# Illinois State

# Investment Policy:

## Working Paper


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# INTRODUCTION

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# OVERVIEW

Illinois is a healthy state bolstered by a vast transportation network, abundant natural resources, an adept labor market, a high quality educational system, an aggressive but responsive private sector, and a diverse and resilient citizenry. Despite these important assets, Illinois, like most industrial states in the Northeast and Midwest, is confronted by a myriad of social and economic problems which must be ameliorated.

Our most threatening dilemma is a growth and investment process charcterized by constant expansion at the periphery of population centers which destroys valuable farmland and open space, consumes limited energy resources and demands new infrastructure which we cannot afford. At the same time, the core of existing population centers has experienced and continues to incur loss of population, housing deterioration, flight of jobs and businesses, underutilization of public infrastructure, increasing unemployment and welfare dependency, and a declining tax base.

In essence, our private market economy in concert with public investments and incentives has been steering a course toward economic obsolescence. Our growth practices are in direct contradiction with what is rational given our financial, land, environmental and energy resources. Historically, state government, through its expenditure, investment and regulatory policies, has responded to the flow of private market activity or has steered such activity away from areas of greatest need rather than seeking to channel private market activity in a rational and coherent manner that conforms to the capacity and needs of citizens, businesses and government.

Although the state has begun to reverse this trend during the past few years, it is clear that we need a comprehensive state investment policy with clear objectives and effective execution in order to shape our destiny as we approach the year 2000.

State government is a particularly appropriate vehicle to serve as a catalyst for planning and coordinating a rational growth and investment policy because, unlike local governments, it has a broad perspective which enables it to deal with issues that transcend municipal boundaries. It is a more appropriate vehicle than the federal government for planning for the future because although it has a broad perspective of policy issues, it is more accountable to local residents. In addition, state government was once the dominant force in shaping economic development policy which stimulated the growth of the United States. One historian even suggests that we might not have made it over the Appalachian Mountains if it had not been for the foresight and investment policies of state governments. Since the fall of the Confederacy, however, states have taken back seats to other levels of government in influencing the nature of our cities, towns and rural areas. Only in last few years have states begun to reassert their capacity and legitimacy to shape development trends.

The components of a state investment policy cannot be limited to state facilities planning, although the nature and location of such facilities greatly influences economic activity. A comprehensive state investment policy must consist of the coordination of the following processes to achieve a uniform set of goals:

1). State capital investments;
2). State facilities planning;
3). Capital investments and facilities planning of other levels of government;
4). State regulatory policy;
5). State economic development programs;
6). State taxation policy;
7). State manpower policy; and
8). Investment of state employee pension funds and short-term deposits.

A state investment program must be driven by a clear set of goals. The following are the goals of a coordinated Illinois investment strategy.

(1) Encourage the revitalization and rehabilitation of towns and neighborhoods, particularly economically distressed towns and neighborhoods.

(2) Improve existing public infrastructure.

(3) Discourage uncontrolled development detrimental to existing towns and metropolitan areas;

(4) Locate new state investments in existing communities;

(5) Preserve farmland;

(6) Protect sensitive environmental resources;

(7) Retain existing commercial and industrial enterprises;

(8) Create economic opportunities for low and moderate income families;

(9) Increase capital availability for expansion and new business formation;

(10) Stimulate employment;

(11) Encourage balanced local economies; and,

(12) Minimize the cost of providing government services.

The following section presents a series of draft recommendations to achieve the stated goals.

Design of Capital Investment Policy, State Facilities Location Policy and Water Allocation Policy to Achieve State Investment Goals.

# RECOMMENDATIONS

## I. TRANSPORTATION

1. Establishment of a long range state transportation plan with the following components.

   (A) Primary emphasis on maintenance and reconstruction of existing highways and roads serving cities and town centers.

   BACKGROUND:

   The state does not possess the financial resources needed to both build new highways and roads and maintain the existing network of highways and roads. Throughout the state, many roads and highways serving town centers and cities are in need of maintenance and in some cases, reconstruction.

   In order to insure that existing communities can retain industrial and commercial enterprises and attract new private investment, the state must allocate sufficient funds to maintain local road networks in reasonable condition.

   COST: ?

   IMPLEMENTATION: Illinois Department of Transportation

(B) Encourage expansion and maintenance of public transportation systems within metropolitan areas.

BACKGROUND:

The limited supply and high cost of fuel, air pollution standards and highway congestion require that more citizens be encouraged to use public transportation through the improvement and expansion of public transportation.

COST ?

IMPLEMENTATION: Illinois Department of Transportation

(C) Where new mass transit facilities are required, encourage joint development with commercial and office space, especially in distressed neighborhoods.

BACKGROUND:

The location of mass transit stations, bus turnarounds and inter-modal terminals can stimulate economic activity in neighborhoods of small towns and cities. Such facilities should include office and retail space which creates new services and jobs.

COST: Funds for joint development projects are available through the Federal Urban Initiatives program administered by the Urban Mass Transportation Administration.

IMPLEMENTATION: Illinois Department of Transportation

(D) <u>Discourage construction of new roads and highways which are likely to result in undesired development of rural areas or will adversely effect the economic well-being of nearby towns and cities.</u>

<u>BACKGROUND</u>:

The extensive construction of highways and roads since World War II has helped accelerate the uncontrolled expansion of metropolitan areas, the loss of prime farm land, the decline of small towns and the deterioration of inner city neighborhoods. In the past, highway planners have overlooked the social and economic costs incurred by communities which lose industry and population that relocates adjacent to newly constructed highways.

In response to debate about the impact of highways on private, exurban development, the Illinois Department of Transportation (IDOT) examined the impact of a highway constructed on farmland along the fringe of the Chicago metropolitan area. IDOT's staff gave the following summary report of the findings.

> A 13.5-mile freeway link opened to traffic in 1974 cost the state and local governments \$8.5 million (\$85 million, total cost).
>
> Two years later, commercial and industrial development that had occurred since

the highway construction began was measured at just three of the seven interchanges along the route. That development is valued at $195 million, making a ratio of state and local investment to private investment 1:23.

Constructed predominantly through farmland on the suburban fringe, the facility involved virtually no dislocation of existing development. Further, IDOT staff believes that, of the total development, at least $90 million in industrial development can be traced to plants that have moved out from the central city (of Chicago).

COST: None. Implementation of this policy will save the state considerable expense.

IMPLEMENTATION: Illinois Department of Tranportation

(E) If new highways must be constructed, then the state should investigate the legality of regulation of adjacent land use.

BACKGROUND:

It is in the interest of the state to prevent careless, ill-planned development which degrades the environment, destroys valuable farmland and drains industrial and commercial activity or population from existing town centers and cities. Construction of a new highway interchange should involve the taking of development easements within 1,000 - 2,000 yards of the proposed interchange by eminent domain. Development easements would be sold only in compliance with an appropriate development plan for the area.

<u>COST</u>: None. Sale of development easements could generate revenue which will compensate the state for its share of the cost of highway construction.

<u>IMPLEMENTATION</u>: Illinois Department of Transportation

(F) <u>Restrict access to state highways by new development which is not in harmony with state investment and growth policies.</u>

<u>BACKGROUND</u>:

By preventing access to state highways, the state will discourage housing, commercial and industrial development which is not in harmony with state growth and investment objectives.

In Massachusetts, this technique was used to resolve a dispute over the siting of a proposed shopping center in the western part of the state. One site was downtown Pittsfield, a community that had expressed an interest in becoming the commercial center for that part of the state. The developer had proposed putting the facility on the periphery of a small community called Lenox where it would have caused serious deterioration of that community's shopping strip. The state blocked the proposed development by not permitting access to the state highway.

<u>COST</u>: No additional cost.

<u>IMPLEMENTATION</u>: Illinois Department of Transportation

II. SEWER AND WASTEWATER TREATMENT FACILITIES

1. <u>Since new sewage and wastewater treatment facilities encourage growth, highest priority for construction should be placed where growth is most desired, within or adjacent to town centers and cities</u>.

<u>BACKGROUND</u>:

The construction of sewer projects has almost as much of an impact on the location of population and economic growth as transportation improvements. The Illinois Environmental Protection Agency makes grants to localities for planning, design, construction and improvement of wastewater treatment facilities. About half of the 1100 eligible municipalities in Illinois receive funding. Factors for assigning priorities do not include consideration of the desirability of growth from a local, regional or state perspective which is likely to occur through the development of treatment facilities.

<u>COST</u>:

No additional costs; reassign priorities for existing funds.

IMPLEMENTATION:

Illinois Environmental Protection Agency

2. If new facilities must be constructed in exurban areas, then the capacity of such facilities should correlate with existing needs rather than assumptions about long-run "future needs" which became an immediate self-fulfilling prophecy.

BACKGROUND:

Present U.S. Environmental Protection Agency policies encourage the construction of wastewater treatment facilities which have considerable excess capacity in even the smallest towns. This policy encourages the sewering of many sparsely-settled sections of communities in order to make the wastewater treatment plants economically viable. Developers are attracted to such areas because of the excess treatment capacity and the community welcomes new development which helps meet the cost of maintaining the facility. This can easily become a vicious and expense cycle.

COST: No Additional costs; reassign priorities for existing funds.

IMPLEMENTATION: Illinois Environmental Protection Agency.

III. WATER RESOURCE ALLOCATION

1. Prepare a state water plan and use state authority to allocate water supply in a manner which

discourages the growth of new communities on the periphery of the Chicago metropolitan area.

BACKGROUND:

Overall, Illinois is a water-rich state. Illinois' greatest metropolis and largest water user, the Chicago metropolitan area, sits adjacent to the world's greatest source of fresh water, the Great Lakes. However, utilization of this resource is severely constrained by a U.S. Supreme Court order restricting diversion of water out of Lake Michigan. The limited availability of Lake Michigan water to communities surrounding Chicago requires them to tap ground water reserves. The protection of these reserves from over-use is essential.

The development of new communities on the periphery of the Chicago metropolitan area not only drains population and economic activity from existing communities, but it increases the use of the region's limited ground water reserves.

COST:

No additional cost.

IMPLEMENTATION:

Illinois Department of Transportation

## IV. LOCATION OF STATE FACILITIES

1. Give preferential consideration for location of state facilities to existing cities and town centers, particularly distressed cities and towns, unless such facilities would have an adverse impact on these communities.

2. Minimize construction of state facilities which serve as growth generators in exurban areas.

3. Encourage adaptive reuse of old buildings when feasible for state office space.

BACKGROUND:

Through the Capital Development Board, the state finances and oversees construction of elementary and secondary schools, junior colleges and universities, hospitals and health centers, correctional facilities and office buildings for state government. Since 1972, the Capital Development Board has completed more than 1,000 construction projects valued at more than $1 billion.

The construction of state facilities has a significant impact on the location of economic activity and population distribution. The construction of state facilities in exurban areas can stimulate growth at the expense of existing towns and cities. However, the location of state facilities in existing business centers and neighborhoods can serve as a catalyst for redevelopment.

COST:

No Additional Costs.

IMPLEMENTATION:

Capital Development Board

4. The Capital Development Board's Capital Assistance Program for School Construction should be continued but with revised programmatic priorities which discourage growth in exurban areas.

BACKGROUND:

The Capital Assistance Program for schools provides capital grants for school construction and reimbursement for construction related debt service. State matching funds are distributed based on a "grant index," which arrays districts on the basis of equalized assessed valuation per pupil, but limits state, participation from 20% for the wealthiest districts to 70% for the poorest districts.

The Program has focused largely on relieving conditions of overcrowding in schools. Since overcrowding has been prevalent mainly in growing suburban and exurban areas, the program has subsidized new school construction in such areas while having minimal impact on the 2,425 schools in towns and cities which violate health-life-safety code standards.

The Capital Development Board should re-orient program by establishing the restoration of existing schools as a top priority rather than responding to and ultimately encouraging growth in exurban areas.

COST:

No additional cost.

IMPLEMENTATION: Capital Development Board.

5. Establish urban state parks and recreation areas which commemorate and preserve areas of historical and architectural significance.

BACKGROUND:

Most of Illinois' state parks, natural areas, and wilderness preserves are located in rural areas. Other states, such as Massachusetts, have established urban heritage parks in community centers, which combine urban revitalization, historic preservation, open space protection and recreational facilities. They are expected to stimulate private investment as well as generate income from tourists.

The Department of Conservation in Illinois has the administrative responsibility for both state parks and historic preservation. In coordination with the Department of Commerce and Community Affairs, the use of urban heritage parks should be initiated as a tool in downtown revitalization.

COST: ?

IMPLEMENTATION:

Department of Conservation and Department of Commerce and Community Affairs.

6. Coordinate the state's Civic Center Assistance program with local downtown and neighborhood commercial revitalization efforts.

BACKGROUND:

The existing Civic Center Assistance program has no criteria regarding the location of civic centers or the market area to be served. Changes in operating procedures or legislation could encourage downtown and older neighborhood commercial center locations and adaptive reuse.

COST:

No additional costs; reassign priorities for existing funds.

IMPLEMENTATION:

Capital Development Board

7. Encourage continuation of policy of awarding construction contracts to minority-owned and staffed firms.

BACKGROUND:

The Capital Development Board currently attempts to insure that minority-owned and staffed firms are able to secure contracts for construction of state facilities. Given the need to promote minority-owned businesses, this policy should be continued.

COST:

No additional cost.

<u>IMPLEMENTATION</u>:

Capital Development Board.

V. STATE CLEARINGHOUSE (A-95 REVIEW)

1. <u>The criteria used by the State Clearinghouse for reviewing applications for federal assistance should encourage investment in existing towns and cities</u>.

<u>BACKGROUND</u>:

The State Clearinghouse circulates state, regional, and local applications for federal assistance under Part I of the A-95 Circular to appropriate state agencies for review and comment. It also develops sets of criteria for these agencies to use to help insure that proposed projects and programs are supportive of state plans and policies.

Once comments concerning a proposal project are received from appropriate state agencies, the Clearinghouse submits comments to the U.S. Office of Management and Budget (OMB).

The A-95 review process is advisory only. The federal funding agency is not required to reject a proposed project because of negative reaction from state or regional clearinghouses.

The review function of the State Clearinghouse could be an effective tool for insuring that proposed federally-assisted projects of state, county and local governments, special districts and private developers conform with state investment policies.

COST: No Additional costs.

IMPLEMENTATION: State Clearinghouse

Use of State Funds and Regulatory Process
to Leverage Private Investment that Achieves
State Investment Goals

I. Housing

1. <u>Establish a state mortgage purchase program or re-institute the Illinois Housing Development Authority's loan to lenders program which is designed to encourage private lenders to provide low interest mortgages in older neighborhoods</u>.

<u>BACKGROUND</u>:

Residents of older neighborhoods experience difficulty in securing conventional financing for housing purchases, particularly during periods of disintermediation. In addition, increasingly high interest rates prevent many moderate income families from qualifying for conventional loans.

Many states have authorized housing finance agencies to address credit availability problems by purchasing mortgages originated in designated neighborhoods or by lending funds to financial institutions which are reloaned in target areas. States which have initiated such programs include: Massachusetts, Missouri, New York, Pennsylvania, New Jersey and Connecticut.

The Illinois Housing Development Authority established a loans to lenders program in 1974. The program has been inactive since 1975.

COST:

IDHA can raise capital for programmatic endeavors through the sale of tax-exempt bonds. Housing finance agencies are able to compete for capital with higher yield private investments because their bondholders do not pay federal income tax on the interest they receive.

IMPLEMENTATION:

Illinois Housing Development Authority

2. Establish a state home improvement loan purchase program with an interest subsidy for single-family housing in neighborhoods of small towns and cities. Only housing owned by low and moderate income families should be eligible for this program.

BACKGROUND:

The aging housing stock of cities and small towns requires considerable renovation and energy conservation measures in order to meet the housing needs of the state. According to research conducted by the Department of Local Government Affairs, 23,000 rehabilitation loans and 40,000 rehabilitation grants are required to meet housing needs that exist.

Many states have addressed the need for home improvement financing by establishing home improvement loan purchase programs which serve as a secondary market for low-interest loans made by financial institutions. New Jersey, Minnesota and Michigan are among several states which have established such programs. As of 1978, the New Jersey program had a portfolio valued at $8.7 million, while the Minnesota program had purchased 7,000 loans valued at $30 million.

COST:

No additional costs; Funds can be secured by sale of tax exempt bonds.

IMPLEMENTATION:

Illinois Housing Development Authority.

3. Investigate the feasibility of establishing a rehabilitation and mortgage loan program for small (2-15 units), older multi-family rental housing.

BACKGROUND:

IDHA has financed the rehabilitation of large multi-family rental buildings in Chicago undertaken by the Chicago Renewal Effort Service Corporation and McHugh Levin. However, rehabbers and community development corporations have experienced difficulty in securing credit to rehabilitate smaller buildings. If a program could be established to finance the rehabilitation of smaller rental buildings, then units designed to shelter low and moderate income families should be given the highest priority.

COST:

No additional costs; funds generated through sale of tax exempt bonds.

IMPLEMENTATION:

Illinois Housing Development Authority

4. Guarantee a percentage of rehabilitation loans secured by older multi-family rental housing.

BACKGROUND:

Many financial institutions are reluctant to make rehabilitation loans which are secured by multi-family rental housing. This reluctance is based on perceived risk and in some cases, actual risk. One way in which to encourage the rehabilitation of rental housing is to guarantee a portion of the loans made by financial institutions. Obviously the state must protect its interest by engaging in sound underwriting on a case-by-case basis.

Other states have guaranteed single-family mortgage loans and home improvement loans, however, none have guaranteed rehabilitation or mortgage loans on multi-family rental buildings

Two entities which have guaranteed loans secured by multi-family rental properties are the City of Hoboken and New York City's Rehabilitation Mortgage Insurance Corporation (REMIC). Hoboken insures 20% of loans made to rehabilitate apartment buildings. REMIC insures up to 90% of rehabilitation loans for rental buildings provided that 90% of the loan does not exceed 50% of the cost of rehabilitation.

COST:

Additional staff costs for underwriting loans. This expense could be covered by application fees and charges for insurance coverage.

IMPLEMENTATION:

Illinois Housing Development Authority.

5. Target new senior citizen housing and subsidized family housing to communities undergoing displacement of senior citizens and low and moderate income families due to revitalization.

BACKGROUND:

Some inner city communities are undergoing substantial revitalization in the form of condominium conversions and private rehabilitation of rental housing with consequent increases in rent. A consequence of this process is the displacement of senior citizens and low and moderate income families to communities already characterized by a high proportion of dependent households. It is not in the interest of the state to encourage such economic segregation.

COST:

No additional costs; subsidized housing is capitalized by sale of tax-exempt bonds and equity participation by private investors.

IMPLEMENTATION:

Illinois Housing Development Authority.

6. Provide technical assistance and loans to community development corporations engaged in housing rehabilitation and development in distressed neighborhoods of cities and small towns.

BACKGROUND:

Throughout the nation, community development corporations have become important vehicles for promoting housing development and restoration in the most distressed neighborhoods. Illinois does not have as many effective community development corporations as other states. This is due, in part, to a lack of expertise and funding.

COST:

Funding for the technical assistance program could be secured from federal grants. The loan fund could be obtained from federal sources, bond proceeds or state revenue.

IMPLEMENTATION:

Illinois Housing Development Authority or The Department of Commerce and Community Affairs.

7. Prepare and publish a model code for building rehabilitation to serve as a guide to Illinois counties and municipalities.

BACKGROUND:

Most municipal and county building codes are designed to regulate new construction. Such codes impose unnecessary requirements on rehabbers which increases the cost of rehabilitation. The cost is usually passed directly onto the consumer. Consequently, rehabilitated housing is economically feasible only if it can attract high rents, thus excluding moderate income families which have the greatest housing needs.

COST:

$50,000

IMPLEMENTATION:

Department of Commerce and Community Affairs.

8. Strict enforcement of state law prohibiting denial of fire and casualty insurance coverage to homeowners on basis of geographic location of the property.

BACKGROUND:

Lack of adequate fire and casualty insurance for single-family housing has a detrimental impact on the viability of neighborhoods. Evidence of insurance redlining has been uncovered in several cases by the Department of Insurance.

COST:

No additional costs.

IMPLEMENTATION:

Department of Insurance

9. Enforement of prohibition against geographic discrimination in lending decisions.

10. Encourage participation of state-chartered lending institutions in special community reinvestment programs such as Neighborhood Housing Service, mortgage pools and Community Development Block Grant programs administered by local governments.

BACKGROUND:

The Commissioner of Banks and the Commissioner of Savings and Loan Associations should be encouraged to evaluate the lending performance of financial institutions to insure that there is no pattern of discrimination against older neighborhoods. Lenders should be encouraged to seek lending opportunities which conform with state investment goals.

COST:

No additional costs.

IMPLEMENTATION:

Commissioner of Banks and Commissioner of Savings and Loans.

11. <u>Prevent the closing and relocation of financial institutions if citizens of small towns and city neighborhoods are left without reasonable access to thrift and credit services</u>.

    <u>BACKGROUND</u>:

    Closing and relocation of financial institutions from older neighborhoods to suburban areas has decreased the access of neighborhoods to private credit needed for housing purchases and improvements.

    Closings and relocations should only be permitted when there is substantial verification of compelling business reasons such as the safety and soundness of the financial institution.

    <u>COST</u>:

    No additional cost.

    <u>IMPLEMENTATION</u>:

    Commissioner of Banks and Commissioner of Savings and Loans.

12. <u>Enforce provisions of the Illinois Mortgage Banking Act</u>

    <u>BACKGROUND</u>:

    The Illinois Mortgage Banking Act was passed in 1977 in response to allegations that some mortgage banking firms were engaged in fraudulent or careless underwriting practices in the origination of single-family loans insured by the

Federal Housing Administration (FHA) or the Veterans Administration (VA). Sponsors of the legislation indicated that the high rate of single-family abandonment in many neighorhoods throughout the state was due to questionable underwriting and inadequate forebearance procedures.

The Commissioner of Savings and Loan Associations is authorized to license and investigate mortgage banking firms operating in Illinois. The regulations promulgated pursuant to the Act should be fully enforced however, the regulations should not be so onerous that they discourage mortgage banking firms from originating FHA and VA-insured loans. FHA and VA loan programs are important vehicles for securing housing for low and moderate income families.

COST:

No additional cost.

IMPLEMENTATION:

Commissioner of Savings and Loans

13. Establish a realistic usury ceiling which does not discourage mortgage lenders from originating single-family mortgages in Illinois during periods of high interest rates.

BACKGROUND:

The state restricts the interest rate financial institutions charge on single-family mortgage loans. If the usury ceiling is unrealistically low during periods of high interest rates, then financial institutions will be reluctant to make single-family mortgage loans. However, the usury ceiling should not be so high that it imposes hardships on consumers.

II. Commercial and Industrial Development

1. Increase the utilization of the financial assistance programs of the Illinois Industrial Development Authority (IIDA) and focus these programs on the retention of existing industries.

BACKGROUND:

Since 1971, IIDA has loaned only $2.9 million to approximately 45 industrial firms.

IIDA should attempt to attract more industrial firms and development groups which could utilize IIDA programs, but are not aware of them.

COST:

No additional costs.

IMPLEMENTATION:

Illinois Industrial Development Authority

2. IIDA should give the highest priority to qualified loan applicants in distressed communities.

3. IIDA should increase its efforts to encourage

<u>community development organizations in areas of high unemployment to package loan applications for community economic development projects</u>.

<u>BACKGROUND</u>:

Limited public resources to subsidize or finance industrial development should be directed to the areas of highest unemployment. Within areas of high unemployment, community development corporations are working to attract industrial and commercial enterprises; however, the performance of such development corporations is hampered by their inability to tap public and private sources of financing.

<u>COST</u>:

No additional costs: reallocation of existing resources.

4. <u>Establish an "early warning system" in order to assist industries which might otherwise relocate or close</u>.

<u>BACKGROUND</u>:

Although many industrial firms close or relocate because of problems which state government cannot ameliorate, some industries may close or relocate because of problems which can be addressed by the state. An ongoing monitoring and technical assistance program involving critical industries in towns and city neighborhoods should be coordinated with local government in order to enable the public sector to address particular problems before they become critical and result in closing or relocation.

COST:

No additional cost; reallocation of existing resources.

IMPLEMENTATION:

Illinois Industrial Development Authority or Department of Commerce and Community Affairs.

5. Empower Illinois Industrial Development Authority to guarantee private loans made to industrial firms by banks, insurance companies and pension funds.

BACKGROUND:

By guaranteeing a portion of loans made to Illinois industries operating in distressed communities, the state can encourage private financing which might not otherwise have been made available.

COST:

Minimal additional staff cost for underwriting loans.

IMPLEMENTATION:

Illinois Industrial Development Authority.

6. Establish a development financing program which can make equity and debt investments in small and medium sized business and industrial enterprises in distressed communities.

BACKGROUND:

One of the major obstacles to the expansion of small and medium sized firms is lack of equity financing. According to research conducted by Belden Daniels of Harvard University, new and small business enterprises face major barriers in acquiring funds in the long term debt and equity markets despite the fact that such firms have yielded a higher return on investment than larger firms. In addition, small and medium sized businesses are responsible for 95% of new jobs created in urban areas.

In response to this problem, the Commonwealth of Massachusetts created the Community Development Finance Corpration which can provide debt and equity financing for projects controlled by community development corporations. CDFC is capitalized by a $10 million bond issue and has additional bonding authority of $30 million.

According to the designers of CDFC, the state will receive a return on its investment in CDFC through the creation of new jobs in distressed communities and the reduction of welfare and unemployment expenditures. One estimate indicates that for every $15,000 invested in a venture, one job will be created which will in turn represent a $3,000 annual return to the state.

COST:

Funds can be raised through the issuance of revenue bonds.

IMPLEMENTATION:

Creation of Illinois Community Development Finance Corporation or Illinois Industrial Development Authority.

III. <u>Revision of method of depositing state funds to insure that the criteria for selecting depositories conform with the state's overall investment program</u>.

BACKGROUND:

___% of state deposits are awarded to financial institutions on the basis of a formula which weights the interest rate bid, the size of the banks and the dollar amount of outstanding loans made within the state. There are two smaller pools of deposits which are allocated according to financial institutions' performance in meeting special community needs.

The majority of state funds should be allocated according to a formula which weights interest rate bids, outstanding loans which conform to state investment goals and the size of the financial institution.

COST:

No additional cost.

IMPLEMENTATION:

State Treasurer

IV. Prudent Investment of State Employee Pension Funds

1. The State Board of Investments should establish criteria to evaluate potential investments of public employee pension funds to insure that these investments conform with the state's investment policy goals.

BACKGROUND:

The State Board of Investments currently manages $6 billion in public employee pension funds. The total assets of these funds are greater than the assets of all but two commercial banks operating in the state.

State pension funds must be invested in a prudent manner to insure that the interest of current and potential beneficiaries is protected. Not only must managers of these funds be concerned about the safety of individual investments, but they must also insure that the entire portfolio of pension fund investments is protected against severe losses due to the collapse of any sector of the economy. Within these constraints, however, it is possible to establish as a high priority investments in ventures which conform with the state's investment policy. Other states which are considering more cautious investment of state employee pension funds to promote economic development within the state include Wisconsin, Massachusetts and California.

<u>COST</u>: No additional cost.

<u>IMPLEMENTATION</u>: State Board of Investments