations

Launch (TBD) – Once the public bank is launched, the team will need to execute on the determined transition plan, hire additional staff, and begin making investments.