A Fiscal Infrastructure Task Force Initiative:

State Bank of Washington

Agenda

- Welcome and Logistics
- Introductions
- Launch Pad – Where we are now?
- Walt McRee
- Ellen Brown
- Lunch Break 12:15 – 12:45
- Dr. Karl Beitel
- Breakout Discussion and Report
- Concluding Action Steps

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Why?

Keep taxpayer money in the state – working for our state

- Infrastructure financing
- Access to capital
- Partner community banking system
- Economic Development
- Jobs

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What's happening today?

Revenue Sources

- City
- County
- Port
- State

Funds

- ....

WALL STREET

Earnings:

8% for Wall Street

1% for Washington

When it could be like this:

Revenue Sources

- City
- County
- Port
- State

Funds

- ....

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Earnings:

8% Washington Bank

1% for Funder

X% Infrastructure

Has any state done t

Yes, North Dakota (E

- 100 years of experience
- $4B in assets
- Acts as a Banker’s Bank
- Promotes development of agriculture, commerce
  and industry
- Consistently profitable
- Deposits insured by state

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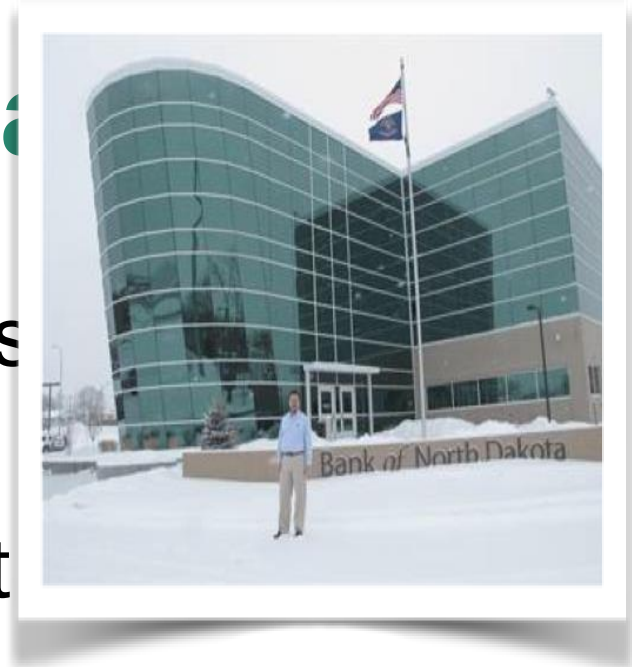
Benefits for North Da



- Some role stabilizing the s economy
- Improved access to credit businesses
- Augments lending capacity for community banks
- Low cost higher education loans
- Profits help fund state government

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Does North Dakota model work for Washington?

No:

NORTH DAKOTA

- Mostly rural population - small and relatively stable
- Agriculture and oil
- Limited infrastructure needs
- Provides direct

WASHINGTON

- Urban/Suburban population - large and growing rapidly
- Diversified industries: Agriculture, High Tech, Aerospace, Marine, Forestry, etc.
- $1.8B infrastructure projects identified to meet needs of fast

What can we learn from BND?

- Excellent financial experience & management
  - WA: Department of Retirement Systems
- Clearly understood mission
- Non-compete with local banks/credit unions
- Accountability and transparency

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An idea whose time has come

SEN. HASEGAWA GROUND WORK

OTHER STATES CONSIDERING STATE BANKING OPTIONS:

Oregon	Virginia
Hawaii	Maryland
Arizona	Massachusetts
California	Illinois
Maine	Florida
Michigan	New Mexico
Idaho	Tennessee

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Our objective

- Establish a bank through the legislative process
- Based on the credit of Washington citizens
- Assure the state more sustainable, sufficient
  revenue sources
- Support infrastructure and other potential needs

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Washington's revenues aren't enough

- $1 Billion+ per year in debt service…today
- Infrastructure
- Underfunding
  - Community College system
  - Mental Health system
  - First Responder training

HEALTH AND SAFETY OF RESIDENTS AT RISK

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The bank’s mission

- Deliver quality, sounds financial services
- Promote and facilitate commerce and industry
- Deliver services on behalf of all inhabitants

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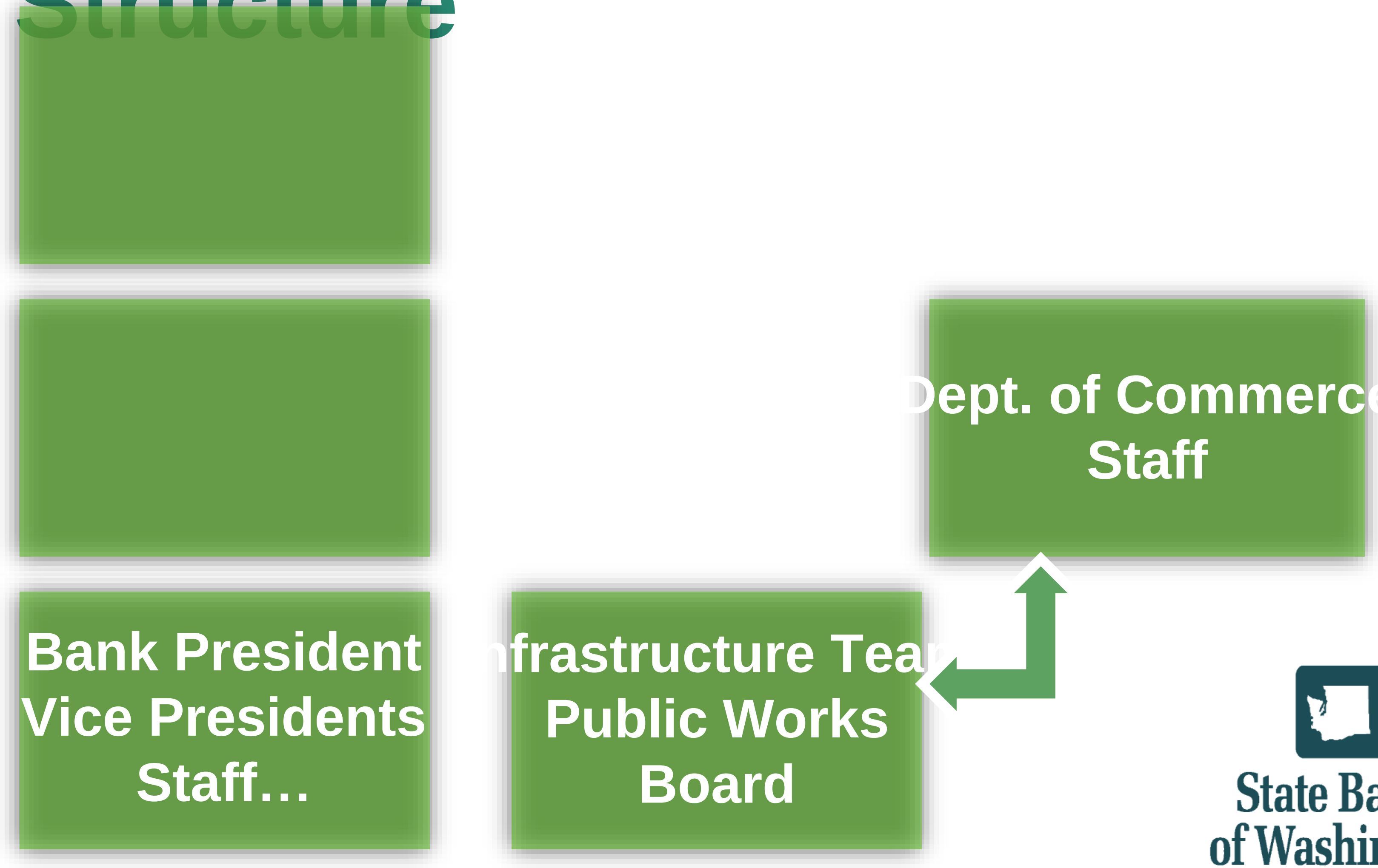
Separate and apart

It is not a piggy bank for the state to break and swipe funds

State Bank of Washington Structure



State Bank Budget Proviso

- Task Force
  - Both Chambers
  - Public with relevant experience
  - Financial Institution experience
  - State agencies

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What Washington State Could Do with Its Own Bank

Ellen Brown, JD
Public Banking Institute

Washington State Public Bank Forum
Seattle, Washington
July 14-15, 2017

Why do we need a *publicly-owned* bank?

- The state has plenty of banks and the government has loan funds.
- The difference is leverage -- $1 of capital can fund $10 in bank loans.
- Private banks can leverage but are costly.

The high cost of private finance

- More spent on Wall Street fees than on roads (L.A. study).
- School districts are paying 300%+ on Capital Appreciation Bonds.
- Debt-strapped governments wind up privatizing public assets, which means high user fees and tolls.

Washington has critical funding needs.

- Budget shortfall of $1.6B
- Affordable housing shortage
- At least $180 billion needed for infrastructure

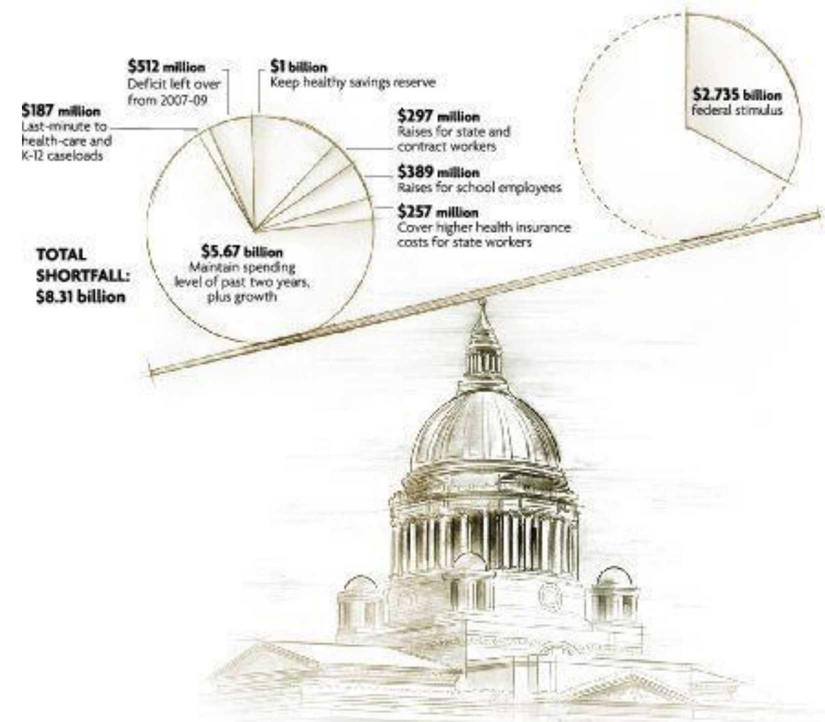
Half the cost of infrastructure is financing.

Bay Bridge retrofit:
principal, $6 billion;
interest, $6 billion.

Bullet train:
principal, $9.95 billion;
interest, $9.5 billion

Infrastructure costs could be cut in half if we could borrow from ourselves.

- But the state doesn’t have the money to lend – or thinks it doesn’t.
- Washington’s $41 billion 2-year budget must be balanced with taxes.



But Washington State has plenty of money—it just can't be "spent".

The state has:

– $90 billion in public pension funds

– $15+ billion in its Local Government Investment Pool & Treasury/Trust Portfolio

The problems of liquidity and risk

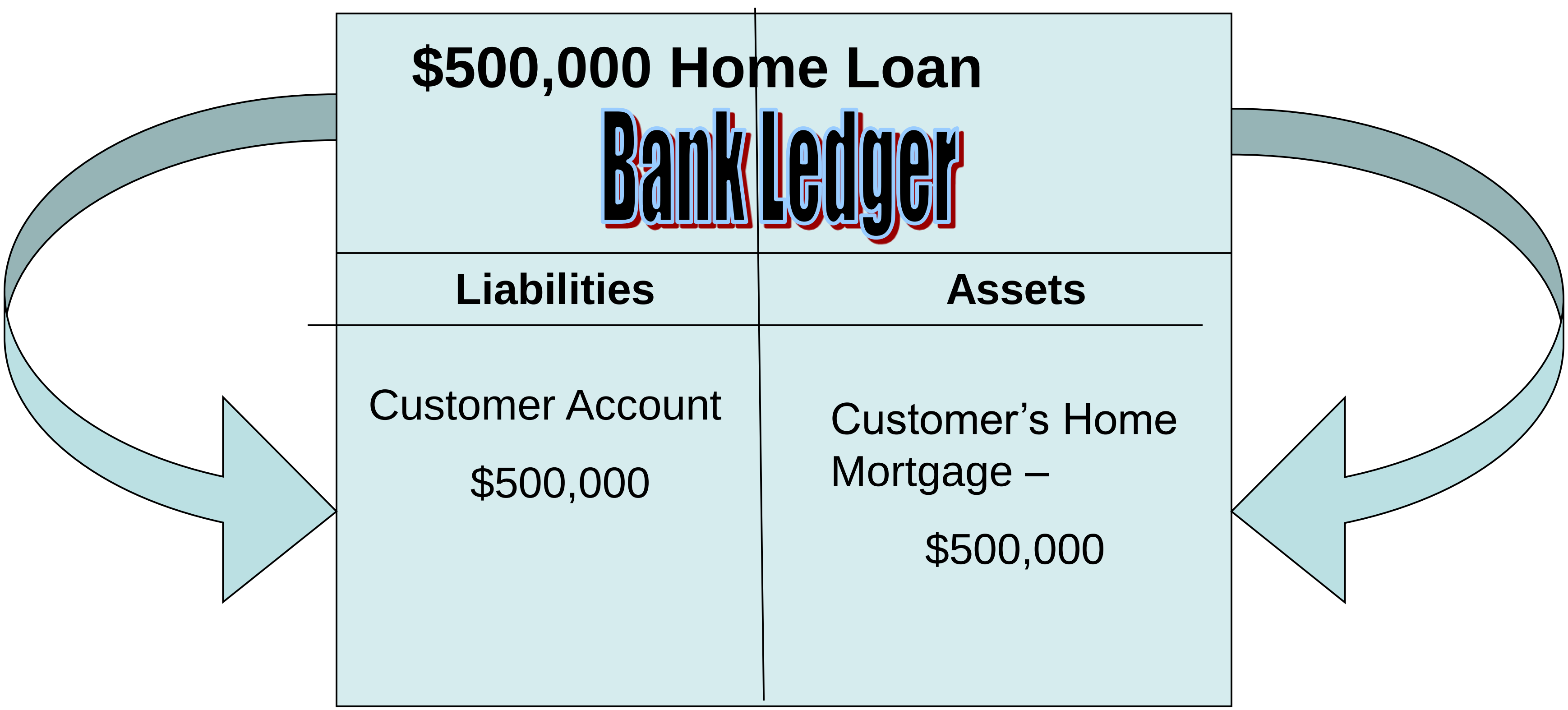
- State revenues cannot be lent long-term through a revolving fund because they might be needed for the budget.
- But a *bank* can turn short-term deposits into long-term loans.

The bankers' secret alchemy: *they don't actually lend their deposits*.

'[B]anks do not act simply as intermediaries, lending out deposits that savers place with them … Commercial banks create money, in the form of bank deposits, by making new loans… Bank deposits make up . . . 97% of the [money] currently in circulation.'

- *'Money creation in the modern economy', Quarterly Bulletin,2014 Q1, Bank of England.*

They do it by double-entry bookkeeping.



Net result: 0.

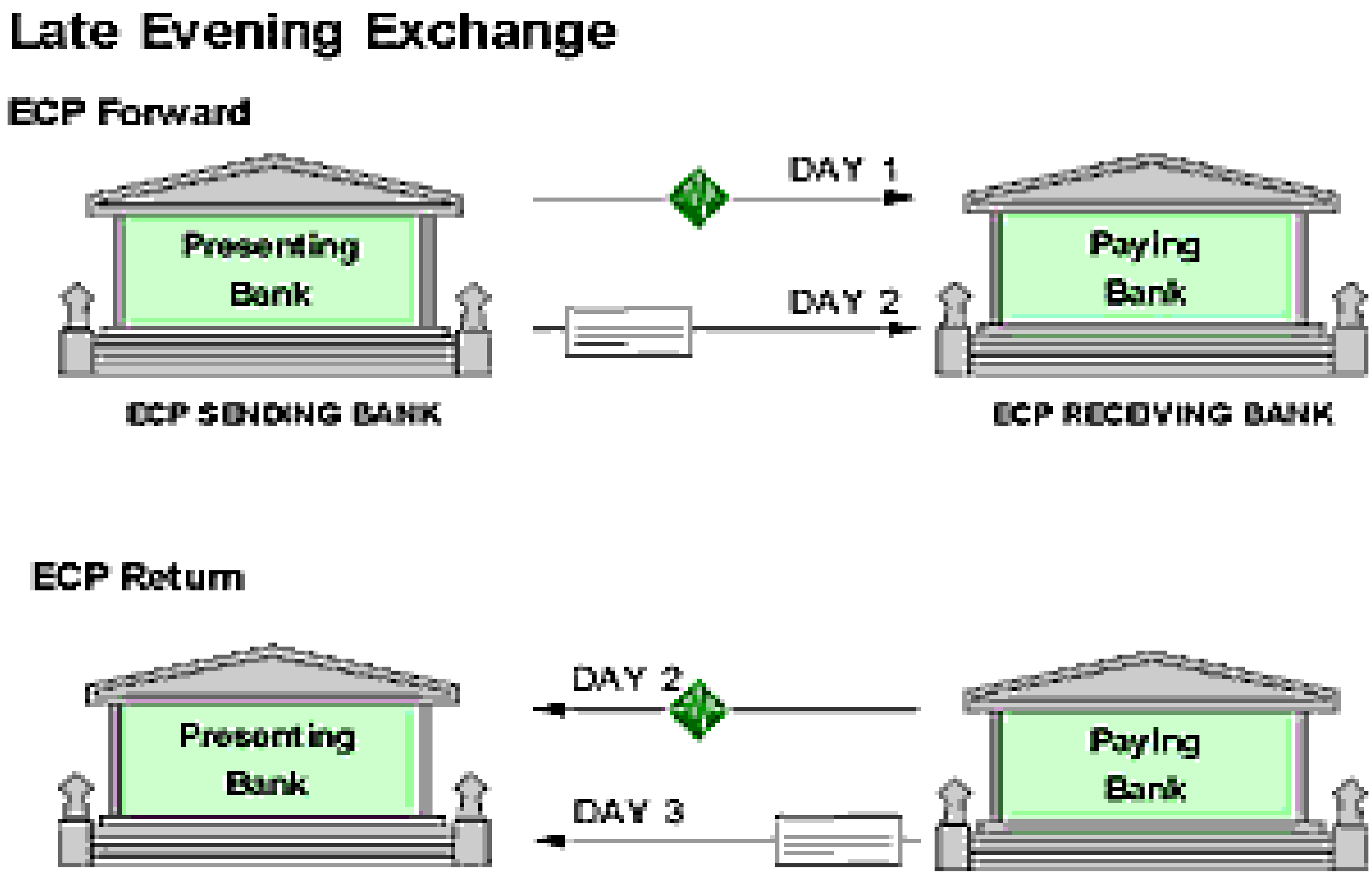
Banking alchemy

- Bank A creates $100K loan =
- $100K check =
- $100K deposit in Bank B

- Bank B creates $100K loan =
- $100K check =
- $100K deposit in Bank A

$200K created; both banks’ books balance

The shell game of balancing the books overnight



Solving the problem of "liquidity mismatch"

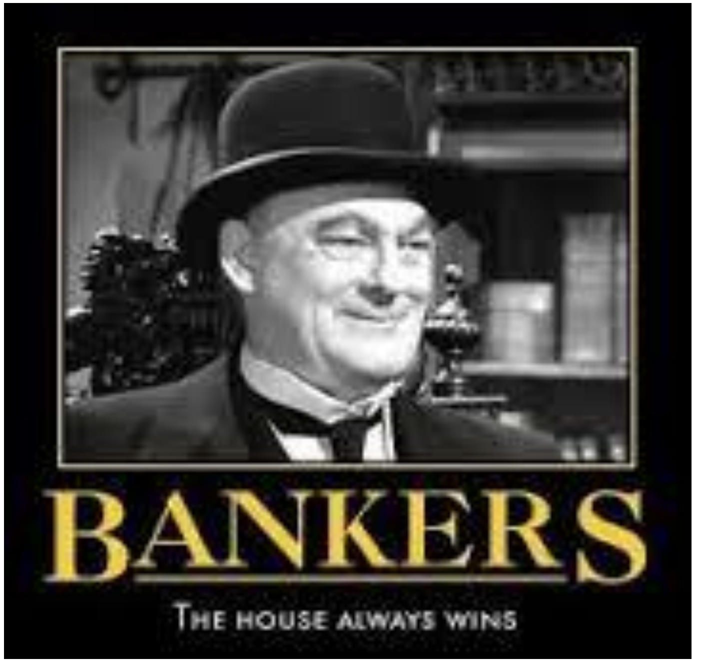
The bank can borrow short-term to cover shortfalls:

- At 1% overnight from other banks (fed funds)
- At 1.36% for a three-month loan from the Federal Home Loan Bank

FHLBANKS
A NATION OF LOCAL LENDERS

Today, Wall Street has control of the money spigots.

- Legally, banks own the deposits.
- They can gamble with them.
- They determine who gets loans and on what terms.
- They can refuse to lend, creating booms and busts.



Can Wall Street banks be trusted with control of our money?

Over a dozen felonies:

- Interest rate rigging on trillions of dollars in mortgages, derivatives, etc.
- Bid-rigging on muni bond debt
- Concealing risk from investors
- Mortgage fraud
- Wells Fargo: 2 million fake accounts

Wall Street triggered the 2008 collapse.

- 9 million jobs lost.
- 10 million foreclosures.
- $19 trillion lost in household wealth.
- Local governments forced into privatization and austerity.

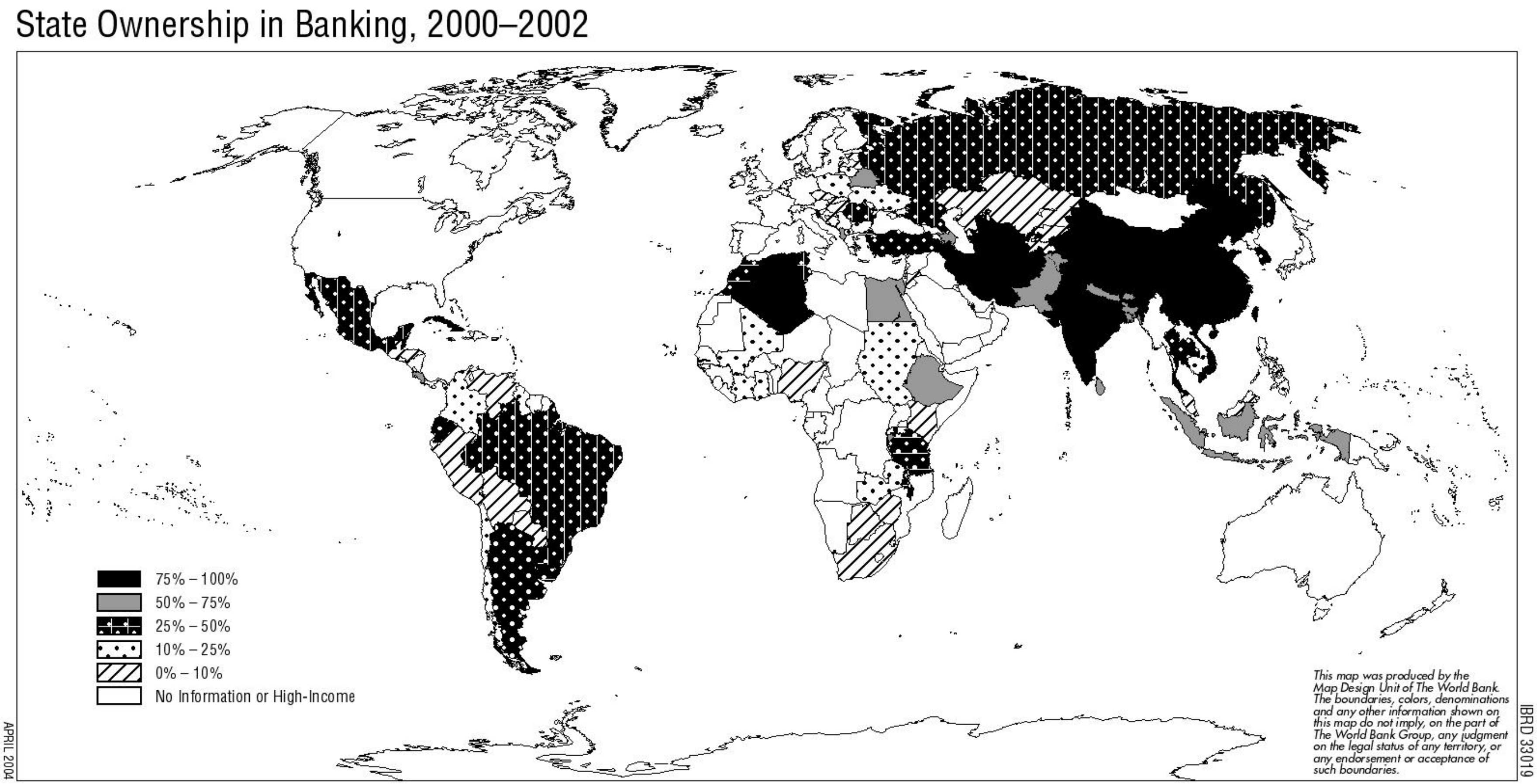
Why are we still doing business with them?

"We are completely dependent on the commercial Banks. *Someone has to borrow every dollar we have in circulation, cash or credit*. If the Banks create ample synthetic money we are prosperous; if not, we starve."

-- Robert H. Hemphill, Credit Manager of the Federal Reserve Bank of Atlanta, 1934

How to recapture the interest and multiply public revenues: own the bank!

Globally, 22% of banks are publicly-owned (40% before recent privatizations).



The *largest* banks globally are also state-owned, including --

- The two largest banks by market capitalization (ICBC and China Construction Bank)
- The largest bank by deposits (Japan Post Bank)
- The largest bank by number of branches (State Bank of India)
- The largest development bank (China Development Bank).
- The world's seven *safest* banks are also publicly-owned, leading with KfW, Germany's public development bank.

The publicly-owned Sparkassen (German Savings Banks) control one-third of German banking assets and have 15,600 branches.

2015 report comparing private German commercial banks with public savings banks (Sparkassen), regional banks and credit unions:

Total deposits and loans are about the same. Yet private banks are less profitable and pay less than half the taxes.

“Economic miracles” have occurred in countries with strong public banking sectors.

- China
- Korea, Taiwan, Singapore, Hong Kong
- Post-war Germany and Japan
- Brazil, Argentina

China’s remarkable infrastructure

- 12,000 miles of high-speed rail built in a decade
- World’s largest dam and power station
- How funded? The government owns 80% of the banks.

The US has one public depository bank – in North Dakota.

- The only state to escape the 2008-09 credit crisis
- The nation's lowest unemployment rate
- One of the lowest foreclosure rates
- Lowest defaults on student & credit card debt

The Bank of North Dakota is *more profitable than Wall Street*.

Wall Street Journal, Nov 16, 2014:

"It is more profitable than Goldman Sachs Group Inc., has a better credit rating than J.P. Morgan Chase & Co. and hasn't seen profit growth drop since 2003. Meet Bank of North Dakota, the U.S.'s lone state-owned bank, which has one branch, no automated teller machines and not a single investment banker. . . . Return on equity, a measure of profitability, is 18.56%, about 70% higher than those at Goldman Sachs and J.P. Morgan."

The BND has had record profits for 12 years

- Spring 2016 annual report showed:
  – total assets of $7.4 billion
  – capital of $749 million
  – a return on equity of 18.1 percent.
- This despite a devastating oil BUST beginning in 2014.

Why so profitable?
BND has lower costs.

- No bonuses, fees, commissions.
- No high-paid CEOs.
- No private shareholders.
- No advertising.
- Massive deposit base – all state revenues.
- Local banks act as front office.
- No need for branches; no ATMs.

BND's savings are passed on to borrowers and communities.

- 2% loans for infrastructure (schools, roads, water facilities, etc.)
- Student loans 2% below federal rate
- 1% loans for startup farms and businesses
- Low-interest loans for affordable housing

The magic of leverage: How Washington could do it.

Capital: $100M from pension funds x 5% = $5M

Deposits: $1B from Local Gov Inv Pool/Treasury x 1.1% = $11M

Loans: $1B less 10% = $900M to lend or invest.

Invested in bonds or loans earning 3% = $27M,

less $16M (cost of funds)

less $3M loan loss reserves (BND withholds 11% of interest income)

= $8M profit x 12.5 years = $100M.

After capital repayment, $13M/profit annually.

Or, using cannabis cash

Capital: $100M from pension funds x 5% = $5M

Deposits: $0.

Loans: $1B less 10% = $900M to lend or invest.

Invested in bonds or loans earning 3% = $27M,

less $5M (cost of funds) & $3M for loan loss

= $19M profit x 5.26 years = $100M.

After capital repayment (or if capital comes from a one-time state injection), $24M/profit annually.

Keeping the bank honest – how to avoid corruption

- New digital blockchain systems allow full transparency and accountability
- Targeted lending, strict underwriting standards
- No speculation
- No bonuses, fees, commissions—no incentive to gamble

Recent studies show that public banks globally are:

- Safer.
- Less corrupt.
- More efficient and more profitable for local governments and local economies.
- Avert banking crises by lending countercyclically.

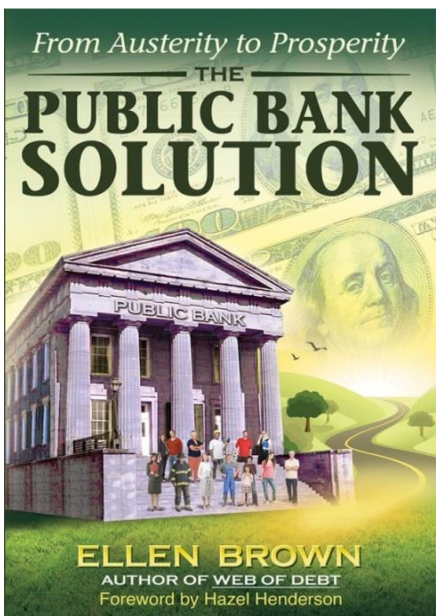
PUBLIC BANKING INSTITUTE

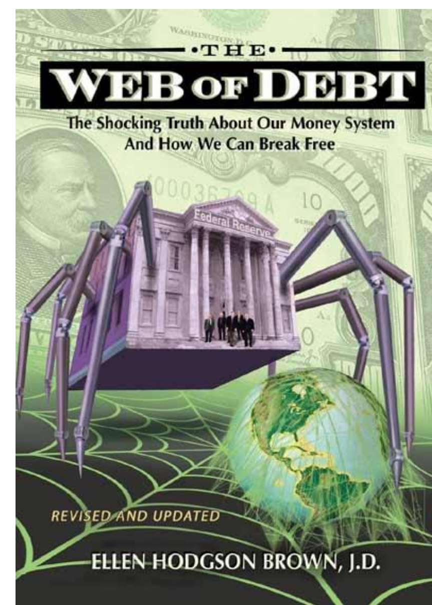
Banking in the Public Interest

For more information –

PublicBankingInstitute.org

EllenBrown.com





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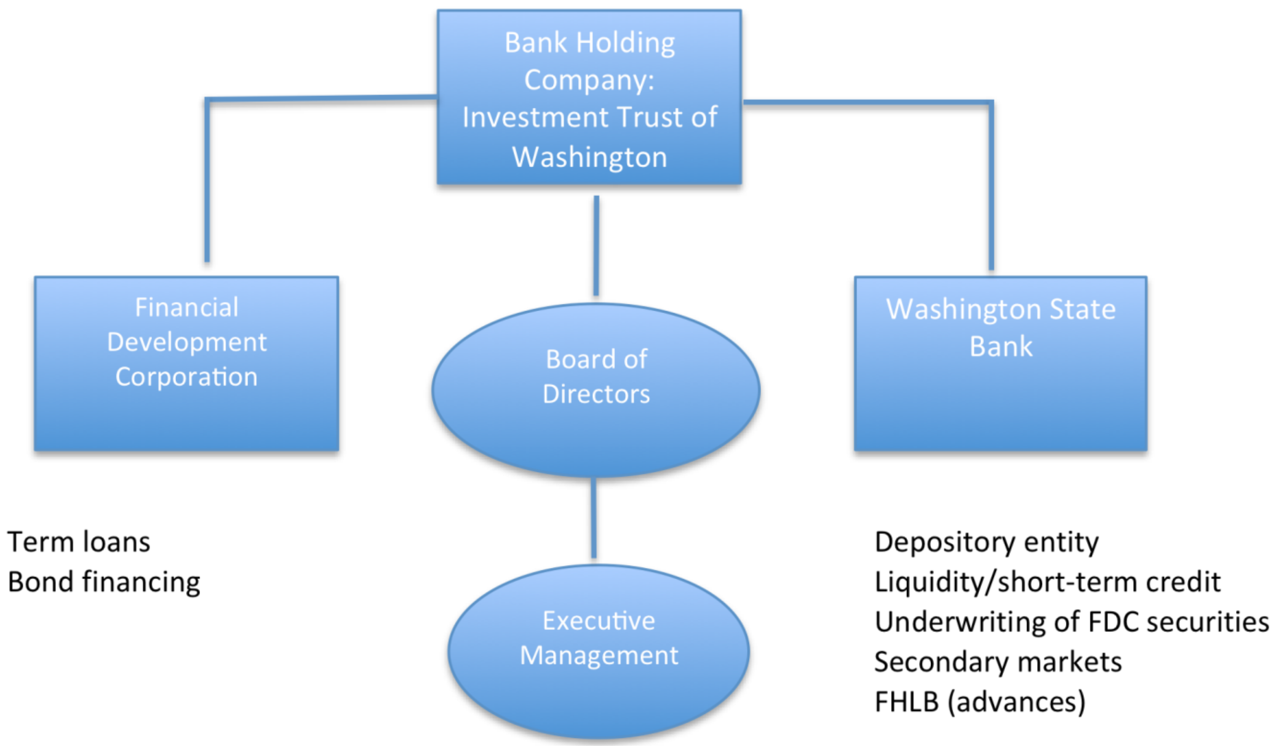
Creating New Public Financial Institutions: Options for the State of Washington

Karl Beitel

Director, Public Bank Project

Form of Incorporation: Bank Holding Company with Subsidiaries



Capitalization

Options:

- General Fund (one-time or limited allocations)
- Pension Funds (public, national in scope)
- Foundations
- Socially Responsible Investment Funds, individuals

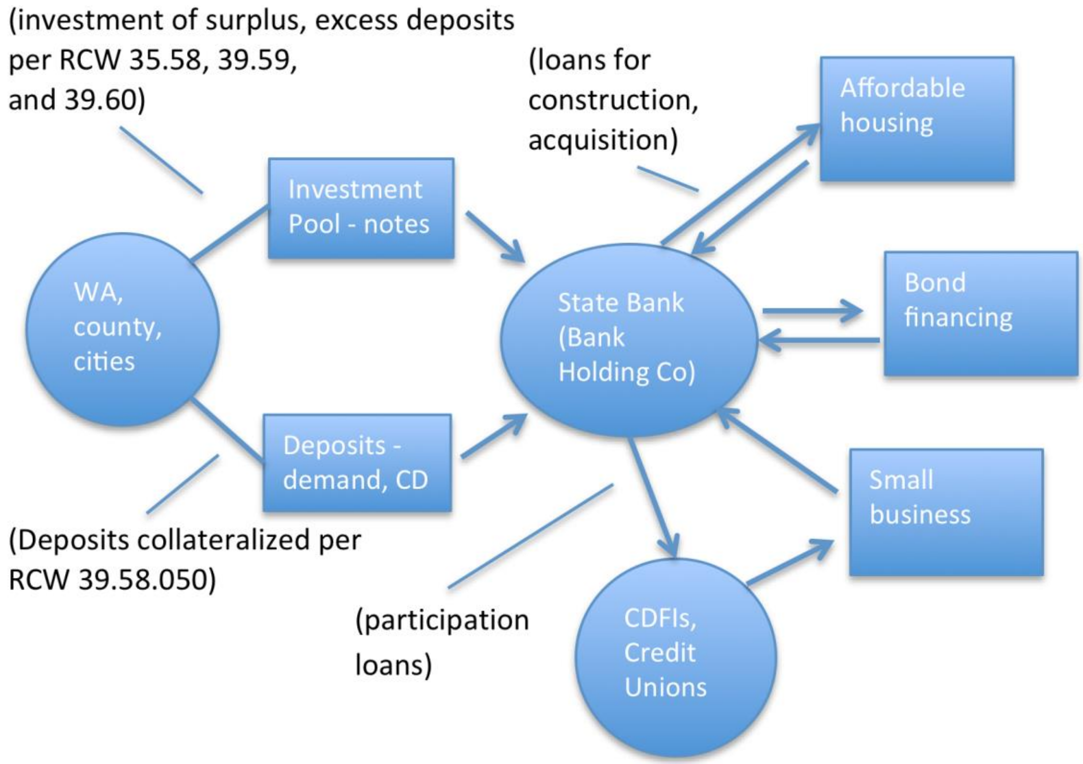
Limited Allocations - E.g., If Washington Public Pension funds allocated ½ of 1%, $45 million in equity

Target level: $250-300 Million; All Tier I (common stock); can have different classes –Class A (voting shares); Class B (non-voting)

Funding Sources

- Local Government Investment Pool – deposits; limited to 150% of Net Worth of depository; 1.5:1 capital multiple
- Washington Trust/Treasury – deposits (investment and depository); Corporate Notes up to 25% of total WTT pool
- Local counties and cities that manage own Investment Pools – allowable investments are regulated by RCW 35.58 and 39.59 and local investment policies (see King County example)
- Other investors that purchase CDs, banker's acceptances, corporate notes/medium term notes (1-5 years in maturity)
- CDFI Bond Guarantee Program – up to $1 billion total
- Public deposits collateralized as per RCW Section 39.58.050; will require a letter of credit from FHLB

State Bank as financial intermediary



Payments of principal and interest received by the Bank are rechanneled back into local investment

Example using King County

- Data from 3/31/16

Maximum Possible Allocation from King County Treasurer's Pool

Issuer	Instrument	Maximum % of Total Pool	Maximum to Single Issuer	Term	Maximum Current Amount (millions)
FDC	Corporate Notes	25%	5%	1-5 years	$288.60
WSB	Certificates of Deposit	25%	5%	1 year	$288.60
WSB	Banker's Acceptances	25%	5%	180 days	$288.60
Total County Placement					$865.80

Mock-up Balance Sheets of Subsidiaries of Bank Holding Company

PHASE ONE

Financial Development Corp

Assets	Liabilities
Loans, Bonds $800m	$800m FDC Notes

Internal liability of BHC

Washington State Bank

Assets	Liabilities
USTR, Agency notes $600m	$300m Equity (Common Stock, Class A)
Bonds, other loans $600m	$350m Deposits (LGIP)
FDC Notes $800m	$300m Deposits (non-investment, WTT)
	$300m Corporate Notes (Other local)
	$500m Corporate Notes, CDs,(non-gov)
Equity (CDFI CUs) $500m	$1,000m (CDFI Bond)
Participations (CDFI CU) $500m	

PHASE TWO

Financial Development Corp

Assets	Liabilities
Loans, Bonds $800m	$800m FDC Notes

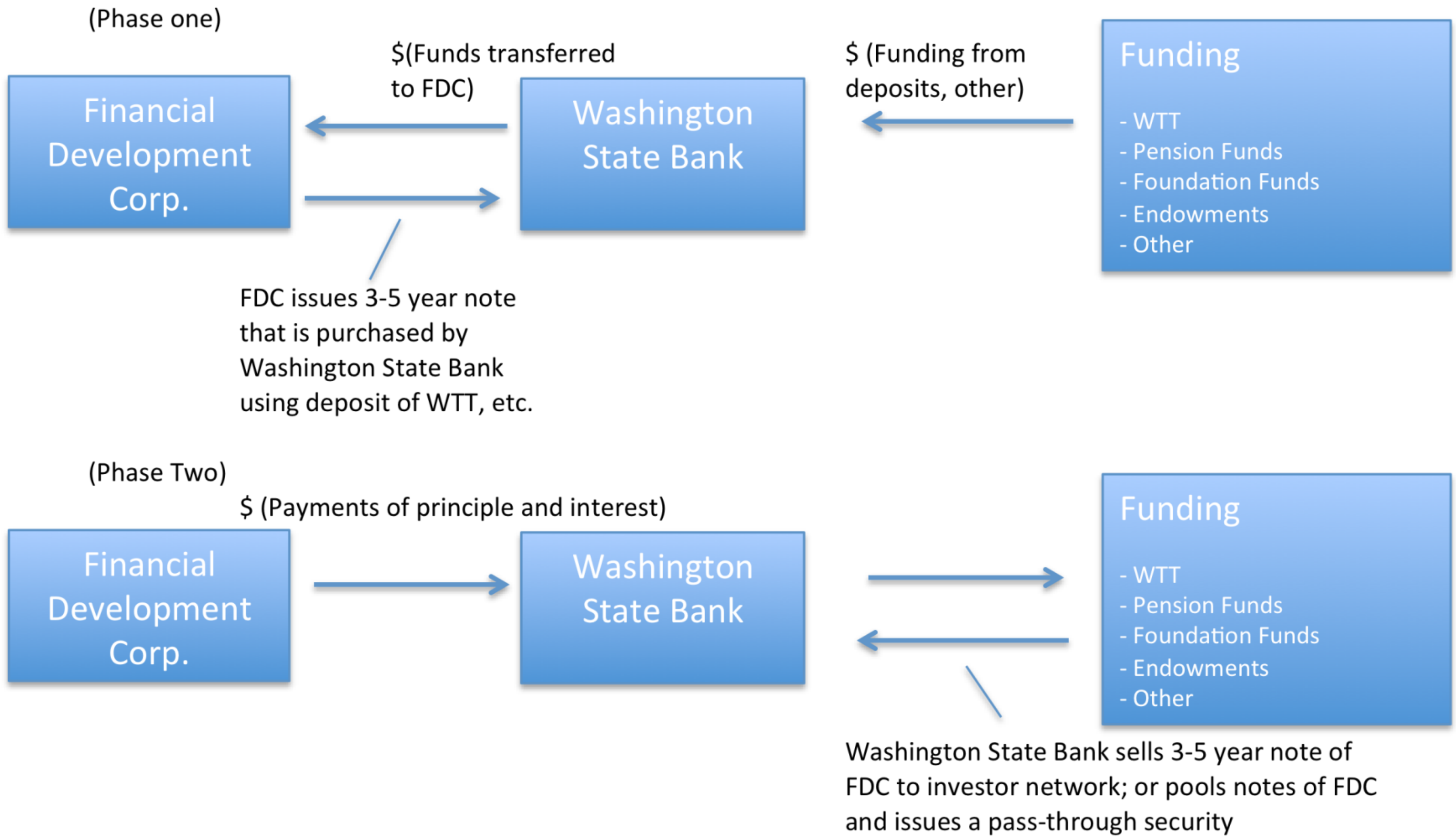
Washington State Bank

Assets	Liabilities
USTR, Agency notes $600m	$300m Equity (Common Stock, Class A)
Bonds, other loans $600m	$350m Deposits (LGIP)
USTR, Agency notes $800m	$300m Deposits (non-investment, WTT)
	$300m Corporate Notes (Other local)
	$500m Corporate Notes, CDs,(non-gov)
Equity (CDFI CUs) $500m	$1,000m (CDFI Bond)
Participations (CDFI CU) $500m	

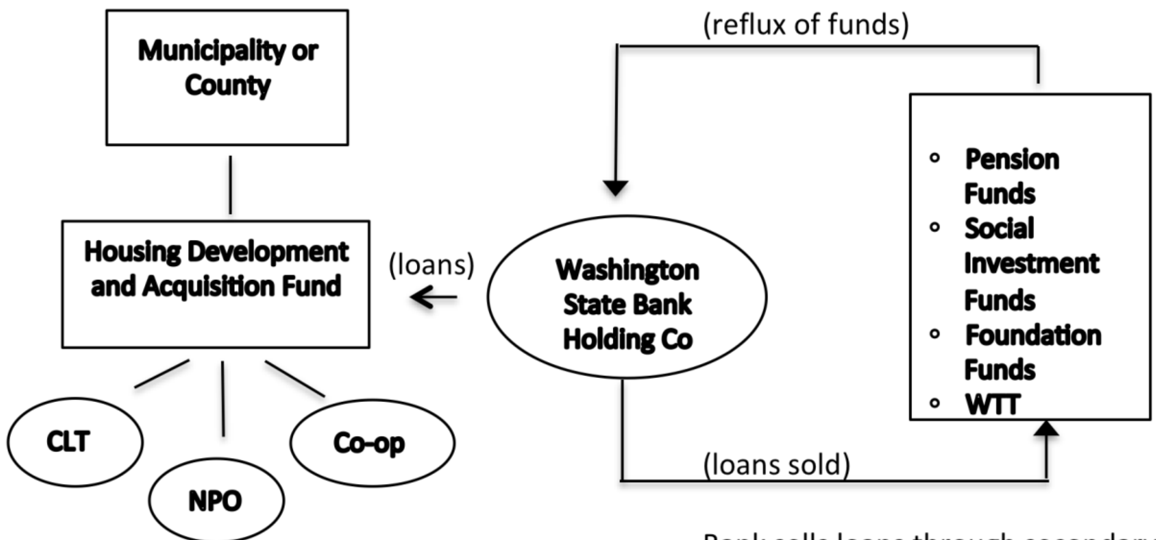
Washington TT, and other investors

Assets	Liabilities
($800 USTR)	$4,500 m
FDC $800m	

Creating Secondary Markets: Underwritiing FDC Liabilities



Creating New Secondary Markets



(CLT: Community Land Trust
NPO: nonprofit housing organization
Co-op is limited equity housing co-op)

Bank sells loans through secondary network of buyers. Funds recieved are used to make additional loans

What Would the Investment Trust of Washington Fund?

- Long-term bond debt of state and local government
- Affordable Housing - Acquisitions and New Development
- Equity (Secondary Capital I and II) and Participation Loans with CDFI Credit Unions
- Targeted Small Business Development, Co-ops

Long-term Infrastructure Bonds

Problems and Limits

- Maturity mismatch if bank purchases long-term series bonds
- If Bank directly finances at below current market rate, “non-conventional debt” - FHLB may not accept as collateral for advances; bonds may be illiquid

Benefits - Recapture

- If Bank acquires short-to-medium term series, payments that would otherwise flow to “outside” investors are recaptured; these funds can be redirected into investments in housing, economic development, etc.

Long-term infrastructure funding should be seen as a limited purpose of the Bank, not its core function or founding objective

Affordable Housing Development

- Establishing and operating new secondary markets would be primary function of the Bank. Buyers would acquire securities with payments based on pass-through of principal and interest on longer-term multi-unit housing development and acquisition loans
- Loans that conform to Fannie Mae guidelines eligible for securitization though Fannie Mae underwriting and securitization programs

- <u>Problems with Fannie Mae DUS</u>
- 125% or greater Debt Service Coverage Ratio (DSCR)
- 80% Loan to value ratio
- Land trusts, certain co-operative housing loans not eligible

- <u>Bank would need to create significant pool of secondary purchasers</u>
- Up to 90-95% Loan to value limit
- 110% or higher DSCR
- Risk pool – must be distributed across a sufficient number of buyers
- For some securities, buyers willing to forgo higher yield in order to support social objectives

CDFI Fund/Partnership with CDFI Credit Unions

- CDFI Bond Guarantee Program
- Bank would need to become Qualified Issuer as per 12 CFR Part 1805
- Can Borrow at 30-year term, below market rate
- Proceeds must be used to support economic activity - loans, investments, through network of participating Treasury-qualified CDFIs
- Up to $1,000,000,000 in total funding
- Each successive loan through CDFI program is $100,000,000
- Funds can be used to make injections of secondary capital into CDFI Credit Unions; is a 5-7 year loans, pays 4-6%, Credit Unions can count as regulatory capital, leverage at up to 10:1 ratio

Some additional considerations

- Legal indemnity
- Financial indemnity
- Conflicts of interest
- Fulfilling founding mandate and social purpose – Articles of Incorporation
- Governance and oversight
- Cost of ongoing operations - staffing

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