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New Finance for America's Cities

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New Finance for America's Cities

What if our new neighborhood community centre was built by a bank in Africa?

Keywords

urban investment; pension fund targeted investment; infrastructure investment; impact investing; urban revitalization; under served capital markets

What is this Research About?

The paper talks about new sources of finance that is available for fueling America's infrastructure projects.

There is a noticeable difference between the way infrastructure projects were funded in the past and now. In the past, infrastructure projects were carried out predominantly by government with public good as the motive. But, lately because of the economic crisis, governments are facing huge deficits. As a result, institutional investors and pension funds are shouldering the role of infrastructure funding. The motive of public good is in turn substituted by private monetary benefit.

A key question the research answers is - **What is the impact of these new investment sources for America's cities?** The research also identifies the best practices of high impact public funds.

What You Need to Know

The research builds on the growing field of 'geography of finance' that deals with how investments shape urban growth. This field ranks high in importance due to two factors:

1. Huge demand for infrastructure caused by an aging population
2. Budget deficit caused by economic crisis. This supply demand gap has made urban investing an attractive option for pension funds looking for long term sustainable opportunities.

The researchers refer to these new infrastructure investments as belonging to a third generation of urban revitalization projects. The first generation of projects was solely funded by governments with acceptable low rates of return. The second generation projects (around mid 1990s) that involved public private partnerships were riskier but involved higher returns than first generation ones. The third generation projects that are in operation look purely at financial returns while assessing investments.

About Research Snapshots

Research snapshots bridge the gap between knowledge and practice through synthesizing existing research and presenting it in a way that is useful and meaningful to diverse perspectives.

The snapshots are part of a knowledge mobilization program hosted by the CBERN SRI Cluster that aims to engage asset owners, investment managers, and professional service organizations that are global signatories to the Principles of Responsible Investment in advance of and during the PRI Academic Network Conference in October 2012.

About the Researchers

Dr. Tessa Hebb is the Director of the Carleton Centre for Community Innovation, Carleton University, Canada. Her research focuses on the financial and extra-financial impact of pension fund investment in Canada and internationally with particular emphasis on Responsible Investment and Corporate Engagement and is funded by the Social Sciences and Humanities Research Council, Government of Canada.



Rajiv Sharma is a D.Phil. candidate in Economic Geography at the University of Oxford, School of Geography and the Environment as a Clarendon and FWW Rhodes Memorial Scholar. For his D.Phil., Rajiv is looking at the role that private institutional investors are playing in the global infrastructure market. His research seeks to identify the factors of success and failure for investments made into the infrastructure asset class using a case study methodology. Rajiv has worked as a research fellow for the United Nations Environment Program Finance Initiative and for venture capital private equity firm, Oxford Capital Partners.

The analysis and study performed for this research uncovers the impact of these third generation project investments on urban growth and America's cities.

What did the Researchers do?

1. The researchers look at various academic studies and research to identify the impact of privatizing public investment. They note the different generations of urban investment strategies starting from pure government investment to public private partnerships to the pure private investments (current).
2. Between 2004 and 2008, the researchers interview over 100 pension fund trustees, officers, other stakeholders and study impact investment strategies of top American public sector funds that had positive impacts - California Public Employees Retirement System (CalPERS), California State Teachers Retirement System (CalSTRS), New York City Employees Retirement System, and Massachusetts PRIM. These four together manage around 500 billion dollars worth of investments. Though all of them target under served markets, their approaches are a tad different. For instance, CalPERS focuses on rate of return first followed by public good, whereas CalSTRS focuses on strengthening its system by investing in diverse ideas and people.

After analyzing these funds implementation and impact, the researchers come up with a list of best practices and risk mitigation strategies for successful impact investing.

What did the Researchers Find Out?

Effective governance systems are a key factor among successful impact investing funds.

Four practices that highly successful pension funds adhere to:

1. They have a goal directed investment strategy. Every asset class and investment is assessed against a targeted rate of return.
2. They assess their investment opportunities prudently seeking help from outside experts if needed or working with investment intermediaries in structuring a deal in the best possible way that would result in both monetary and social benefits.
3. They manage their investments smartly by delegating implementation to expert vendors subject to appropriate rewards.
4. They maintain a clear focus on investment strategy at the board level. This helps when it comes to assessing investment options or division of responsibilities between the board and senior management.

New financial sources result in 'further financialization of urban space':

What this means is that locations that offer higher returns are targeted for investment and less promising areas are left behind. As a result, investments tend to be concentrated in some geographical regions.

Both opportunity and danger with substituting private gain for public good as the major driver in investment decision-making for urban investments:

Balancing these competing needs will be a key decision in the future.

Why is this Relevant to...

The management community: Pension fund owners and investment managers

The research is relevant to pension fund owners and investment managers because it lists the various best practices that can be followed for impact investments. High impacting pension funds have the following primary attributes: goal directed investment

Who's who...

California Public Employees Retirement System (CalPERS), California State Teachers Retirement System (CalSTRS), New York City Employees Retirement System, and Massachusetts PRIM:

These are the pension funds studied for the research. Together they manage around 500 billion dollars worth of investments. CalPERS, with \$230 billion investments, is one of the largest public sector pension funds in the world.

Michael Porter and Mark Kramer:

In a [Harvard Business Review](#) article (2011) they suggest that businesses and, by extension, investors in those businesses need to focus on creating 'shared value' that both generates profit and addresses human needs. They argue that such an approach will insure future innovation and productivity.

Interview with Michael Porter on "Creating Shared Value":



What is...

Impact investment

It refers to investments that result in both positive financial returns and a range of ancillary benefits for our communities. An impact investor seeks to create social good or improve the health of the environment, as well as achieve financial returns.

Capital market

It is a market for securities (debt or equity), where business enterprises (companies) and governments can raise long-term funds. Capital markets may be classified as primary markets and secondary markets. In primary markets, new stock or bond issues are sold to investors via a mechanism known as underwriting. In the secondary markets, existing securities are sold and bought among investors or traders, usually on a securities exchange, over-the-counter, or elsewhere.

strategy, assessing investment opportunities using best resources, professional fund management and focused board-level decisions. These practices point towards an effective governance system as a key characteristic of successful pension funds.

The policy community

The research is relevant to the policy community because the researchers point out a lack of transparency in infrastructure investments. The researchers identify ambiguity in the usage of common terms such as 'infrastructure asset' or 'economic infrastructure'. For instance, some investors consider power stations and terrestrial satellites as part of 'economic infrastructure'. Some investors don't. In the view of researchers, this lack of standardization casts a serious doubt over infrastructure investments being called as transparent.

What Next?

The management community

The management community can equip themselves with various best practices cited in the research. By taking a careful look at the environment in which a fund is operating, managers can insulate their investments against any political/financial risks. Investment managers that deal with political risks could acquire skills in lobbying and stakeholder engagement or seek external advice when needed.

Also, by merely selecting less risky funds, the investments tend to be concentrated in one geographical region that might defeat a fund's purpose of developing underdeveloped regions. Investors need to be aware of this reality and exercise caution while selecting funds.

The policy community

One clear action item for the policy community would be to clarify all types of investments that qualify within the label – 'infrastructure'. This not only brings about transparency in industry but makes reporting processes robust. These initiatives could help accelerate the growth and adoption of impact investing.

What do you think is the next step? Submit your comments:

> [Post a Comment \(1\)](#)

What Remaining Research Needs to be Done?

There is one limitation with respect to this research - It is entirely based on case studies of four US public sector pension funds, namely CalPERS, CalSTRS, NYCERS, and New York Common that had targeted infrastructure investment programs.

Also since 2004 when these organizations were identified, the number of foundations, mutual funds doing impact investing have increased. Additional research is required to assess the current state of the industry.

What Else to Read

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