The Legacy Obligation Trust
A new approach to funding pension & OPEB liabilities

Connecticut Pension Sustainability Commission

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• Connecticut resident for 25 years

• Recovering banker

• Bankruptcy & turnaround consulting since 1993

• Focus on municipal distress since 2009

• Municipal / State distress consulting
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  • State of Kansas

• Chapter 9 experience
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  • Jefferson County, Alabama
  • City of Detroit, MI

• Managing Director, EisnerAmper Public Sector Advisory Services
Presentation Agenda

1) Legacy Obligation Trust (“LOT”) – Executive Summary

2) Background on LOT concept development

3) The LOT Model
   - Design
   - Examples
   - Who else has seen this?

4) Benefits, Reforms, Working Groups

5) Discussion
Executive Summary

• The Legacy Obligation Trust ("LOT") concept is a new approach to solving the underfunded municipal pension and retiree healthcare problem in the United States.

• A government unit makes an in-kind contribution of real assets – like land, buildings, infrastructure, enterprises
  - to a professionally and independently managed trust
  - for the benefit of one or more underfunded municipal pensions and retiree health plans.
Executive Summary

• The trust issues **Certificates of Trust ("COTs")** as the means of conveying **ownership**

• COTs function like **shares of stock** if thousands or tens of thousands of units are issued, **permitting ownership division among more than one pension/OPEB fund**

• COTs are structured as **marketable securities**
Executive Summary

• The government unit’s intended benefits include:
  • an immediate credit against its unfunded liability based on the fair market valuation of the assets contributed to the trust
  • the pension & OPEB funded ratios increase, which may improve the credit rating agencies’ assessment of the government unit
  • an immediate, positive cash flow impact on the unit’s budget as the “catch-up” payment for the underfunding goes down
  • the independent, professional manager is incented to create additional value to further increase the pension’s funded ratio

• The LOT concept is a new idea that has not been previously implemented in the U.S.

• In-kind contributions to pensions have been utilized in the U.S. and internationally.
Background on LOT concept development

- City of Detroit bankruptcy
- Certificate of Participation note holders
  - Financed $1.4 billion pension contribution
- Offered recovery
- Final outcome
- Judge Rhodes’ opinion on Plan of Adjustment

An alignment of interests could be the path to fixing legacy obligations
Legacy Obligation Trust Model

**LOCAL GOVERNMENT UNIT ("LGU")**
- REAL ESTATE
  - Vacant land
  - Buildings
  - Foreclosures
- INFRASTRUCTURE
  - Bridges, Tunnels, Airports, Roads
- ENTERPRISE
  - Hospitals, Nursing homes, Utilities

** LOT**

**PENSION FUNDS & OPEB FUNDS**

**LOT MANAGER**

**ASSETS**

**MANAGE**

**STEP 1:** Unit transfers assets to LOT

**STEP 2:** LOT issues *marketable* Certificates of Trust ("COT") to the pension & OPEB funds evidencing beneficial ownership

**STEP 3:** Hire independent manager
The LOT Manager maximizes economic value

**Step 4:** LOT Manager negotiates sale, lease, or other economic interest with private sector enterprise where all beneficial interest accrues for the LOT.

**Step 5:** Success of deployed assets increase the value of the COT which benefits the pension & OPEB funds.

Assets are re-valued each year.
Further thoughts on Capital Asset Universe

- **Undeveloped assets** can be converted to cash generating, unlocking new value.
- **Developed assets** need to be assessed for highest and best use and potential for profitable turnaround.

<table>
<thead>
<tr>
<th>UNDEVELOPED</th>
<th>DEVELOPED ENTERPRISE ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>No $</td>
<td>Making $</td>
</tr>
<tr>
<td>• Raw Land</td>
<td>• Stadiums</td>
</tr>
<tr>
<td>• Government occupied buildings</td>
<td>• Golf Courses</td>
</tr>
<tr>
<td></td>
<td>• Utilities</td>
</tr>
<tr>
<td></td>
<td>• Hospitals</td>
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<tr>
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<td>• Skilled Nursing Facilities</td>
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## Connecticut Universe of Assets (at cost)

<table>
<thead>
<tr>
<th>State of Connecticut's Capital Assets (Net of Depreciation, in Millions)</th>
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</thead>
<tbody>
<tr>
<td><strong>Governmental Activities</strong></td>
</tr>
<tr>
<td>Land</td>
</tr>
<tr>
<td>Buildings</td>
</tr>
<tr>
<td>Improvements Other Than Buildings</td>
</tr>
<tr>
<td>Equipment</td>
</tr>
<tr>
<td>Infrastructure</td>
</tr>
<tr>
<td>Construction in Progress</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

- **Total Primary and Enterprise Capital Assets** $19.8 billion
- **Total Component Unit Capital Assets** $771 million
- **Total Universe** $20.5 billion
  - *This figure does NOT represent fair market value*

*all figures net of depreciation*
Examples

Queensland Motorways
Queensland, Australia

Batterson Park
Hartford, CT
Who else has seen this?

- Rating agencies
- Universities
Aligned incentives make the “gears” turn

Labor and management become partners for economic growth

- **PENSIONS & OPEB:**
  - Funding ratios increased immediately
  - Retirees share in upside
  - Marketable COT enhances valuation

- **UNIONS:**
  - Current employee interests align with economy

- **ECONOMY:**
  - Stimulate new jobs and incent government to create growth environment
  - Enhance neighborhoods
  - Generate new tax revenue
A sustainable solution requires other reforms...

- The LOT concept cannot be assumed to be the only reform necessary to effect sustainable change.
- LOT implementation must be met with the fiscal discipline to adopt best practices in budget management.
- Without other reforms, the bad habits of the past can create the legacy obligation funding problem again in the future.
CT PSC Working Groups

**Capital Asset Selection**
- Selection criteria
- Potential alternative uses
- Opportunity Zone / Enterprise Zone

**Economic Development**
- Industry initiatives
- Potential regulatory reform
- Potential tax reform

**Legal**
- Legislative considerations for asset contribution
- COT design considerations / Treasury acceptance
- Trust governance and design

**Accounting / Actuarial**
- Confirmation of accounting/actuarial treatment
- GASB Perspectives
- Rating Agency reactions
Appendix A

Detailed Description of the Legacy Obligation Trust model
Legacy Obligation Trust Model

**LOCAL GOVERNMENT UNIT (“LGU”)**
- REAL ESTATE
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**PENSION FUNDS**
**OPEB FUNDS**

**LOT**

**STEP 1:** Unit transfers assets to LOT

**STEP 2:** LOT issues *marketable* Certificates of Trust (“COT”) to the pension & OPEB funds evidencing beneficial ownership

**STEP 3:** Hire independent manager

**LOT MANAGER**
STEP 1 – LGU Transfers Assets to the LOT

LGU identifies universe of potential assets for an in-kind contribution

• What are the assets that government does *not* need to own?
  ➢ Real estate, infrastructure, enterprises
  ➢ Governments often hold assets to maximize political, not economic, utility
  ➢ Such assets hold unrealized equity value that, if professionally managed, could be unlocked to increase actual value and drive economic growth.
    ➢ Examples might include:
      • Raw land to be developed into alternative commercial use
      • State offices are consolidated to empty entire buildings that could be leased or sold to the private sector

• The value of the in-kind contributed assets provide immediate credit to the pension and OPEB funds
  ➢ Valuation methodology needs to be commercially reasonable
  ➢ LOT assets must be re-valued each year
STEP 2 - LOT Issues Certificate of Trust

Pension & OPEB funds will own and hold Certificates of Trust (“COTs”)

• The COTs serve as evidence of ownership of the LOT

• A large number of COTs may be issued to accommodate a division of ownership between multiple pension and OPEB funds

• The COTs’ value is based on the desk-top valuation of the assets at time of contribution and annually thereafter

• The COTs could be structured as marketable securities
  ➢ If the LOT assets generate steady cash dividends, the COTs may become an attractive investment opportunity for third-party money managers

    □ Such a secondary market gives the pension & OPEB funds a liquidation option without forcing the sale of the assets from the LOT

    ➢ A secondary market for COTs eliminates the need for an annual desk-top valuation

    □ The COT market price becomes a proxy measure of the economic fortunes of the government that has contributed the assets
STEP 3 – Government hires LOT Manager

The LOT Manager is incentivized to maximize economic utility of trust assets

• The assets contributed to the LOT dictate the skill set of the manager to be hired

• The LOT Manager must be independent, authorized, and empowered
  ➢ The LOT Manager is not subject to government control or influence
  ➢ The LOT Manager is authorized and empowered to sell, lease, or contribute the assets to joint ventures
  ➢ The integrity and professionalism of the LOT Manager is critical to success
STEPS 4 and 5 – LOT Manager

The LOT Manager is incentivized to maximize economic utility of trust assets

• The LOT Manager’s authority and governance structure must be well defined in advance
  ➢ Protocols for transparency must be established
  ➢ Auction protocols must be defined

• A Board of Trustees provides oversight on the LOT Manager
  ➢ Board members will include representatives of the beneficiary pension & OPEB funds, members of the business community, and labor

• New value creation is the LOT Manager’s measure of success
  ➢ Growing LOT asset value further offsets unfunded pension liability, minimizes “catch-up” payments, and stimulates the economy
  ➢ Granting a share of the COTs to the LOT Manager aligns incentives