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Should the next mayor seek to expand the use of city pension funds to develop affordable housing?

The Bloomberg Administration's New Housing Marketplace Plan (NHMP) to increase the supply of affordable housing is winding down, and the city's ability to fund affordable housing is increasingly strained, as described in brief numbers 1 and 2 of this series.

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WHY IT MATTERS (CONT'D)

Some of the mayoral candidates have suggested tapping the city pension funds as a way to maintain or increase the funding available to create and preserve affordable housing. The pension funds of New York City (collectively "NYCRS") have some $137 billion in assets and might appear to be a valuable source of capital.[1] However, the law limits the potential uses of these funds and restricts the mayor's ability to control their use.

THE BASICS

The trustees of pension funds have a fiduciary duty to the beneficiaries of the funds to maximize earnings while limiting overall risk. As a result, their investments must generate risk-adjusted market returns, and the trustees limit how much of the portfolio they can invest in any one type of asset class (such as real estate) and limit how risky any individual investment can be. Spreading risk across multiple asset classes with different risk attributes serves to decrease the overall riskiness of the portfolio. Overall, trustees look to achieve an aggregate rate of return that is both consistent with their investment policy and adequate to meet obligations to the beneficiaries.

Investment opportunities that also provide social benefits (by increasing the stock of affordable housing, for example) can only be made if they generate returns "commensurate with the overall risk, liquidity, security, and structure of comparable non-targeted investments."[2] Within these limits, city pension funds have found ways to help finance the construction and rehabilitation of affordable housing that is located in lower-income neighborhoods.[3] The largest affordable housing program financed by NYCRS, called the Public Private Apartment Rehabilitation Program (PPARP), has invested over $757 million in the preservation or construction of 29,694 units of affordable housing.[4] The program has primarily relied on 100% mortgage insurance from the State of New York Mortgage Agency (SONYMA) to protect the pension funds from defaults and thereby lower the risk of the investment.[5]

Through this program, city pension funds offer long-term, fixed-rate mortgages at rates determined prior to the start of construction. The combination of mortgage insurance and the ability to invest with a long-term horizon allows the pension funds to offer fixed mortgage rates that, in turn, allow city housing programs to stretch their limited subsidy dollars further. While the interest rate cannot be below market rates, the ability to lock-in an interest rate even before construction begins and well in advance of the completion of construction (when the construction loan will be superseded by a permanent mortgage) increases the predictability of the project's finances and simplifies the process of securing financing. These benefits of having access to pension financing, however, are not sufficient on their own to create affordable housing in

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1 New York City Comptroller. (2013, July 19). *State Street Selected as Next Custody Bank for NYC Pension Funds*. Retrieved from http://www.comptroller.nyc.gov/press/2013_releases/pr13-07-127.shtm

2 New York City Employees Retirement System. (2007). *Investment Policy Statement.* On file with the Furman Center.

3 Pension funds are allowed to make "economically targeted investments" (ETIs) that fit within approved asset classes and earn a market return, and some of the city's pension funds make such investments in affordable housing projects. For example, the Teachers' Retirement System devotes roughly two percent of its funds to ETIs, which have posted returns of nearly nine percent since their inception in 1981. United Federation of Teachers. (2013, May 16). Pension fund does well by doing good. *New York Teacher.* Retrieved from www.uft.org/print/node/58871

4 New York City Comptroller, Bureau of Economic Development. *Economically Targeted Investments.* Retrieved from http://www.comptroller.nyc.gov/bureaus/ed/economically-targeted-investments.shtm

5 The city has its own insurance fund, a subsidiary of its Housing Development Corporation (HDC) called the Residential Mortgage Insurance Corporation (REMIC), but its capacity is much more limited.

New York City because significant subsidy is still required to offset the high costs of land and construction.

Separate from what are acceptable uses for pension fund dollars, the mayor's power to determine how these funds are used is limited. Investment decisions for the funds are controlled by the board of trustees for each of the five funds in NYCRS. The mayor appoints, at most, a minority of the members of those boards; other trustees are appointed by the comptroller, labor unions, the public advocate, and the borough presidents. Furthermore, it is the city comptroller, and not the mayor, who is responsible for making investment recommendations to the trustees and implementing their decisions.

QUESTIONS & CONSIDERATIONS

It is not surprising that NYCRS is often looked to as a potential solution to the city's affordable housing funding needs given the large amount of money contained in the funds. As noted above, city pension funds already provide fixed-rate, long-term mortgages for affordable housing that increase the depth and predictability of the mortgage market for developers and allow city subsidy dollars to stretch further. One option would be to increase the size of this program. However, the limited number of originators approved under PPARP and constraints on the subsidy dollars available for the projects that may be able to take advantage of these types of mortgages may limit the potential for further growth in this program.

Moreover, the fiduciary responsibilities of the pension funds further limit the range of their options for aiding the development of affordable housing. Pension fund dollars cannot replace city or federal subsidies for affordable housing because pension funds must earn market-rate returns.[6] In addition, the mayor lacks majority control over the investment decisions of the funds, so using the funds to support the mayor's affordable housing plans requires the cooperation of the comptroller and the funds' trustees.

Candidates promising to expand the use of the pension funds to finance affordable housing should specify exactly how much of the funds could be invested in loans to affordable housing developers, how that lending would help make construction affordable given restrictions on the funds' investments, and how the mayor would secure the cooperation of all the other decision-makers necessary to invest more pension dollars in the city's affordable housing programs.

6 Four of the NYCRS funds have committed equity dollars to the Sandy rebuilding in partnership with private developers who will also be putting in their own capital. In this case, they are looking for a return commensurate with the risk of investing.