EXECUTIVE SUMMARY

The State of Connecticut continues to face the consequences of decades of failure by prior administrations to adequately and responsibly fund the state’s pension obligations. These failures have threatened not only the financial and economic stability of the state, but have jeopardized the future of retirement security for hundreds of thousands of working people and their families, including teachers, law enforcement officers and caregivers to our state’s most vulnerable citizens.

State leaders, particularly those from both Labor and Management, have taken essential steps over the last eight years to begin the hard work of righting Connecticut’s history of pension underfunding. These collaborations have resulted in sacrifices by workers and have created new innovative payment reform plans to set Connecticut on a more disciplined path to financial recovery. Recent Labor-Management agreements have created new retirement tiers that increase employee contributions, prevent overtime spiking and require other sacrifices. New annual “stress tests” of the state’s retirement systems will serve as an important monitoring tool for policymakers, better assuring that future generations don’t repeat the mistakes of the past.

These steps have already improved the financial health of the state’s retirement systems, but more is necessary to adequately strengthen the state’s financial outlook, and reaffirm Connecticut’s obligations to those who have spent their lives working and sacrificing under the belief and promise of financial security and stability for their families.

Policy makers across government are continuing to explore new and innovative solutions to manage Connecticut’s unfunded liabilities. A new state administration, as well as a new term of constitutional officers and lawmakers, is beginning the process of declaring its proposals for consideration.

The Connecticut General Assembly, through Public Act 17-2 June Special Session, Sec. 180, established the Connecticut Pension Sustainability Commission to continue this work. The Commission was mandated to study the feasibility of placing state capital assets in a trust and maximizing those assets for the sole benefit of the state pension system. More specifically, this legislation mandated that the Commission fulfill the following:

1. Perform a preliminary inventory of state capital assets for the purpose of determining the extent and suitability of those assets for including in such a trust;
2. Study the potential impact that the inclusion and maximization of such state capital assets in such a trust may have on the unfunded liability of the state pension system; 3. Make
recommendations on the appropriateness of placing state assets in a trust and maximizing those assets for the sole benefit of the state pension system;
4. Examine the state facility plan prepared pursuant to section 4b-67g of the general statutes; and
5. If found to be appropriate by the members of the commission, make recommendations for any legislation or administrative action necessary for establishing a process to
   a. Create and manage such a trust, and
   b. Identify specific state capital assets for inclusion in such a trust.

Although the Commission was given a one-year term to perform its labors, beginning on January 1, 2018, the slow appointment process resulted in a July 2018 start. The Commission spent approximately six months researching and receiving presentations of verbal and written testimony from project managers, actuaries, academics and various experts from across sectors and across the country in order to better understand the costs, benefits and opportunities in reinvesting public assets in order to optimize those assets, while strengthening the state’s financial position.

On a parallel track, the Commission worked to identify legal and policy considerations and criteria (See Appendices) that must or should be factored into any decision to transfer any state asset for the purposes of reinvesting it into the state’s pension funds. As explained earlier in this report, the Commission has been working closely with the state Office of Policy and Management (OPM) in an effort to apply these proposed criteria to the state’s inventory of capital assets so that the state can determine what assets may be appropriate for a state entity to consider reinvesting for the benefit of the state’s pension funds. That effort by OPM remains ongoing as of the publication of this report.

The Commission’s final report was to be delivered to the Legislature’s Finance, Revenue & Bonding Committee as of January 1, 2019. However, a temporary extension was sought and granted by the Speaker of the House so that the Commission could complete its report.

**Background**

The State of Connecticut has experienced serial budget deficits dating back more than a decade. Analysis of these deficits indicate that escalating fixed costs have contributed significantly to the imbalance, specifically required annual contributions to retired teachers’ and state workers’ pension funds. This growing obligation has crowded out spending for other governmental
programs and created uncertainty and concern for businesses and credit markets, conceivably depressing economic vitality.

The cause of these burgeoning pension costs is primarily the failure by previous governors and legislatures to make annual contributions to the pension funds in anticipation of actuarially-projected future obligations – typically described today as the “unfunded liabilities.”

The State has struggled to find a path to a balanced budget with these increasing fixed costs. Early in 2017, an information forum sponsored by members of the Finance, Revenue & Bonding Committee included a presentation posing the opportunity to consider a new concept, what subsequently came to be called the Legacy Obligation Trust, or LOT. It was this concept, viewed as a potential means to mitigate state pension unfunded liabilities, which led to the Legislature’s decision to create the Pension Sustainability Commission, specifically tasked with proving out the concept (not tasked with all aspects of pension sustainability).

**Commission Information Gathering Process**

At the beginning of the Commission’s tenure, the focus of invited presenters was on the background and causes of the State’s fiscal condition and deficit history. Presenters included Ben Barnes, Secretary of the Office of Policy & Management, and Jim Millstein, Principal of Millstein & Co (presentations in Appendices). This report contains a number of charts and other data-derived documents which illustrate the sources and consequences of both the current and future budget situations. The presentations also noted efforts to date intended to address the deficit situation. Presenters included Jim Smith and Bob Patricelli, the Chairs of the former Connecticut Commission on Fiscal Stability and Economic Growth, which had previously considered transfer of the CT Lottery to the pension funds (Report in Appendices).

Subsequent presentations focused on examples of initiatives similar to the LOT concept instituted overseas as well as New Jersey’s experience in seeking to use its state lottery to reduce budget deficits there. Lastly, but very importantly, the Commission examined the consequences of doing nothing, leaving the State in the untenable circumstances of increasing budget deficits on State services and the local economy.

**Commission Deliberative Process**

Early on in the Commission’s discussions, it was agreed that the process would be best served by a better understanding of several key areas: accounting/actuarial benefits; the state capital real estate asset universe (including the CT Lottery) for potential donation to the funds; legal
issues; and economic opportunity considerations. Working groups (Membership in Appendices), comprised of Commission members, were created to investigate these subjects more thoroughly and then report back to the full Commission on issues, insights and recommendations. The group entrusted with evaluating the State capital asset opportunity was particularly important. Much discussion centered on the critical issue of whether there were sufficient “eligible” assets to justify the creation of an independent LOT manager structure to implement the concept. Unfortunately, the short timeframe for the workgroup’s deliberations and the aforementioned lack of resources made it virtually impossible to reach conclusions on several of the essential issues.

**The Legacy Obligation Trust Concept**

The Legacy Obligation Trust concept is predicated on the assumption that governmental entities own a multitude of capital assets but typically don’t manage such assets to optimize value, primarily because that’s not their priority. The concept involves the governmental unit making an in-kind contribution of real assets -- such as land, buildings, infrastructure or enterprises – to a professionally and independently managed trust. The trust “manager’s” responsibility would be to manage such donated assets to maximize value for the express benefit of one or more underfunded pension funds. In return, the manager would be compensated for the additional value created.

State-owned assets offer immediate value and a dedicated cash stream to support the legacy obligations. Additional value may be realized if these assets are managed more efficiently but the upside may be more limited. Undeveloped assets such as raw land and government occupied buildings, can be assessed for their potential to be repurposed for a higher and better use. To the extent that their present utility can be substituted or eliminated, such assets can be developed to generate cashflows, unlocking value that will offset legacy obligations and afford budget relief.

Importantly, the LOT concept was not intended to be a “silver bullet” for the pension sustainability problem. Rather, it might serve, at best, as a contributory means to mitigate the pension crisis by increasing funded ratios and restoring confidence in the State’s fiscal stability.

Several potential benefits would accrue from such a trust, specifically:

- The government unit would receive an immediate credit against its unfunded liability based on fair market valuation of the assets contributed to the trust;
• The pension or OPEB funded ratios would increase, potentially improving the credit agencies’
assessment of the governmental unit;

• The pension funds would receive an immediate, positive cash flow impact on the
governmental unit’s budget, as the “catch up” payment for the underfunding is reduced.

An adjunct to the LOT concept is the potential creation of Certificates of Trust (COTs), an
instrument which would potentially increase the liquidity of donated assets by establishing a
public market for such certificates, suitable for investment by public and private sector portfolio
investors.

Treasurer-Managed Capital Asset Investment (“Hybrid” Model)

Then State Treasurer Nappier and staff presented an alternative approach to the LOT concept,
embedding the manager’s role within the Office of the Treasurer. As stated in the presentation,
“A prudent transfer of State assets that can be developed and improved within the confines and
authorities of current pension fund governance.” Components of the plan:

1. Monetize CT Lottery revenues and transfer other state capital assets to the TRF in order to
mitigate the impact of moving to a more realistic investment return assumption of 7.5% (from
8%). Assets would be invested consistent with the Investment Policy Statement, including asset
allocations, approved by the Investment Advisory Council, and the requirements of pension fund
governance.

2. Pay off the Pension Obligation Bonds (POBs) in Fiscal Year 2026 (the first full fiscal year they
can be redeemed), thereby allowing for more options for responsible recalculation of future
contributions.

3. Following payoff of the POBs, re-amortize the TRF’s remaining unfunded liability and further
reduce the investment return assumption to 7%, consistent with capital market expectations.

This proposal would potentially: generate net General Fund savings of $440 million from FY
2020 through 2025; bring General Fund costs roughly in line with budgetary funding
“constraint;” and improve TRF cash flow by $560 million.

After Fiscal Year 2025, the State would be in a position to pay off the POBs for roughly $1.9
billion, using the estimated State ADEC and the POB debt service payment for that year,
subsequently Saving $2.25 billion in deb
1. Virtually all DOT and DEEP capital assets are not appropriate for donation to the pension funds and can’t be considered. However, improvements of such real estate assets to generate revenue which can benefit transportation and environmental investment priorities should be considered.

2. Donating the CT Lottery to the pension funds (securitization) is not as sensible as donating only the proceeds of the Lottery.

3. Donations of capital real estate assets pose challenges for pension fund liquidity and portfolio balance. Managing the trust within the aegis of the Treasurer’s Office may mitigate these concerns.

4. The Commission had insufficient time and resources to perform the inventory analysis as mandated by statute and can’t conclusively determine whether there are sufficient capital assets to justify the trust concept. However, it did establish a set of asset selection criteria to be considered when evaluating the suitability of specific capital state assets for donation.

**RECOMMENDATIONS**

The Commission’s key feasibility findings and conclusions with regard to this concept are outlined below.

**Trust Concept:** The Commission believes it is feasible for the state to establish a mechanism to identify and transfer state assets into a trust for the sole benefit of the state’s pension funds, but that the concept will require further analysis and action by this Commission or another state entity or agency for reasons explained below.

**Identification of Real Estate Assets:** There is insufficient information at this time for the Commission to conclusively identify any specific state real estate assets that may be appropriate for contribution into a trust for the purpose of reinvesting those assets for the sole benefit of the state pension funds. The Commission has developed a list of criteria that should be considered in a state evaluative process – involving OPM, the Office of the State Treasurer and any other state authority that the legislature should designate – for the purposes of determining what real assets are appropriate for transfer into a trust for the benefit of the state’s pension funds.

The Commission established some criteria to ensure that any transfer process factor a minimum of all legal, policy and practical considerations before making such transfer. In the event that the legislature decides to continue exploring the concept of reinvesting state real estate for the
benefit of the state pension funds, it is imperative that the legislature provide explicit policy guidance as to whether properties classified as state parks or as forest land or state farm land, or properties designated as “Historic”, or any other type(s) of properties should or should not be considered in addition to those simply designated as surplus. The policy implications for such an asset reinvestment and transfer, while potentially worthwhile, are too significant for the scope of this Commission’s existing charge.

**Trust Governance:** In the event that OPM’s ongoing effort to apply the Commission’s criteria to the state’s real property inventory should successfully identify real assets that may be appropriate for transfer to a trust to be reinvested for the sole benefit of the state pension funds, the Commission reviewed potential governance structures. Governance concepts reviewed included governance by an independent trust or by the Office of the State Treasurer. The Commission has found that it is only feasible for any such trust, as outlined in this report, to be managed under the sole authority of the state Treasurer who has sole fiduciary authority over the pension funds. The Commission does not believe it is legally feasible or advisable for any trust to be managed by an independent non-state authority over pension fund investments outside of the authority of the state Treasurer. Attempting to do so has the potential to interfere with the state Treasurer’s fiduciary responsibility, as well as the essential tax exempt status of the pension funds.

**Transfer of Lottery Proceeds vs. Transfer of Lottery Asset:** The Commission explored various concepts involving the use of Connecticut Lottery revenue for the benefit of the state pension funds, including the State of New Jersey’s revenue-allocation model, the securitization of all or some of the anticipated value of the Connecticut Lottery or an entire asset transfer. Based on research and analysis presented to the Commission and attached to this report, including analysis by the Office of the State Treasurer, the Commission believes that the concept of transferring proceeds of the Connecticut Lottery to the pension funds is feasible. The Commission also believes that wholesale transfer of the Connecticut Lottery, as an asset to the funds, is also technically feasible, although the Commission notes that the Office of the State Treasurer raised important concerns about how that approach would affect the liquidity of the pension funds. A wholesale asset transfer would increase the value of the pension funds’ assets and reduce the unfunded liability, however, it would also reduce the ADEC and result in negative cash flows to the funds. In the event that the Connecticut Lottery proceeds are directed to the state’s pension funds, the determination as to how those proceeds are allocated after transfer is under the authority of the Office of the State Treasurer. Donation of the lottery as an asset may be feasible subject to certain concerns related to liquidity and the need to create or modify the governance structure.
**Further Analysis:** The Commission recommends that, should the legislature wish to explore the specific concepts identified in this report further, that such work be conducted by either the Office of the State Treasurer and/or through the continuation of the existing Connecticut Pension Sustainability Commission in order to avoid duplicative work by another newly established state entity. The Commission also recommends that the legislature, in pursuing additional analysis, designate sufficient resources to allow for professional legal, accounting, actuarial and/or other necessary consulting services to verify the feasibility of these concepts.

1. The Legislature should recommission the group to continue its work through conclusion, for a period of not less than one year.

2. The Legislature should appropriate $100,000 so that necessary validation by third-party experts can be accomplished.

3. The reconstituted Commission should focus on an in-depth analysis of capital real estate assets to determine eligibility and relative “attractiveness” for donation, taking into account potential value and obstacles. The analysis effort should yield a decision as to whether there are sufficient eligible assets to justify the creation of a LOT-like management entity.

4. The Commission should focus on a LOT-like concept based on the “hybrid” approach championed by former Treasurer Nappier.

5. The Legislature and the Governor should consider donating the proceeds of the CT Lottery (not the Lottery asset itself) to the Teachers Pension Fund for a period of six years, or until the bond can be reamortized without violation of the bond covenants. The method of donation should be based on the model proposed by former Treasurer Nappier.
HISTORY OF PENSION FUNDING

State Employees Retirement System (SERS)

The primary reason for the poor funding status of the State Employees Retirement System (SERS) is that, while it began offering benefits from 1939 onward, it was operated entirely on a “pay as you go” basis until 1973, when a phase-in to actuarial funding first began. The first full ARC payment wasn’t made until 1987. Between 1989 and 2009, five retirement incentive programs (RIPs) were adopted, however, no adjustment was made in the state’s funding plan to account for the actuarial cost of these RIPs. The state’s actuarially required contribution (ARC) was also routinely reduced between 1993 and 2000 and was further reduced by over $300 million between FY 2009 and 2011.

In an effort to reduce the cost of the system, new less-generous tiers were established in 1984 (tier 2), 1997 (tier 2A), 2011 (tier 3), and 2017 (tier 4). In addition, there is an increasingly less-generous formula for retiree cost-of-living adjustments (COLAs) for employees who retire after June 30, 1999, October 2, 2011, and June 30, 2022. Finally, changes to the normal retirement age, an early retirement penalty, and new employee contributions that applied to existing employees were adopted in 2011 and 2017.

As noted above, funding for the system began to transition from “pay as you go” to a prefunding model starting in 1973, with the first full ARC contribution made in 1987. In 1995 the actuarial method was changed from “entry age normal” to “projected unit credit” and a new 40-year amortization schedule was adopted. That amortization schedule was rebased in 1996 and 1997. In 2009, the return assumption was reduced from 8.5% to 8.25%, and then further reduced to 8.0% in 2013. In 2017, a major modernization of the funding approach was adopted which included returning to entry age normal, reducing the return assumption to 6.9%, transitioning from “level percent of payroll” to “level dollar amortization” over a five year period, extending the amortization period to 2047 for approximately 4/5ths of the outstanding liability and layering future gains and losses over separate 25-year periods. This approach was widely viewed as positive by ratings agencies, and stress testing performed by the Pew Charitable Trust has shown that the state faces very little risk of insolvency in the SERS plan due to market variations.
Subsequent to the Commission’s deliberations, Governor Lamont proposed combining the transitional and statutory amortization bases that are to be paid-off by 2047 as well as the adoption of market performance risk-sharing features for future retiree’s COLAs.

**Teacher’s Retirement System (TRS)**

The reasons for the poor funding status of the Teachers’ Retirement System (TRS), like SERS, include late adoption of actuarial prefunding, consistent underpayment by previous legislatures of the statutorily required annual contribution and optimistic return assumptions. TRS began promising benefits in 1917, but was funded on a pay as you go basis until 1980, and full funding of the ARC was not achieved until 2006. While the full calculated ARC has been paid since then, the return assumption was 8.5% until 2017 when it was reduced to 8.0%. Changes in retiree COLA formula were adopted for members who retire after 1992 and will be further reduced for members who joined the system after 2007. Member contributions were increased in 1992 and 2018.

Seeking to improve the funding of the system, the state issued $2.2 billion in Pension Obligation Bonds in 2008. These bonds contained a covenant that pledged that the state would make the ARC payments under the amortization scheme that was adopted at the time. This covenant constrains the State’s ability to mitigate TRS pension obligations to this day.

In February 2019, Governor Lamont proposed that unfunded liabilities in both the Teachers’ Retirement Fund and the State Employees’ Retirement Fund be treated in a similar fashion. For SERS, the unfunded liability as of June 30, 2016 would be funded over a 30-year period ending in FY 2047 and for TRS, the liability as of June 30, 2018 would be funded over a 30-year period ending in 2049. In both systems, future gains and losses would be amortized over new 25-year periods. If we assume that any potential asset contribution would therefore be treated as an actuarial gain in the year in which that asset was contributed, the impact on annually recommended contributions, at an assumed 6.9% discount rate for 25 years, is equal to approximately 8.5% of the value of the asset contributed. For example, if either fund were to receive an asset valued at $100 million, the State’s contribution toward the unfunded liability in that fund would be expected to decrease by approximately $8.5 million per year for the next 25 years.

Two other factors will influence the estimate provided above. First, SERS is in the middle of a transition from level percent of payroll to level dollar amortization, but TRS would only begin that transition under the Governor’s proposed budget. That means that, if the asset transfer were to be made before the change in amortization method was complete, the impact of an asset transfer would be somewhat smaller than the figure noted above prior to the end of the
transition period and somewhat higher thereafter. Second, while the General Fund supports 100% of the unfunded liability for TRS, it only supports approximately 72% of the cost of SERS (the remainder being attributable to positions funded by non-General Fund sources), so the General Fund impact of a $100 million asset transfer to SERS would be expected to be about $6 million per year.

THE LEGACY OBLIGATION TRUST (“LOT”)

OVERVIEW
The Legacy Obligation Trust (“LOT”) design is where a government makes an in-kind contribution of real assets – like land, buildings, infrastructure, enterprises - to a professionally managed trust for the benefit of one or more underfunded municipal pensions. The trust issues Certificates of Trust (“COTs”), much like shares of stock, and divides them among the various pension funds the government unit sponsors. The COTs convey the fair market value of the assets to the pension funds.

To maximize economic utility of trust assets, which will in turn, increase the fair market value of the COTs, the independent LOT manager could be awarded a limited share of COTs to align a powerful profit incentive with the recovery of stakeholders and the State. The LOT manager can explore various alternatives including a sale, lease, or other strategic partnerships and joint ventures with the private sector and / or existing stakeholders. Driving economic value of the assets contributed to the trust further offsets the legacy obligations.
There are five basic steps to the establishment and functioning of the Legacy Obligation Trust construct.

**STEP 1 – Asset Evaluation:** The first task of the asset evaluation process is where a government unit takes inventory of all of its capital assets, including real estate, infrastructure, and enterprises. An underlying premise is that government assets often hold unrealized equity value that, if managed for profit, could be unlocked to increase actual value and drive economic growth.

The universe of government-owned assets can generally be divided into two broad categories: (a) developed enterprise assets and (b) undeveloped assets:

- **DEVELOPED ENTERPRISE ASSETS:** State-owned enterprises, authorities, utilities, and other cash generating assets offer immediate value and a dedicated cash stream to support the legacy obligations. Additional value may be realized if these assets are managed more efficiently but the upside may be more limited. The disadvantage of contributing such assets is that the related cashflows already have a constituency that will be deprived of that benefit. Other sources of funding would be required for that constituency to remain unimpaired.

- **UNDEVELOPED ASSETS:** Raw land and government occupied buildings can be assessed for their potential to be repurposed for a higher and better use. To the extent that their present utility can be substituted or eliminated, such assets can be developed to
generate cashflows, unlocking value that will offset legacy obligations and afford budget relief. Examples might include:

- raw land to be developed into alternative commercial use like retail, residential, or even alternative energy production like solar farms
- State offices are consolidated to empty entire buildings that could be leased or sold to the private sector

The advantage of undeveloped assets is that they hold great upside potential and can generate an economic multiplier effect. The disadvantage of such assets that they require professional management and the benefit of time to unlock the higher and better use value. To the extent that contributed assets exist in the government’s designated Opportunity Zones, such assets’ investment attractiveness is enhanced.

The fair market value of the in-kind contributed assets provide immediate credit to the pension and OPEB funds.

The second task is to establish criteria for asset-selection. The criteria evaluation should consider whether the government could part with an asset either by virtue of its surplus status or by a re-prioritization of public policy.

**STEP 2 – Certificates of Trust:** The LOT issues Certificates of Trust to the government unit’s pension fund(s); the LOT could issue, say, 100,000 certificates – much like shares of stock. The large number of issues COTs accommodates 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. Over time, as 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 reliable secondary market for COTs eliminates the need for an annual desk-top valuation. Ultimately, the COT market price becomes a proxy measure of the economic fortunes of the government that has contributed the assets.

**STEP 3: LOT Manager:** Critical to the success of unlocking the hidden equity value in contributed assets is the on-going management of the assets. The selection of the LOT Manager is a consequential exercise for the pension retirees. The skill set of the LOT Manager must be matched to the majority of assets that are contributed. A large firm, with a deep
professional bench, might be best suited to the long-term nature of the management effort. Realistically, there is no single firm that could bring the breadth of expertise to manage all assets; the LOT Manager should be enabled to sub-contract the necessary expertise to manage specialized assets but still take responsibility for performance.

The governing charter for controlling the LOT Manager is a subject that requires further development. Ideally, the LOT Manager should be able to function independently of government control or influence – or as much as politically feasible. Independence and minimization of government interference is presumed to enhance the ease of repurposing contributed assets to higher and better utility. In addition, the level of manager independence will have a direct impact on the accounting treatment of the LOT, as more fully explained later in Section X.

**STEPS 4 & 5: LOT Manager Authority & Empowerment:** The LOT Manager should be authorized and empowered to sell, lease, or contribute the assets to joint ventures with the private sector. New money invested in the LOT has the potential to enhance asset value, create new jobs and drive COT valuation that benefit the creditors and pension plans.

The range of the LOT Manager’s authority must be memorialized in a management contract a set of by-laws so that there is no ambiguity that would interfere with the disposition and repurposing of contributed assets. Such a contract can mirror other management contracts that the pension fund may use to engage other asset managers. By structuring the COTs as marketable securities, the creditors and pension plans have a liquidity option to monetize their recovery once the assets in the trust are perceived to be growing in value.
Above all else, the LOT Manager’s reputation and integrity must be of the highest caliber and beyond reproach. From the selection process to the continuing oversight of the LOT Manager, there has to be transparency of behavior that is consistent with other pension asset manager protocols.

Oversight of the LOT Manager will likely vary from government to government. A Board of Trustees providing oversight is one approach; Board members might include representatives of the beneficiary pension & OPEB funds, members of the business community, and labor. In Connecticut, the single fiduciary role of the State Treasurer would compel that office’s direct oversight of the LOT Manager.

New value creation is the ultimate measure of success and, consistent with the effort to align incentives, should be tied to the LOT Manager’s compensation. While compensation design has not yet been fully developed, a combination of fees and a small percentage of COTs could be granted to the LOT Manager. The COTs could be restricted: some would be earned over time and some earned based on valuation enhancement performance. Growing LOT asset value further offsets unfunded pension liability, minimizes “catch-up” payments, and stimulates the economy.

**PRIOR EXAMPLES OF IN-KIND CONTRIBUTIONS**

*The LOT concept is a new idea that has not been previously implemented in the U.S.* In-kind contributions, however, to satisfy legacy obligations like bond indebtedness and pensions have, however, been utilized in the U.S. and internationally. Four examples include:

- **City of Detroit** - The use of real assets as a form of payment was the key to settling the City of Detroit’s Chapter 9 bankruptcy in 2013-2014. Several European banks had financed a $1.4 billion contribution to Detroit’s grossly underfunded pension; these creditors accepted the transfer of certain valuable real estate along Detroit’s waterfront and downtown area, including the Joe Louis Arena and the Detroit Windsor Tunnel. As the new owners of City assets, these creditors’ long-term recovery became dependent on their willingness to invest new money to maximize the economic value of their assets. Presiding bankruptcy court Judge Steven Rhodes specifically cited this creative alignment of the City’s redevelopment with creditor recovery as an important feature of the City’s successful exit from bankruptcy.

- **City of Hartford** - In 2017, the City of Hartford received a $5 million credit against its pension liability when it transferred the title of Batterson Park to the City’s pension fund. This action helped the City narrow its cash budget deficit and demonstrates that an in-
kind contribution of real assets can successfully be used to offset pension liability.

- **State of New Jersey** - New Jersey’s 2017 transfer of its lottery to the State’s pension system was nationally recognized as an in-kind asset contribution that dedicated a substantial revenue stream to satisfying pension obligations. This transfer, however, took that same revenue stream away from the state’s general fund budget that was otherwise funding education and senior citizen-oriented programs. The bond rating agencies generally regarded this particular move as either “credit neutral” or slightly “credit positive”.

- **Queensland Australia** - Australia’s third largest state, Queensland, experienced a fiscal budget deficit in 2009 in the wake of the global recession. Rating agency downgrades followed rising deficits that ultimately prompted Queensland to announce it would seek to sell or lease major government-owned assets in response to the crisis. After strenuous public objection to the outright privatization of assets, Queensland contributed the state-owned Queensland Motorways Ltd., a 70-kilometer state-owned toll road, to the pension fund. Queensland received an AU$3 billion credit against its underfunded pension. The pension fund hired professional infrastructure managers who improved operations and expanded the toll road. In less than five years, the pension sold the toll road to the private sector for AU$7 billion. In short, Queensland unlocked AU$7 billion of hidden equity value sitting on its balance sheet for the benefit of the pensions.

It is also noteworthy that the State of New Jersey recently issued a Request for Qualifications to select a professional advisor to assist the State select and develop strategies to maximize the value of State-owned assets to fund the State’s pension plans, other post-employment benefit obligations, and existing bonds that collectively exceed more than $200 billion in obligations. The advisor will evaluate various State assets, including real property, buildings, roads, transit facilities, rights of way, air rights, development rights, naming rights, and infrastructure such as airports, bridges, water facilities, ports, parks and recreational facilities. New Jersey is seeking to complete this evaluation in six months.

In addition, Illinois’ Governor J.B. Pritzker recently announced the formation of a pension task force that will evaluate the potential to make in-kind contributions of state-owned capital assets to fund the state’s outstanding $134 billion of unfunded pension liabilities.
**LOT BENEFITS**
The intended benefits of the LOT structure for a government unit includes:

- an immediate reduction in the Actuarially Determined Employer Contribution (ADEC), formerly referred to as Annually Required Contribution or “ARC”) based on the fair market valuation of the assets contributed to the trust;

- the ADEC reduction has affords the government unit the opportunity to reduce its general fund budget expenditure;

- the contributed assets can potentially be returned to the property tax rolls as they become economically productive;

- an alignment of economic interests of the government unit, labor unions, the business community, and ultimately, the taxpayers

On the expectation that asset values grow, governments will recognize that the upside valuation makes a dent in the unfunded liabilities and can have a positive cashflow impact. As such, the government will have an incentive to create a business and regulatory environment that can further drive asset value.

**CONCERNS AND VULNERABILITIES**
As noted earlier, the LOT construct has not been fully implemented previously and represents a new approach that will likely go through trial and error and be modified to suit each government.

S&P Global Market Intelligence released a short advisory on February 19, 2019 entitled “Pension Brief: Are Asset Transfers A Gimmick Or A Sound Fiscal Strategy? In this advisory, S&P expresses concern for weak investment returns, demographic challenges, and the potential for economic decline increasing the longer the current expansion lasts. They acknowledge that some state and local governments “have looked to develop creative solutions to help mitigate expanding liabilities and bolster wanting asset levels... they are considering asset transfers along with other revenue streams that can be used to both improve pension funding levels and provide budgetary relief.”

S&P has four key questions in considering an asset transfer’s impact on credit quality:

1) Is the valuation of the asset reasonable and verifiable?
2) Is liquidation of the asset practical?
3) Does the plan have such a low funded status that liquidity issues may arise prior to the realization of a future revenue stream?
4) Is the asset valuation technique an attempt to reduce contribution requirements in the short term while further underfunding the pension system and compounding future contribution requirements?

These are excellent questions and begs additional thoughts on the LOT design considerations.

1) **Reasonable and Verifiable Valuation:** an independent valuation at the initial transfer and then regularly afterwards will be required to satisfy S&P’s concern. The valuation process should be done by one or more independent professional firms with expertise in the particular assets. Under the LOT design, there would need to be two valuations: one for the assets and a second for the Certificates of Trust. If the LOT development progresses to the point where cash dividends are being paid, a viable secondary market may develop for the COT holders and a true market price could be used to value the COTs. Such a design could satisfy S&P’s concern.

2) **Asset Liquidation Practicality:** This concern is addressed as part of the asset selection criteria before the transfer. An asset like a lottery cannot be sold to a private third party; therefore, there should be confidence that the cash generating capacity is steady and reliable. Like New Jersey, a lottery could be transferred directly to the pension but not the LOT construct. The LOT, by design, should have the authority to sell its assets to third parties under the terms and conditions outlined in the LOT Manager’s contract.

S&P’s concern has additional implications whether assets should be contributed directly to the pension or to an independent vehicle like the LOT. The answer may vary with the type of asset contributed.

Developed enterprise assets, especially those that have tax-exempt debt attached, may best be contributed directly to State pensions in order to avoid triggering refinancing requirements. These assets are likely to be cash-generating enterprises and authority-owned assets that may continue to provide a public benefit while under pension fund ownership. Undeveloped assets may best be suited for contribution to an independent vehicle that is under professional management to maximize value under a highest and best use strategy.
3) **Pension Funding Status**: The pension fund liquidity management is a serious concern and requires careful coordination during the asset selection process. A government pension must assume that undeveloped assets contributed to a LOT may require five to eight years of management before it throws off a positive cashflow. Contributing a balance of cashflowing and non-cashflowing assets to a LOT can help abate S&P’s concern. In addition, the government could enhance pension liquidity by funding ADEC plus a supplement cash contribution. State Treasurer Denise Nappier raised this very issue was raised during the course of the Commission’s deliberations. Treasurer Nappier further expressed concerns about whether such asset transfers may jeopardize attached tax exemption. In addition, the LOT management construct could hinder or conflict with the State Treasurer’s fiduciary duty.

4) **Funding Discipline**: This last S&P concern is perhaps the most compelling. The government unit needs to exercise the necessary fiscal discipline not to underfund in the future if they are going to pursue an in-kind asset contribution strategy. In the absence of such discipline, the asset transfer would be regarded as a “one-shot” gimmick that defers meaningful reform. The LOT concept holds the potential to make a significant dent in legacy obligations but is not the definitive answer to pension and OPEB underfunding. True pension reform must include the elimination of pension spiking, adjustment of employee contributions, elimination of structural budget deficits, establishment of “rainy day” budget reserves, and re-setting the discount rate.

**CT STATE LOTTERY TRANSFER**

**Concepts Explored**

The Commission heard from several speakers who addressed the potential for the Connecticut State Lottery to serve as a vehicle for improving the funding status of the TRS. The Connecticut Lottery is a quasi-public asset valued at approximately $5 billion and generates approximately $345 million in revenue (Testimony of Greg Smith, President of the Connecticut Lottery) for the state’s general fund.

Jim Millstein, CEO of Millstein and Co., appeared before this Commission and revisited a recommendation of the Fiscal Stability Commission that the state contribute the lottery in kind to the TRS at a fair market value. He suggested that this be accomplished in a manner similar to
what was done in New Jersey in 2017 wherein the lottery enterprise in its entirety was transferred to the New Jersey state pension funds in a 30-year concession agreement. The lottery enterprise was valued as an asset worth over $13 billion, and part of that transfer, the annual net proceeds of the New Jersey lottery, valued at over $1 billion annually, would flow to the pension funds as well. Francis Chin of American Public Infrastructure LLP was involved in the New Jersey transaction and explained to the Commission that a new actuarial technique was developed to set forth how the ADEC would be calculated, but the impact of this transfer would be an immediate decrease in the unfunded liability and a decrease in the state’s ADEC. Although initially budget neutral due to the loss of that same amount in the General Fund, Chin clarified that it shifts to level credit over time.

Millstein identified several potential benefits of such an asset transfer. First, it would provide a dedicated source of funding for the TRS. Second, it would replace the annual appropriation to the TRS from the state budget with revenue from the lottery. Third, it would increase the funded status of the TRS thereby reducing the state’s pension liability vis-à-vis a reduced ADEC. This reduced ADEC would offset the loss of the lottery revenue to the General Fund. Moreover, the improved UAAL would result in an improvement to the state’s credit rating. State Treasurer Denise Nappier, however, cautioned that “the General Fund’s gain would be the TRF’s loss because less cash would flow into the TRF and trigger greater negative cash flows.” She also noted that although the value of the lottery concession estimated at $5 billion would be included as a plan asset for actuarial purposes, it would not be valued this way for financial statement purposes in accordance with GASB rules.

The Commission considered an alternate version of that plan in which the Lottery itself would not be transferred, but the revenue of the lottery would flow into the TRS. This concept obviously does not allow the TRS to benefit from receipt of the $5 billion asset itself and thus the TRS would not experience an immediate increase in its funded ratio. However, the annual proceeds would relieve the General Fund of a portion of its ADEC while at the same time reducing the income that the General Fund otherwise would have received, leading some to consider it essentially a wash, or budget neutral.

Treasurer Nappier instead proposed an alternative plan wherein lottery revenues would be monetized by using revenue bonds sufficient to generate cash proceeds of $1.5 billion that would be deposited into the TRF. In addition, $1.5 billion of state owned assets would be transferred into the TRF, and an irrevocable trust would be established. Treasurer Nappier estimated that her proposal would generate approximately $440 million in savings to the General Fund from FY 2020 through FY 2025, and the TRS cash flow would be improved by approximately $560 million. Finally, after FY 2025, the State could pay off the Pension Obligation
Bonds for $1.9 billion using the state ADEC and debt service payment for that year. Also, the
TRS’s investment return assumption could be lowered from 8% to 7%. Nappier insisted that the
success of this proposal is dependent on the legislature continuing discipline imposed by the
bond covenants and that the legislature should only be permitted to appropriate less than the
ADEC by a supermajority vote with public notice. Her plan would result in a significant reduction
in the anticipated TRS funding “spike” from $3.25 billion to $1.78 billion. It is important to note,
however, that Treasurer Nappier’s proposal is dependent on the existence of at least $1.5 billion
in state assets that could be transferred to the TRS.

Next Steps

Before any of the above-mentioned proposals can be seriously considered, several steps must
be taken. A determination of the exact fair market value of the CT Lottery would be required as
would an examination of how/if the management of the Lottery would remain in its current form
or be changed.

TREASURER-MANAGED CAPITAL ASSET INVESTMENT (“Hybrid” Model)

Background and Overview

The Connecticut Retirement Plans and Trust Funds (“CRPTF”) was established by the Treasurer of
the State of Connecticut (“the Treasurer”), and approved by the Investment Advisory Council
(“IAC”), in accordance with the provisions of subsection (c) of Section 3-13b of the Connecticut
General Statutes. Invested assets of the following plans and trusts are pooled together:

1. State Employees’ Retirement Fund,
2. Teachers’ Retirement Fund,
3. Connecticut Municipal Employees’ Retirement Fund,
4. Probate Judges and Employees Retirement Fund,
5. State Judge’s Retirement Fund,
6. State’s Attorneys’ Retirement Fund,
7. Soldiers’, Sailors’ and Marines’ Fund,
8. Arts Endowment Fund,
9. Agricultural College Fund,
10. Ida Eaton Cotton Fund,
11. Andrew C. Clark Fund,  
12. School Fund,  
13. Hopemead Fund, and  
15. Other Post-Employment Benefits Trust Fund

Pursuant to the Connecticut General Statutes, the Treasurer is the principal fiduciary of the CRPTF. Responsibilities in this regard are governed by fiduciary law and standards, and by the Constitution and laws of the State of Connecticut.

In carrying out these responsibilities, and as an elected Constitutional Officer of the State of Connecticut, the Treasurer is responsible for the investment and custody of all CRPTF assets and the selection of and contracting with all money managers, investment partners and other service providers.

The Treasurer may retain money managers, investment partners and other service providers to assist in the management of the assets held by the CRPTF and will exercise prudence and care in selecting, instructing and supervising such providers of investment and investment related services. The Treasurer may invest CRPTF assets directly into companies, including investment funds, limited partnerships, limited liability companies, REITs and conduct due diligence, select and monitor the management of such direct investment vehicles. Consistent with Section 3-13i of the Connecticut General Statutes, before the retention of any such money manager, investment partner or professional consultant, the Treasurer will present recommendations to the IAC for its consideration. After such presentation, unless waived by a vote of the IAC, the IAC will have up to 45 days to review and comment upon any proposed contract for investment advisory services prior to the execution of such a contract by the Treasurer. The Treasurer is responsible for negotiating the terms of the contract and subsequent amendments to said contract.

**Asset Allocation**

To provide a means for investing pension plans and other trust fund assets in a variety of investment asset classes, open end investment portfolios known as combined investment funds (“CIF”) have been established. The CIFs are as follows and are classified as Liquid, Hybrid Liquid and Illiquid portfolios.

**Liquid**
1. Mutual Equity Fund (US Equity)
2. Developed Markets International Stock Fund (Developed Markets Equity)
4. Core Fixed Income Fund (Core Bonds)
5. Inflation Linked Bond Fund (Global Inflation Linked Bonds)
6. High Yield Bond Fund (High Yield Bonds)
7. Emerging Market Debt Fund (Emerging Market Bonds)
8. Liquidity Fund (Cash and Short Term Investments)

**Hybrid Liquid**
9. Alternative Investment Fund (Hedge Funds, Private Credit and Real Assets) Illiquid
10. Real Estate Fund (Real Estate Separate Accounts and Funds)
11. Private Investment Fund (Private Equity, Venture Capital)

The asset allocation to the CIF’s for each of the CRPTF is established by the Treasurer, with approval of the IAC, based on (1) capital market theory, (2) financial and fiduciary requirements, and (3) liquidity needs. Benefit payments, trust distributions and plan expenses in excess of contributions are paid from the investment program.

A broad array of asset classes is considered for inclusion in a potential asset allocation structure. Each asset class has its own distinct characteristics, as well as expectations for long term return and risk behavior. Mathematical modeling is used to determine which mix of asset classes maximizes return at each level of risk. In addition to the asset allocation policy then in place, several alternative asset mixes are selected for further analysis. The liabilities or trust distribution needs are modeled in detail and projections are made based on the actuarial or spending assumptions underlying each of the retirement plans and trusts. The behavior of both the asset classes and the liabilities are tested under different economic scenarios using sophisticated simulation software. The outcomes of these tests are then examined to determine which asset mix offers a balanced risk/return tradeoff as measured by the impact on the liabilities or spending policy over multiple time horizons.

For purposes of this report, the capital assets discussed by the Pension Sustainability Commission (“Commission”) could be considered for inclusion in the Real Estate Fund (“REF”) and/or the Real Assets portion of the Alternative Investment Fund (“AIF”), subject to the guidelines established in the Investment Policy Statement (“IPS”). Further details of these considerations follows.
**Real Estate Assets**

Capital assets identified for transfer into the pension plan(s) that would otherwise qualify as real estate assets could be allocated to the R

The REF is the CIF through which the CRPTF makes investments in the real estate asset class. The investments may consist of a number of different investment strategies and investment vehicles, including externally managed commingled funds, separate accounts and/or publicly traded real estate securities. All investments in real estate assets are expected to adhere to the standards of fiduciary obligation to the beneficiaries of the CRPTF, and will be considered in the context of the relevant risk/reward factors of this asset class and consistent with the statutory requirements for consideration of investments by the Treasurer in accordance with Section 3-13d (a) of the Connecticut General Statutes.

Investment selection entails a comprehensive, thorough process of due diligence and investigation of the critical factors on which an investment decision is to be based, including quantitative and qualitative analysis of the investment partner, its professionals and their ability to successfully implement their stated investment strategy within the context of current and prospective market environments.

In general and at time of investment, the following REF investment restrictions/limitations would apply to any State assets that are classified as real estate:

- The Investment Partners will follow the contract process for the State of Connecticut Retirement Plans & Trust Funds Responsible Contractor Policy – Real Estate Fund.
- Open-ended Real Estate Investments will be structured to include clearly defined redemption provisions. For closed-end investments, exit or sale provisions will be clearly defined.
- Investment Partners will value all portfolio investments at least annually by qualified third-party appraisal firms or internal processes that are deemed to be institutional quality.
- Independent third party valuations will be obtained, at a minimum, every three years (subsequent to completion of construction) or on an as needed basis.
- No more than 10 percent of the target REF will be allocated to any one individual investment vehicle in which the CRPTF does not have the ability to exit the investment or terminate the manager. Each separate account will not exceed 20% of the target REF.
- No single investment partner will manage more than 25 percent of the market value of the REF allocation.
• General Partners will be required to ensure that all REF investments adhere to all limitations imposed by Connecticut and/or federal law.

**Infrastructure Assets**

Capital assets identified for transfer into the pension plan(s) that would otherwise qualify as infrastructure assets could be allocated to the Real Assets sub-target allocation within the AIF depending on the capacity within the asset allocation for the real assets strategy.

In general and at time of investment, the following REF investment restrictions/limitations would apply to any State assets that are classified as infrastructure:

• Investment managers will adhere to the investment strategy, diversification limits and administrative guidelines described in their private placement memorandum and related contracts;
• Investment managers will be required to ensure that all AIF investments adhere to all limitations imposed by Connecticut General Statutes and/or federal law;
• No more than 20% of the AIF’s policy target allocation should be invested in any one investment vehicle.

**WORKING GROUPS SUMMARIES**

**Legal Subgroup**

The legal subgroup initially looked at the legal issues raised by the concept of transferring certain state property to a Legacy Obligation Trust ("LOT"), a privately managed and held entity which might be able to be sold by the state to create immediate revenue which the state could use help pay down underfunded long term obligations. As our review developed, we determined that each piece of property under consideration for inclusion in the LOT would require a detailed and specific legal review to determine how, when, and with what, if any conditions the property was acquired, what legal restrictions might attach to an attempt to sell the property because of answers to those questions, and what other legal restrictions might attach to each property because of applicable statutes, constitutional requirements, and common law requirements.

As these considerations are discussed more fully in the report of the Asset Selection Subgroup, they will not be further discussed here. In light of these concerns, and in light of presentations
by the Treasurer about the benefits of making any transfer of assets to the Treasurer, rather than a LOT, the Commission has already voted preliminarily that it would support a transfer of the CT Lottery or its proceeds to the Treasurer for the purposes discussed above, but has not pressed for transfer of other state properties. If that continues to be the Commission’s recommendation, then there will no need for further analysis of these issues. Because it appeared that the LOT concept was not going to be recommended by the Commission, there was no analysis of the other issues raised by the LOT concept such as fiduciary issues and even the legality of transfer of state assets to a privately managed entity.

The Commission was also informed that federal law requires that lotteries such as the CT Lottery must be owned and operated by a state to comply with federal law. This requirement comes from the fact that federal law generally prohibits the promotion of lotteries in interstate commerce, 18 U.S.C. Secs. 1301-1304, 1953(a), but exempts Lotteries “conducted by [a] State acting under the authority of State law.” Id. Secs. 1307(a)(1), 1307(b)(1), 1953(b)(4). These requirements are detailed and analyzed in an opinion of the Office of Legal Counsel of the U.S. Department of Justice dated October 16, 2008, entitled “Scope of Exemption Under Federal Lottery Statutes for Lotteries Conducted by a State Acting Under the Authority of State Law,” available on the Commission’s website. Because of this legal requirement, it appears that the only way to use the value of the State Lottery or its revenues towards pension sustainability would be for the legislature to direct or guarantee those revenues to a particular pension-related purpose, or to entrust the revenues or the lottery and its revenues to the Treasurer for specified purposes. Such an avenue, to the best of the Commission’s present knowledge, appears to be lawful.

**Capital Asset Inventory Subgroup**

The Capital Asset Selection Work Group was charged with reviewing and evaluating all State capital assets to determine their suitability for inclusion into an “in kind” contribution to the pension systems to improve their funding ratios, reducing the unfunded liabilities and, therefore, lower the state’s actuarially required contribution payments “ARC.” This included reviewing, but not limited to, land, buildings, roads, airports, healthcare facilities and all other State assets.

The Work Group proposed specific criteria for the selection of State-owned assets to be included in a Pension trust which were accepted by the Pension Sustainability Committee:

1) Properties that are not currently being utilized for government functions.

2) Properties that clear a Phase 1 environmental study and require further remediation.
3) Only properties owned by the State of Connecticut and the component unit authorities.

4) Properties not classified as State parks or forest land including state farm land preservation easements.

5) Properties surplus to the State of Connecticut needs – this would require state agency approval to transfer from agency with custody and control of each particular property of via a legislative mandate.

6) Properties that have been determined to be eligible for transfer legally (certain statutes may prohibit particular from being transferred based on state or federal law)

7) Properties that have been designated as “Historic.”

8) No DOT Rights of ways as FHWA, under 23 code of the federal Regulation (CFR) 710.403 requires that the proceeds from the sale of any excess property by the DOT must be deposited in the state transportation fund and to be utilized as the state’s matching for future transportation projects.

With the assistance of Paul Hinsch, Director of the Bureau of Assets Management within the Office of Policy and Management (“OPM”), the Work Group applied these criteria to the Inventory of Real Property maintained by OPM.

The inventory of Real Property lists approximately 6,800 properties, consisting of both land and structures. The application of the agreed-upon criteria reduced this overall number significantly to no more than a few dozen, essentially properties that have been or are in the process of being declared surplus.

Following this initial analysis, the Pension Sustainability Committee debated whether the criteria were too limiting. A proposal was made to limit the criteria to the following:

- Only properties owned by the State of Connecticut
- Properties that have been determined to be eligible for transfer legally.

In discussing this proposal, the Committee debated whether it should consider property that is currently being used for government functions and if so, what factors should be included in a
cost-benefit analysis to determine whether a property that is currently used for a governmental function could be put to a better use as a contribution (directly or indirectly) to the pensions. After robust discussion of these issues, there was consensus that such policy determinations were not within the Pension Sustainability Committee’s current authority and that it would be helpful if the legislature identified more clear directives and standards for any future analysis. Although the Pension Sustainability Committee did not vote to limit the criteria, it was unanimous that for any property under consideration for transfer, it would be necessary to ensure that no legal restrictions prevented such transfer. There is no central repository in which legal restrictions on parcels or buildings is recorded. Accordingly, it will be necessary to consider each property individually to determine what, if any restrictions may exist, and if so, whether such restrictions may be overcome.

There are large classes of properties for which it is reasonable to conclude that the legal restrictions are overwhelming, specifically:

- Land designated as a state park, forest or other public trust
- Land subject to agricultural, transportation, conservation or open space easements
- Land subject to federal highway regulations
- Property subject to federal airport regulations
- Land subject to federal railway regulations

Moreover, there are myriad state laws that relate to the acquisition, use and disposal of state real property, including the recent constitutional amendment regarding the legislatively-mandated transfer of real property. This constitutional amendment imposes the following restrictions on such transfers:

- It requires a public hearing on bills to authorize the transfer, sale, or disposal of state-owned properties, such as state parks, forests, and conserved lands, to nonstate entities and
- It requires a two-thirds vote of the Connecticut General Assembly to authorize the transfer, sale, or disposal of land under the control of the state agriculture or environmental protection departments.
In addition to this procedural change, there are several other statutes that must be assessed to determine whether and how they apply to each property under consideration for transfer. Of course the legislature could change certain of these limitations if it wished to do so, but the Commission has no way of knowing what changes the legislature may wish to consider.

The following is a non-exclusive list of such statutes:

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<th>Statutes relating to real property acquisition / limits on use or purpose</th>
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It will also necessary to assess whether there are any property-specific restrictions, such as deed restrictions or conditions of gift. Finally, because of the laws related to property purchased with bond funds for each property under consideration, it will be necessary to determine if the property was purchased with bond funds and if so, whether there are any conditions or restrictions on the transfer of the property.

[The Accounting/Actuarial and Economic Development subgroups deliberations did not merit separate reports.]

**Key Findings, Conclusions & Recommendations**

The State of Connecticut continues to face the consequences of decades of failure by prior administrations to adequately and responsibly fund the state’s pension obligations. These failures have threatened not only the financial and economic stability of the state, but have jeopardized the future of retirement security for hundreds of thousands of working people and their families, including teachers, law enforcement officers and caregivers to our state’s most vulnerable citizens.

State leaders, particularly those from both Labor and Management, have taken essential steps over the last eight years to begin the hard work of righting Connecticut’s history of pension underfunding. These collaborations have resulted in sacrifices by workers and have created new innovative payment reform plans to set Connecticut on a more disciplined path to financial recovery. Recent Labor-Management agreements have created new retirement tiers that increase employee contributions, prevent overtime spiking and require other sacrifices. New annual “stress tests” of the state’s retirement systems will serve as an important monitoring tool for policymakers, better assuring that no future generation repeats the mistakes of the past.
These steps have already improved the financial health of the state's retirement systems, but more is necessary to adequately strengthen the state's financial outlook, and reaffirm Connecticut's obligations to those who have spent their lives working and sacrificing under the belief and promise of financial security and stability for their families.

Policy makers across government are continuing to explore new and innovative solutions to manage Connecticut's unfunded liabilities. A new state administration, as well as a new term of constitutional officers and lawmakers, is beginning the process of declaring its proposals for consideration.

As explained earlier in this report, the Connecticut General Assembly, through Public Act 17-2 June Special Session, Sec. 180, established the Connecticut Pension Sustainability Commission to continue this work. The Commission was mandated to study the feasibility of placing state capital assets in a trust and maximizing those assets for the sole benefit of the state pension system. More specifically, this legislation mandated that the Commission fulfill the following:

1. Perform a preliminary inventory of state capital assets for the purpose of determining the extent and suitability of those assets for including in such a trust;
2. Study the potential impact that the inclusion and maximization of such state capital assets in such a trust may have on the unfunded liability of the state pension system;
3. Make recommendations on the appropriateness of placing state assets in a trust and maximizing those assets for the sole benefit of the state pension system;
4. Examine the state facility plan prepared pursuant to section 4b-67g of the general statutes; and
5. If found to be appropriate by the members of the commission, make recommendations for any legislation or administrative action necessary for establishing a process to
   a. Create and manage such a trust, and
   b. Identify specific state capital assets for inclusion in such a trust.

In order to fulfill its mandate, the Commission spent approximately six months researching and receiving presentations of verbal and written testimony from project managers, actuaries, academics and various experts from across sectors and across the country in order to better understand the costs, benefits and opportunities in reinvesting public assets in order to optimize those assets, while strengthening the state's financial position.

On a parallel track, the Commission worked to identify legal and policy considerations and criteria (See Attachment __) that must or should be factored into any decision to transfer any
state asset for the purposes of reinvesting it into the state's pension funds. As explained earlier in this report, the Commission has been working closely with the state Office of Policy and Management (OPM) in an effort to apply these proposed criteria to the state's inventory of capital assets so that the state can determine what assets may be appropriate for a state entity to consider reinvesting for the benefit of the state's pension funds. That effort by OPM remains ongoing as of the publication of this report.

Following the efforts outlined above, the Commission has reached consensus on certain findings regarding the feasibility of a concept that can be generally characterized and defined as “the contribution of state assets (real or other) that have the potential to generate income into a trust, the proceeds of which are dedicated to one or more of the state pension plans.”

The Commission's key feasibility findings and conclusions with regard to this concept are outlined below.

**Trust Concept:** The Commission believes it is feasible for the state to establish a mechanism to identify and transfer state assets into a trust for the sole benefit of the state's pension funds, but that the concept will require further analysis and action by this Commission or another state entity or agency for reasons explained below.

**Identification of Real Estate Assets:** There is insufficient information at this time for the Commission to conclusively identify any specific state real estate assets that may be appropriate for contribution into a trust for the purpose of reinvesting those assets for the sole benefit of the state pension funds. The Commission has developed a list of criteria that should be considered in a state evaluative process – involving OPM, the Office of the State Treasurer and any other state authority that the legislature should designate – for the purposes of determining what real assets are appropriate for transfer into a trust for the benefit of the state's pension funds. The Commission developed the criteria to ensure that any transfer process factor a minimum of all legal, policy and practical considerations before making such transfer. In the event that the legislature decides to continue exploring the concept of reinvesting state real estate for the benefit of the state pension funds, it is imperative that the legislature provide explicit policy guidance as to whether properties classified as state parks or as forest land or state farm land, or properties designated as “Historic”, or any other type(s) of properties should or should not be considered in addition to those simply designated as surplus. The policy implications for such an asset reinvestment and transfer, while potentially worthwhile, are too significant for the scope of this Commission’s existing charge.
**Trust governance:** In the event that OPM’s ongoing effort to apply the Commission’s criteria to the state’s real property inventory should successfully identify real assets that may be appropriate for transfer to a trust to be reinvested for the sole benefit of the state pension funds, the Commission reviewed potential governance structures. Governance concepts reviewed included governance by an independent trust or by the Office of the State Treasurer. The Commission has found that it is only feasible for any such trust, as outlined in this report, to be managed under the sole authority of the state Treasurer who has sole fiduciary authority over the pension funds. The Commission does not believe it is legally feasible or advisable for any trust to be managed by an independent non-state authority over pension fund investments outside of the authority of the state Treasurer. Attempting to do so has the potential to interfere with the state Treasurer’s fiduciary responsibility, as well as the essential tax exempt status of the pension funds.

**Transfer of Lottery Proceeds vs. Transfer of Lottery Asset:** The Commission explored various concepts involving the use of Connecticut Lottery revenue for the benefit of the state pension funds, including the State of New Jersey’s revenue-allocation model, the securitization of all or some of the anticipated value of the Connecticut Lottery or an entire asset transfer. Based on research and analysis presented to the Commission and attached to this report, including analysis by the Office of the State Treasurer, the Commission believes that the concept of transferring proceeds of the Connecticut Lottery to the pension funds is feasible. The Commission also believes that wholesale transfer of the Connecticut Lottery, as an asset to the funds, is also technically feasible, although the Commission notes that the Office of the State Treasurer raised important concerns about how that approach would affect the liquidity of the pension funds. A wholesale asset transfer would increase the value of the pension funds’ assets and reduce the unfunded liability, however, it would also reduce the ADEC and result in negative cash flows to the funds. In the event that the Connecticut Lottery proceeds are directed to the state’s pension funds, the determination as to how those proceeds are allocated after transfer is under the authority of the Office of the State Treasurer. Donation of the lottery as an asset may be feasible subject to certain concerns related to liquidity and the need to create or modify the governance structure.

**Further analysis:** The Commission recommends that, should the legislature wish to explore the specific concepts identified in this report further, that such work be conducted by either the Office of the State Treasurer and/or through the continuation of the existing Connecticut Pension Sustainability Commission in order to avoid duplicative work by another newly established state entity. The Commission also recommends that the legislature, in pursuing additional analysis, designate sufficient resources to allow for professional legal, accounting, actuarial and/or other necessary consulting services to verify the feasibility of these concepts.
In conclusion, the Commission thanks all of those from within and outside state government who presented research and analysis that will assist our state in identifying additional mechanisms to further strengthen Connecticut’s financial stability, and assure retirement security for teachers and state workers.