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States Consider Asset Transfers As Way To Shore Up Plan Funding.

As many states grapple with massive unfunded pension liabilities, some are looking into transferring government-owned assets to their pension plans as a way to boost funding. And while asset transfers such as these could present issues of their own, more public pension plans are likely to explore this avenue.

“There’s a depth where some governments find themselves in where they’re so deep in the hole on underfunding that you cannot credibly tax your way out, you can’t cut your way out and you can’t grow your way out,” said Michael Imber, a managing director at EisnerAmper LLP, an accounting firm based in New York. “Short of defaulting, the only way that I think you can change the math is if you start contributing hard assets.”

Illinois, New Jersey and Connecticut — states that face perpetual funding issues — are publicly looking into transferring assets to their pension plans, while a few other states will likely follow soon, sources said.

Mr. Imber sits on Connecticut’s Pension Sustainability Commission, which was created in 2017 and tasked with studying “the feasibility of placing state capital assets in a trust and maximizing those assets for the sole benefit of the state pension system,” according to the state website. Connecticut Gov. Ned Lamont has proposed legislation that would restructure the state $18.7 billion Teachers’ Retirement Fund and create the TRF Special Capital Reserve Fund, which would initially be funded with $381 million out of the state’s current year general fund surplus and provided with a backstop funded by lottery proceeds.

In February, Illinois Gov. J.B. Pritzker created the Pension Asset Value and Transfer Taskforce to examine state assets and recommend how they can be used for the pension funds to help stabilize the state’s finances.

Illinois’ five state pension plans have a $134 billion unfunded liability. During a speech last month, Illinois Deputy Gov. Daniel Hynes likened the state pouring billions of dollars into its pension system in recent decades, while seeing its unfunded liability continue to grow, to the ancient Greek mythology of Sisyphus, who continually tried pushing a boulder up a mountain only to have it repeatedly roll back down.

In New Jersey, Treasurer Elizabeth Maher Muoio put out a request last month for qualification for financial advisory firms to help the state determine if certain state assets — such as roads, transit facilities and airports — could be used to help finance the $70.9 billion New Jersey Pension Fund, Trenton.

“While the idea of maximizing the value of state assets has been discussed for many years, little concrete action has ever been taken,” Ms. Muoio said in a statement. “At the direction of the governor, we designed this RFQ to explore tangible, creative solutions to help maximize the state’s assets in order to minimize the burden to taxpayers.”

Trying to win big

New Jersey was the first state to transfer an asset to its pension plan. In July 2017, then-Gov. Chris Christie signed a law making the lottery a pension fund asset and providing about $1 billion a year for the pension fund through lottery revenue.

“The transfer has helped offset the amount that must be contributed from our general fund as we continue our commitment to ramping up payments by 10% each year until we meet the full actuarially required contribution by 2023,” Jennifer Sciortino, a spokeswoman for the state Department of the Treasury, wrote in an email.

Michael D. Belsky, executive director of the Center for Municipal Finance at the University of Chicago’s Harris School of Public Policy, said the basic theory behind an asset transfer is that pension funds have a fiduciary obligation to grow assets for their pensioners, so the funds are more likely to do a better job managing the asset than the government itself.

“If it’s operating more efficiently, not only does its value go up, but whatever excess cash flows they have should increase too,” Mr. Belsky said. “If you’re operating a lottery or a toll road or something like that more efficiently, you should have an increase in cash flow, and that excess cash can go toward making pension payments.”

But when a government transfers an income-producing asset like a lottery, it doesn’t necessarily bring in more money, it simply moves the revenue in its books, said Todd N. Tauzer, San Francisco-based director of U.S. public finance at S&P Global Ratings. “It’s state-owned revenue that’s already being used in the budget that they’re now transferring to the pension system, but whatever holes that leaves in the budget they still have to fill them,” he said. “It’s not like they created a new revenue stream.” The type of transfer that most excites EisnerAmper’s Mr. Imber is a government taking undeveloped, non-income-producing assets and finding a way to have them produce revenue, such as putting raw land into a trust, selling it to a power provider for solar energy, and putting the revenues toward the pension plan.

But figuring out which assets to transfer is difficult. “The idea of parting with assets is as much a political decision as it is an economic decision,” Mr. Imber said. “The trick is that if you’re going to maximize the economic utility of assets contributed for the benefit of the pension, after you make the contribution you have to take the politics out of it, otherwise you won’t unlock the hidden equity that might be sitting in the asset.”

Australian example

A 2017 white paper from the Stanford Global Projects Center focused on an in-kind contribution in Queensland, Australia. In 2011, the Queensland government transferred a 40-year concession to operate a toll road to government-owned QIC Ltd. that manages its defined benefit fund. The pension fund received the toll road at a value of A$3.1 billion ($2.2 billion), then made improvements like adding lanes and new roads, and sold the asset three years later for A$7.1 billion.

Michael Bennon, managing director of the Stanford Global Projects Center, said the success in Queensland can be a guide for U.S. pension plans. It can also be a “two birds with one stone” arrangement — funding a pension plan with an asset that then encourages the plan to upgrade and optimize the asset — he said.

However, Mr. Bennon said that part of what made the Queensland transfer work was the fund’s direct investment capability for its infrastructure allocation. It hired professionals capable of managing and structuring infrastructure investments. But most U.S. pension funds “go through infrastructure funds, so it’s more difficult for them to do one of these direct investments from a capability perspective,” he said.

Mr. Belsky said an asset transfer needs to be done in conjunction with other strategies, like potential increased participant contributions, raising the retirement age or raising taxes. “It’s not a panacea.”

For Mr. Tauzer, an asset transfer could be a net positive for a given state, but the “reason why they’ve got such a large unfunded liability in the first place has to do more with the funding discipline over time, and if they don’t correct those issues, these one-time changes won’t do much in the grand scheme of things.”

PENSIONS & INVESTMENTS

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