

DIVESTMENT FROM FOSSIL FUELS

A Guide for City Officials and Activists
February 2014

INTRODUCTION

Climate change represents the single greatest long-term threat to our cities and citizens. The health, wealth, infrastructure and ability to maintain basic services of cities will increasingly be degraded as our planet warms and our weather worsens. Yet local governments are currently sharing in the profits made by the fossil fuel industry – investing in the very companies that are directly responsible for this threat.

According to current scientific predictions, we can only put 500 gigatons more of carbon dioxide (CO₂) into the atmosphere and still keep global temperature rise below 2°C, a goal that the United States and nearly every other country on Earth has agreed to meet. Here's the terrifying part: the fossil fuel industry has 2795 gigatons of CO₂ in their coal, oil and gas reserves, five times more than we can burn and stay under the 2 degree threshold.¹ If we're going to see serious progress on slowing climate change, we're going to have to keep that carbon in the ground, and that means addressing the fossil fuel industry head-on.

Divestment, a strategy pioneered in this country during the anti-apartheid movement, is a powerful tool that we can use in this fight. The logic of divestment is simple: We shouldn't be funding our retirement by investing in companies whose operations ensure we won't have a safe planet to retire on. It's not worth greening your city for the next generation, if you're also investing millions in companies that are threatening that generation's future. Local governments have the opportunity to be leaders in combatting this contradiction by divesting their funds – general, retirement, utility, pension, etc. – from fossil fuel companies.

Seattle, WA, under the leadership of former Mayor Mike McGinn, has already taken this bold step, working to pull over \$17.6 million out of fossil fuel stocks. To date, twenty-five local governments have pledged to divest from fossil fuels, and not to invest in them in the future. By joining the momentum generated by the success of the movement in getting foundations, campuses, congregations, and investment firms in divesting billions of dollars worldwide, local governments can make a strong and profound statement – that profiting from climate disruption and its ever-increasing human toll is morally bankrupt and fiscally imprudent.

This climate activism is part of a rich history of making change via how and where we invest our money. The anti-apartheid divestment movement – targeting companies doing business in South Africa – is widely acknowledged as critical in the eventual progress of that country. In addition, many of our cities participate in fair trade, sweat-free, or local purchasing efforts. If cities across the country - many of whom have already made commitments to fight global warming - divest from fossil



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SUMMARY

Climate change represents the single greatest long-term threat to our cities and citizens.

Cities should not invest in companies that profit from fossil fuels, the main cause of climate change.

Divestment can have a serious impact and send an important message.

We offer the tools to help you get started on a divestment campaign.

This brief was written by James Irwin, Senior Associate at COWS and Satya Rhodes-Conway, the managing director of the Mayors Innovation Project and a former councilmember in Madison, Wisconsin.

fuels, the effect will be profound, both financially and by making a statement that profiting from the misery of future generations is wrong.

THE IMPACT OF CLIMATE CHANGE ON CITIES

Cities will bear the brunt of climate change impacts, so they must also be the drivers of solutions to climate change. The list of risks to cities directly related to climate change is long and apocalyptic:

Sea level rise will lead to inundation of coastal cities – where the likelihood of flooding has already significantly increased.² In the US alone, 3.7 million people live within one meter of the high tide mark, and in 544 municipalities and 38 counties, over 10 percent of the population lives even lower than that. Over two thousand towns and cities in the US are vulnerable – with 22.9 million Americans in total living within six meters of mean high tide.³

Ocean level rise will disrupt everything from transportation (many transportation tunnels are at or below sea level), and energy generation (often located near water for cooling), to the availability of fresh water, which will increasingly be at risk of saline infiltration. All of these effects were on evidence during the flooding of New York City and New Jersey caused by Hurricane Sandy: subways, bridges and tunnels were inundated; power generators shorted out leaving millions in darkness; cell facilities flooded leaving many without phone service, and thousands were left without running water and had to depend on deliveries for potable drinking water.

Extreme heat and cold events will become increasingly common. Heat waves are worsened by the urban heat island effect. In 2003, 70,000 Europeans died during a single heat wave. Heat waves further tax energy supplies, which are likely to become increasingly unreliable. The 2011 drought and heat wave that hit Texas, Oklahoma, New Mexico, Arizona, southern Kansas, and western Louisiana caused 95 deaths and cost \$12 billion. The 2012 drought impacted half the country and killed 123 people.⁴

Extreme weather is already becoming a more regular occurrence, costing cities millions in recovery efforts and millions more in infrastructure costs. Stronger and more dangerous hurricanes, floods, droughts, tornadoes and blizzards take a tremendous toll on our cities. In 2012 alone, the US experienced 11 disasters that cost over \$1 billion each. While the full costs have not been tallied, experts estimate that the 2012 cost of these mega-disasters will surpass \$60 billion.⁵ Some estimates of the damage from Hurricane Sandy put it at \$60 billion by itself.⁶

Cities are also uniquely vulnerable to pandemics – the close proximity of the population and the multitude of vectors will prove challenging in dealing with the spread of tropical diseases that comes with increased temperatures.

Cities depend to varying degrees on imports of food, clean water, and energy, all of which are vulnerable to climate disruption in their production and transportation. These factors are likely to contribute to increased social unrest, mass migration, and poverty, all of which will impose an increased burden on cities and their infrastructure.

As if that weren't enough, the cost of dealing with these pending crises will be tremendous and will likely far exceed the resources of most local governments to handle – even with outside assistance when it is

“There is a clear economic argument for divestment. While fossil fuel companies do generate a return on our investment, Seattle will suffer greater economic and financial losses from the impact of unchecked climate change.”

– Mike McGinn, Former Mayor, Seattle

Extreme weather is already becoming a more regular occurrence, costing cities millions in recovery efforts, and millions more in infrastructure costs

available. On top of everything else, the potential financial consequences of climate change for cities and local governments are calamitous, and will mean fewer resources for the other important things these governments do and fund.

THE FOSSIL FUEL INDUSTRY

The fossil fuel industry is the most profitable in the history of the world – making over \$1 trillion in profit since 2001.⁷ It has done so with the help of massive government subsidies (some estimates put the total at three-quarters of a trillion dollars worldwide)⁸ and by paying for very few of the externalities of their business. Worse, they spend some of those profits to fund climate deniers, warping public opinion, bankrolling politicians, and lobbying against any and every effort to address climate pollution.⁹

We shouldn't be funding our retirement by investing in companies whose operations ensure we won't have a safe planet to retire on.

The litany of their misdeeds is long: supporting dictators,¹⁰ degrading the environment,¹¹ displacing indigenous peoples,¹² and refusing to clean up after the disasters they cause.¹³ If they continue their current operations unchecked, they will surely bring about the worst climate change scenarios. While the past profits of this industry are attractive to asset managers, it is clear that this industry's actions are wrong. Cities should refuse to share in their profits.

On a purely financial level, the future profitability of these corporations is questionable. Between 50 and 80 percent of the value of fossil fuel companies is derived from their unburned reserves – worth a conservative estimate of \$20 trillion.¹⁴ A strong price on carbon will make it likely that much of this will stay in the ground, posing a clear financial risk for shareholders. An increasing number of financial analysts are worried that impending regulations may cause a serious decline in value for many fossil fuel companies, so turning to other investments now may make good sense.

It is clear that cities and local governments – whose citizens will bear the brunt of impacts from the climate crisis – should refuse to financially benefit from fossil fuels and should seriously consider the future volatility of those assets. We shouldn't be funding our retirement by investing in companies whose operations ensure we won't have a safe planet to retire on.

DIVESTMENT

Divestment can have a profound impact. As Archbishop Desmond Tutu, who won a Nobel Peace prize for his work to end apartheid in South Africa, said in a video supporting fossil fuel divestment, "The divestment movement played a key role in helping liberate South Africa. The corporations understood the logics of money even when they weren't swayed by the dictates of morality. Climate change is a deeply moral issue too, of course... Once again, we can join together as a world and put pressure where it counts."¹⁵

Divestment has the potential to affect companies' market valuation, and it also contributes to making the activities of these companies more visible and socially unacceptable. The potential financial scale of local government fossil fuel divestment is significant. Local government retirement systems in the United States held \$484 billion in cash and investment holdings in 2011.¹⁶ Local governments (including counties, school districts, and special districts) held \$1.5 trillion in cash and securities holdings in 2007.¹⁷ Obviously, not all of these funds are invested in fossil fuels, but a significant portion is. San Francisco alone is calling for a divestment of nearly a billion dollars.

Most importantly, public divestment from fossil fuels is part of a much broader movement of climate activism. Campuses across the world have student-led divestment movements, and there are ongoing fights to keep

Canada's tar sands in the ground and to block the construction and transport of massive coal resources via the west coast. Hundreds of cities have signed the Mayors Climate Protection Agreement. This is another important piece in the fight against climate change.

HOW TO DIVEST

The process of divesting does not have to be especially onerous or complicated, though that will vary depending on the size and financial structures of the government(s) involved. It also does not need to be an immediate process - other organizations are working on a 5-year divestment timeline. Here are the steps your local government needs to take:

1. Determine what funds your government controls and how much is invested in fossil fuel companies.

For most jurisdictions, the process will start with an assessment of what funds the city has, and where those funds are invested. These may include the city's general fund, retirement fund, pension fund, insurance fund, utility funds, and others. Not all are necessarily under the local government's direct control - some may have their own administration, or the city may invest in a state fund. Determining where the money is and who controls it are essential first steps in a divestment campaign.

If the city has limited holdings or does not directly control its funds, leaders and activists should commit to no future fossil fuel investments and to work with the governing bodies of the authorities that control the pension or other funds to convince them to divest and work with them on a plan to do so. Once a list of publicly controlled funds is developed, the holdings need to be assessed for fossil fuel content. GoFossilFree.org provides a list of the top 200 companies by estimated carbon reserves at: <http://gofossilfree.org/companies/>.

The financial structure of some portfolios may make determining where these assets are located (in mutual funds, for example) less straightforward, but is certainly within the capacity of the entities managing those funds.

2. Meet with the managers of the funds.

These are the people who will implement divestment and who can be your strongest ally - or your worst opposition. It is important to recognize that the first responsibility of the managers of public money is its preservation, the maintenance of sufficient liquidity to meet financial obligations, and growth. Other requirements are secondary, and thus it is important to show that divestment will not harm the financial viability or future of these investments, and indeed may enhance it.

Given that all fund managers are seeking to manage risk in order to balance safeguarding public or retirement

table 1

Companies with the top 10 largest carbon reserves¹⁸

Company	Gigatons CO ₂	Primary Fuel
Severstal JSC	141.6	Coal
Lukoil Holdings	43.56	Oil and/or Gas
Exxon Mobil Corp.	41.03	Oil and/or Gas
BP PLC	34.6	Oil and/or Gas
Gazprom OAO	28.83	Oil and/or Gas
Chevron Corp.	21.22	Oil and/or Gas
ConocoPhillips	19.14	Oil and/or Gas
Total S.A.	18.02	Oil and/or Gas
Anglo American PLC	16.75	Coal
Royal Dutch Shell PLC	16.2	Oil and/or Gas

funds with ensuring growth, a frequent concern about divestment is that it will increase risk. While it is true that constraining a portfolio (thereby reducing diversification) adds some element of risk, it is such a small increase as to be insignificant. A recent comprehensive study determined that excluding the 15 worst carbon offenders from a US portfolio adds an additional risk of 0.0006 percent. Removing a comprehensive list of fossil fuel companies adds an additional absolute portfolio risk of 0.0101 percent. These figures are of course dependent on market performance – should fossil fuel stocks underperform, a screened portfolio will do better than one including dirty companies.¹⁹

In fact, it is quite possible that maintaining investments in fossil fuels introduces greater risk into portfolios for the long-term than the risk resulting from divestment. Given the increasingly catastrophic impacts of burning fossil fuels outlined above, there is a growing domestic and international move toward regulation of carbon emissions. Indeed, such a move seems inevitable if we are to take climate change seriously. Regulation of the industry, most likely in the form of a carbon tax and subsidy removal, will make fossil fuel extraction more expensive; potentially so expensive as to price many of the players out of the market. This would result in the significant devaluation of fossil fuel stocks.

“San Francisco has aggressive goals to address climate change. It’s important that we apply these same values when we decide how to invest our funds, so we can limit our financial contributions to fossil fuels and instead promote renewable alternatives.”

- Supervisor John Avalos²²

Furthermore, if we continue to ignore the devastating effects the fossil fuel industry and carbon emissions have on the environment by letting the industry continue to extract its reserves unchecked, we run the risk of causing catastrophic damage to the environment, the effects of which will reach far beyond a single industry. Ultimately, these effects may very well threaten holdings across all market sectors regardless of how diversified a portfolio may be.

As a California Public Employees’ Retirement System (CalPERS) report on sustainable investment puts it, “[i]n the longer term, we recognize that rising demand for food and resources globally, coupled with the likely effects of climate change, will have a potential impact on risk-adjusted returns.”²⁰ A 700-page report commissioned by the British government in 2006 and written by economist Nicholas Stern, chair of the Grantham Research Institute on Climate Change and the Environment at the London School of Economics, predicted that climate change could reduce global GDP by as much as 20 percent by 2050.²¹ For any large investor with assets across the global economy, this poses a significant long-term risk to their portfolio.

Another argument opponents may make is that using a climate screen on investments decreases the potential earnings and return on investment of a portfolio – a do-gooder tax. There is a growing body of evidence that removing fossil fuel investments from a portfolio imposes negligible penalties – although it doesn’t increase gains either.²³ A hypothetical portfolio that divested of fossil fuels 10 years ago would in fact have slightly outperformed a benchmark portfolio including them.

Divestment also does not have to be an immediate process – the analysis and rebalancing of a portfolio can take time, and a planned selloff of fossil fuel assets should probably proceed over several years. This will further minimize transaction costs and give time to rebalance portfolios.

3. Craft legislative or executive language to remove city holdings from fossil fuel companies and/or ensure they won’t be invested in the future.

In Seattle, WA the mayor took executive action to divest the City’s general funds and called on the pension board to divest the city retirement fund’s holdings.²⁴ In San Francisco, CA the Board of Supervisors passed a resolution calling on the pension board to divest from fossil fuels.²⁵ They are now working with the pension board on divestment.

Where possible, instruct fund managers (often the City Treasurer or a private manager contracted by the Treasurer) to cease investing in fossil fuels stocks and to divest any holdings over a reasonable time period. Where the city doesn't have direct control, work with or call on the governing body of the funds to do so. In many cases, smaller cities' general funds and/or retirement are part of larger state investment pools, in which case state action will be needed. You'll need to figure out what approach is right for your city.

In some cases, governments are already effectively divested, because of their limited holdings or how they've chosen to invest. In those instances, a resolution indicating the city's intent not to invest in fossil fuels in the future is a powerful statement and shows solidarity with others in this movement.

The Mayors Innovation Project, in cooperation with ALICE (the American Legislative and Issue Campaign Exchange) has model resolutions and ordinances available for cities interested in introducing them.

4. Build support for a public commitment to divestment.

Elected leaders need public support on issues like this. Citizens can provide that support through letters, phone calls and emails to your mayor and city council, or through attending meetings where the issue will be discussed. Letters to the local paper are also helpful. See www.350.org and www.gofossilfree.org to reach other activists in your area, get support, and access many more resources.

The corporations understood the logics of money even when they weren't swayed by the dictates of morality... Once again, we can join together as a world and put pressure where it counts.
– Archbishop Desmond Tutu

5. Consider reinvesting the funds in more positive ways.

While simply moving funds from the worst climate polluters is valuable, there is a corresponding opportunity in where those funds are reinvested. There are myriad resources available to guide investment professionals in more sustainable investments in the stock market, from a host of publicly traded environmentally-screened mutual funds²⁶ to a wide range of exchange-traded funds that invest in particular clean energy sectors.²⁷ Indeed, there are many professional investment managers who specialize in socially-responsible investing (SRI).²⁸

Cities can follow the lead of programs such as the New York State Comptroller's Green Strategic Investment Program, which has invested about \$400 million in public equity index funds (HSBC Climate Change Index Fund and the FTSE Environmental Technology 50), private equity (the largest share going to the Hudson Clean Energy Partners), and even a fixed income fund (World Bank green bonds).²⁹ Similarly, CalPERS Alternative Investment Management (AIM) program provides approximately \$1.2 billion to innovative firms that create more efficient and less polluting technologies than current products and invests another \$500 million in their own public stocks environmental index fund.³⁰

Outside of the traditional stock market, cities have the opportunity to consider investment strategies that promote broad-based sustainable development. Sometimes called "Economically Targeted Investments" or ETI, these strategies entail investments with rates of return comparable to conventional investment options, but that also improve the economic wellbeing of a region by stimulating job and business creation; increase or improve the stock of affordable housing; or improve infrastructure. ETIs are not an asset class in and of themselves, meaning that they do not exhibit a common set of performance tendencies and are not subject to common regulation. Instead, ETI is an investment perspective that highlights a range of often-overlooked local financial opportunities, and offers both social and financial returns.

As of 2007, public-sector pension funds had committed approximately \$11 billion to ETI.³¹ For example, the Contra Costa County (CA) Retirement System and the Los Angeles (CA) City, County, Fire and Police Pension Fund have both devoted portions of their funds to ETI.³² As of December 31, 2011, the five-year overall return on the pension funds' ETI's was 7.00 percent, compared with Barclays US Aggregate Bond Index, with a five-

year return of 6.50 percent.³³

Another possibility is to invest in transportation infrastructure projects or infrastructure-directed funds.³⁴ In this country, the Dallas (TX) Police and Fire Pension system became the first U.S. pension fund to invest directly in a major road project with its investment in the Texas Department of Transportation's LBJ managed express lanes project on I-695 in Dallas.³⁵

New York City uses a portion of its pension assets to provide capital for low, moderate, and middle-income housing construction and improvement.

There are also likely to be many opportunities at the city level to invest in clean energy generation and energy efficiency. Doing so locally has additional economic benefits through job creation. Western Michigan University's Green Revolving Loan fund paid for 101 projects, achieving a 47 percent return on investment and a payback period of just over two years.³⁶ An analysis of campus energy efficiency projects generally found returns on investment of up to 63 percent. Cities can also invest in programs that renovate buildings for energy efficiency, which can provide an attractive return on investment via energy savings.

One way to direct investment toward cleaner and more efficient energy projects is via so-called "Green Banks." Connecticut, for example, developed a Clean Energy Finance and Investment Authority,³⁷ capitalized in part through state public benefits funds, which could be a model for municipalities or groups of municipalities who want to support clean energy programs via credit enhancements and private capital investments.

CONCLUSION

The destructive impact of climate change will be felt primarily in cities. Profiting from that self-destruction is unethical and illogical. Divesting public funds from fossil fuel companies poses minimal financial risk—and may indeed reduce risk in the longer term—and there are many reinvestment opportunities that foster climate solutions and provide comparable financial returns.

GETTING STARTED

1. Determine what funds your government controls and how much is invested in fossil fuel companies.
2. Meet with the managers of the funds to enlist their support.
3. Craft legislative or executive language to remove your holdings from fossil fuel companies and/or

TIPS FOR ACTIVISTS

» *Know your target*

Who can decide to divest – the Mayor? The City Council? The City Treasurer? A Pension Board? Find out who they are, what they care about, and who they listen to.

» *Know the process*

Executive order? Resolution? Ordinance? Figure out what you're asking them to do and the process for doing it.

» *Be informed*

How does your city invest its funds now? What actions have they taken in the past against climate change?

» *Ask nicely*

Start by asking the decision maker to work with you to do this. There's plenty of time to make the case publicly if they don't want to champion divestment.

» *Personal touch*

Email is easy, but you'll be taken more seriously if you set up a meeting and show the decision maker that you're prepared and knowledgeable.

» *Voters matter*

Elected officials answer to their constituents, so get their constituents to contact them! Direct, individual emails or phone calls are best (rather than form letters or petitions). Always include your name and address.

ensure they won't be invested in the future.

4. Build support for making an official, public commitment to divestment by legislative or executive action.
5. Consider investing the funds in more positive ways, particularly in energy efficiency and clean energy.

RESOURCES

- » The Mayors Innovation Project provides information, sample resolutions, supporting materials, and specific technical assistance on this issue: www.mayorsinnovation.org
- » The American Legislative and Issue Campaign Exchange, ALICE, is a one-stop, web-based, public library of progressive model and exemplary law and supporting materials on a wide range of issues in state and local policy, including divestment: <http://www.alicelaw.org/>
- » 350.org is building a global grassroots movement to solve the climate crisis. Our online campaigns, grassroots organizing, and mass public actions are led from the bottom up by thousands of volunteer organizers in over 188 countries: www.350.org
- » The Fossil Free Campaign wants institutions to immediately freeze any new investment in fossil fuel companies, and divest from direct ownership and any commingled funds that include fossil fuel public equities and corporate bonds within 5 years. They have a number of resources for activists working on this issue: <http://gofossilfree.org/>
- » "Do the Investment Math: Building a Carbon- Free Portfolio" by Patrick Geddes at the Aperio Group analyzes the financial impact of divestment.: https://www.aperiogroup.com/system/files/documents/building_a_carbon_free_portfolio.pdf
- » "Global Warming's Terrifying New Math" a hard-hitting article in Rolling Stone by Bill McKibben that discusses the three simple numbers that add up to global catastrophe - and that make clear who the real enemy is: <http://www.rollingstone.com/politics/news/global-warmings-terrifying-new-math-20120719>
- » "The \$20 Trillion Carbon Bubble." Brad Johnson interviews John Fullerton for *Climate Progress*: <http://thinkprogress.org/climate/2012/03/26/432617/the-20-trillion-carbon-bubble-interview-with-john-fullerton-part-one/>

ENDNOTES

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- evidence of a negative relationship. It concluded that “a variety of factors, such as manager skill, investment style and time period, is integral to how ESG [environmental, social, and corporate governance] factors translate into investment performance; therefore, it is not a ‘given’ that taking ESG factors into account will have a uniform impact on portfolio performance, and we expect significant variation across industries.” See http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf and http://www.law.harvard.edu/programs/lwp/pensions/conferences/cm_europe12_09/Shedding_light_on_responsible_investment_free_version.pdf.
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About us

The Mayors Innovation Project is a learning network among American mayors committed to "high road" policy and governance: shared prosperity, environmental sustainability, and efficient democratic government. We are a project of COWS (Center on Wisconsin Strategy). This work is generously supported by the Surdna Foundation. We can be contacted at:

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