Welcome to today’s web seminar
Leveraging public assets for pension solvency

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Webinar Overview

State and local policymakers facing pension solvency challenges are increasingly exploring the transfer/lease/sale of public assets to shore up underfunded public pension systems

Webinar will explore:

• Opportunities, challenges, and early lessons learned

• Case study demonstrating how one municipal government—Pittsburgh, PA—evaluated its options and decided which course to take

• The perspective of pension fund administrators
Context

• U.S. state and local public pension funds currently face over $1 trillion in unfunded liabilities
  o Drives interest in new solvency solutions

• In addition to structural reforms and increased pension contributions, some are seeking to leverage assets as part of solution set
  o Sales, leases, asset transfers (both physical assets and/or revenue streams)

• Not a new concept:
  o Proposed 2008 Chicago Midway Airport lease would have split 90% of net proceeds between pensions and infrastructure—deal scuttled amid Great Recession
  o Proposed 2013 sale of Philadelphia Gas Works—rejected by Council over labor provisions
  o 2017 NJ legislation transferring NJ Lottery proceeds to pensions

• Major reviews underway in New Jersey, Connecticut and Illinois now
Potential Opportunities

• Significant compatibilities between assets and pensions
  o Temporal nexus—long-term investors, long-lived assets
  o Some asset classes (e.g., toll roads, water) have long, attractive track record of returns and performance

• New infusions of the proceeds from asset sales/leases, transferred revenue streams, and/or transferred assets can potentially:
  • Improve pension solvency
  • Avoid interest paid over time on pension debt
  • Accelerate amortization of pension debt
  • Avoid budget crowd-out, future service cuts, tax increases
  • Improve the efficiency of asset management & shed non-core assets
  • Improve credit outlook
  • Facilitate new opportunities to improve service and modernize infrastructure
Risks with Asset Transfers

- Governments generally struggle with valuing public assets & tend to overvalue relative to the market

- Liquidity concerns—how difficult to sell the asset?

- Danger of booking future revenues before they materialize
  - Like pensions, real outcomes highly dependent on assumptions about revenue growth, etc.
  - Example: what if New Jersey residents stop playing Powerball, or dedicated pension tax revenues fall short?

  - “To the degree that they are based on unsubstantiated valuations, create liquidity concerns, or otherwise undermine long-term funding progress, S&P Global Ratings would view them as negative credit factors.”
Risks with Asset Transfers (continued)

• Pension funds will take on operating responsibilities and risks of any transferred assets. Some examples:
  • *Revenue risk*—like pension returns, revenues are projected over decades, subject to assumptions and potentially volatile, like lotteries
  • *CapEx risk*—assets degrade and need to be rebuilt
  • *Regulatory risk*—changes in federal/state law and regulation
  • *Operating risk*—many risks inherent in some asset operations (see recent Cali fire and PG&E bankruptcy example)
  • *Social risk*—local community resistance can delay or even cancel infrastructure proposals; rates are a major driver
  • *Environmental risk*—risks of more stringent environmental regulations requiring infra upgrades (e.g., water plant filtration systems, etc.)

• Risk that policymakers will substitute for—not augment—traditional ER/EE pension contributions via asset transfer

• Leveraging assets without making needed reforms to address the underlying risks that led to underfunding in the first place
Policy Considerations

• Can you find a viable commercial framework where value can be captured?
• How do you ensure that the asset will improve alongside the pension system?
• If infrastructure investment is the goal, what are the relative merits of direct investment in projects versus pooled infra investment funds?
• How do you navigate political pressures that could dampen the commercial aspects of the transfer? (e.g., user fee rate setting, escalation, etc.)
• How do you avoid political decisionmaking seeking to drive local pension investment?
• A transfer is a transformation moment if properly done, to enhance value for both pensioners and asset users
• Infrastructure public-private partnership lessons:
  • Asset valuations are difficult—market discovery still most effective process
  • Despite differences in cost of capital, PPP can often drive equal or more value than alternative
  • Balancing act between commercial viability and public interest considerations
Questions?

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Case Study: Pittsburgh’s 2010 Evaluation of Options to Shore Up Its Pension Funds

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The Problem and Key Drivers

• Severely Underfunded Pension Reserves

• At Risk of State Takeover

• Concern about increased (& incremental) annual contributions
Pittsburgh’s Approach to Addressing the Problem

• Mayor’s Proposal
• City Controller’s Proposal
• City Council’s Directive
  • Articulate a full slate of options
  • Commission independent evaluation of the options
  • Open debate to public comment
Slate of Options

- Transfer the parking assets to the Comprehensive Municipal Pension Trust Fund
- Sell the parking assets owned by the parking authority
- Increase revenue by outsourcing management of the parking garages and meter system
- Issue a bond backed by increased parking revenue
- Lease the parking assets to a private-sector operator
- Agree to a state take over of the pension plan
Pittsburgh’s Evaluation of Using Parking Assets to make an In-Kind Contribution to the Pension Fund

• Significant legal barriers to transferring assets to the pension fund

• Operational hurdles

• Defeasance requirements related to outstanding bonds
Pittsburgh’s Decision

• Not to pursue the option of an in-kind contribution

• City Council offered an alternative plan: invest in City’s parking assets, raise rates and dedicate a portion of the increased revenue to the pension fund

• In December 2010, the City of Pittsburgh dedicated a portion of its annual parking tax revenue to its pension plans through 2041
View from Today

- The City of Pittsburgh is in stable condition according to recent reports from Moody’s and Standard & Poor’s
- Pension funding level at 56% (versus 34% in 2010)
- Annual contribution covering payouts
- S&P raise the city’s debt rating to AA-
- City preparing to borrow $60 million to fund infrastructure needs
- Lessons Learned
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Primary Considerations

- Fiduciary duties
- Asset allocation
- Staff resources
- Investment performance
- Liquidity
Fiduciary Duties

• Public pension fund assets are held in trust for the exclusive benefit of plan participants
• Public pension trustees operate as fiduciaries
• Main fiduciary responsibilities:
  ▲ Sole and exclusive loyalty to plan participants
  ▲ Act with care, skill and diligence of a prudent person or prudent investor
  ▲ Diversify investments
Fiduciary Duties and Infrastructure

• Public pension fund trustees may not make investment decisions solely or primarily on the basis that they will enhance local or regional economies or provide needed investment or jobs

• Investments must comply with the fund’s investment policy

• Public pension investment policies typically describe how factors such as risk, expected return, costs, liquidity, asset allocation strategy, etc. are to be considered in the investment process
Public Pension Fund Asset Allocation

• Asset allocation is the single-most important decision public pension fund trustees make with respect to managing the portfolio

• Any public pension fund infrastructure investment must fit within the fund’s asset allocation strategy and target asset allocation
Other Considerations

• Infrastructure investments require pension fund staff resources and expertise

• Not every fund has the resources and expertise, or access to them, needed to invest in infrastructure

• Other vital considerations for public pension funds are investment performance, net of fees; and liquidity
Liquidity

• The purpose of public pension funds is to pay benefits
• Public pension benefits must be paid in cash
• Any public pension fund investment eventually must be either liquidated or able to generate income
• Funds must consider their projected liability stream: when must benefits be paid?
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