Center for American Progress

Using Pension Funds to Build Infrastructure and Put Americans to Work

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Introduction and summary

America's infrastructure—its roads, bridges, water and sewer systems, energy grids, and telecommunications systems, to name a few—is outdated and is, in far too many places, crumbling due to lack of sufficient public investment.[1] America's construction workers faced levels of unemployment close to 14 percent in 2012,[2] and our construction industry is experiencing lackluster levels of activity, as the value added by the industry in 2011 was still more than $100 billion lower than the prerecession high.[3] And while public and private employee pension funds are confronting distressing levels of unfunded liabilities due to the most recent market crash and rising levels of retirement—with 90 percent of the pension funds that responded to a Wilshire Consulting survey reporting higher amounts of liabilities than assets[4]—public pension funds and private funds managing union pensions have more than $4.5 trillion in assets.[5] Any one of these indicators alone would signal deep economic distress. Together, they should be setting off alarm bells that new economic policies are needed. The Center for American Progress is calling for new federal policies that encourage responsible pension-fund investment in U.S. infrastructure projects because such policies can help reverse these negative trends and make a significant contribution to putting the economy on sounder footing.

The Center for American Progress estimates that all levels of government, together with the private sector, invest approximately $130 billion annually in energy, surface transportation, and water infrastructure.[6] But the estimates also show that an additional $129 billion per year is needed for at least the next 10 years to repair and improve our transportation and water systems, dams and levees, and energy infrastructure, all of which are critical to supporting globally competitive businesses and a high quality of life in communities across America.[7]

Private investment from sources such as pension funds cannot close this gap in infrastructure funding unilaterally. Nevertheless, it makes sense to find ways to accelerate private investment in infrastructure so that annual government appropriations can be directed to projects in which user fees or other dedicated revenues such as gas taxes or sales taxes and the expanded use of tolling—fees charged for the use of highway facilities—is not likely to be sufficient to repay investors. CAP estimates that at least $60 billion a year in infrastructure improvements could be financed with private capital, thereby relieving federal and state budgets of this upfront cost, although in some cases government appropriations may be part of the mix of funds used to repay investors over time.[8] Even with a ready and eager pool of private investment capital, public policies that promote an increase in dedicated revenues are needed to generate the funds necessary to repay investors for their risk and effort.

Canada, Australia, and many of the EU nations are investing more in their infrastructure and modernizing it at a more rapid pace than the United States.[9] A significant portion of this updating and expansion is being financed with pension-fund capital invested in projects through public-private partnerships, which give investors an equity stake in the infrastructure asset through a long-term lease—commonly known as a concession agreement—or through outright ownership.[10] In some high-profile infrastructure projects overseas, U.S. pension funds are major investors. The largest public pension fund in the United States, the California Public Employee Retirement System, for instance, recently took a 12.7 percent equity stake in the London Gatwick Airport with a $155 million investment.[11]

Pension funds are making these types of investments when opportunities align well with their investment-portfolio needs and can thus contribute to achieving fund solvency. Over the next decade investment consultants forecast that pension funds will invest $3.5 trillion in traditional infrastructure and what is termed "social infrastructure"—public buildings such as schools, government facilities, and hospitals.[12] According to *The Financial News*, "the investments … in these funds … would build 170,000 new hospitals or pay for 73,000 miles of three-lane motorway, enough to circle the globe three times."[13]

This hefty level of investments represents a very small share of overall U.S. and international pension-fund investments. The Organisation for Economic Co-operation and Development, or OECD, estimates that less than 1 percent of pension funds worldwide are invested in infrastructure projects, excluding indirect investment in infrastructure via the equity of listed utility companies and infrastructure companies.[14]

U.S. pension funds are much less active in infrastructure investment than their counterparts in Canada, Australia, and the European Union. In Australia, retirement funds, known as superannuation funds, are increasingly investing in infrastructure.[15] While these Australian funds also struggle to find financially feasible domestic infrastructure projects in which to invest, their domestic market is maturing. An average of approximately 5 percent of their assets is invested in Australia, with some funds' investment stakes in the double digits and representing as much as $80 billion available to invest in infrastructure.[16] The question is: Why are U.S. pension funds less active in infrastructure investment than their international counterparts? What can be done to spur such investment in financially rewarding and publicly needed domestic infrastructure projects? This report highlights the key challenges that U.S. pension funds face in increasing transportation-related investments in roads, bridges, ports, waterways, airports, transit, and rail. It then discusses policy options that are aimed at reducing or removing these barriers.

One key factor in the relatively low level of pension-fund engagement in U.S. infrastructure investment is the existence of the robust tax-exempt municipal-bond market, typically referred to as the "muni market." In 2012 this nearly $400 billion market offered states and localities easy access to low-cost capital for infrastructure projects.[17] Municipal bonds are financially beneficial to investors with tax liabilities. Since pension funds are not taxable entities, infrastructure projects financed with tax-exempt debt don't offer pension funds a financially attractive vehicle through which to make investment in U.S. infrastructure projects. That's the reason pension funds don't enter the muni market. Likewise, neither state and local governments nor quasi-governmental entities such as ports and airports need to engage pension investors because of the strength of the muni market.

Beyond the muni market's effect of crowding out tax-exempt investors, where there are infrastructure investments in the United States that offer a competitive rate of return to pension funds, the funds themselves have confronted significant barriers to investments. These barriers include a lack of experience; lack of investment-review capacity; the paucity of opportunities for investments that align with pension-fund needs and expectations; a mismatch between infrastructure deal structure and size and pension-fund needs and obligations; an aversion to operational and headline risks where there is a possibility of negative publicity associated with the investment; and political conflict and uncertainty where the viability of an investment can become subject to legislative action.

One reason to address these barriers is that adding pension funds to the "investor table" increases the number of willing investors, which in turn increases the supply of capital, creating a healthier marketplace that can produce a lower cost for capital. In addition, engaging pension funds at the investor table can mean that there is an investor that will demand employment policies that will ensure that workers are well trained and well paid throughout the construction and operation of the projects.[18] For these reasons, CAP believes that a strategy that increases pension-fund investment in infrastructure will contribute to increasing the pace of American infrastructure repair and improvement while boosting the likelihood that our projects are built by well-trained workers who can do high-quality work.

New federal and state policies and resources can address some of these challenges by helping make pension funds more knowledgeable of and comfortable with infrastructure investments. Options include policies that close the knowledge and capacity gap through education and training, increase investor confidence in the infrastructure sector, and boost the predictability of returns on such investments. Specifically, we suggest:

Closing the information gap to build experience

- Establish a national infrastructure bank that has the capacity to hire experts who can work with pension funds where investment needs align with infrastructure projects.
- Provide seed capital to launch a network of fee-supported nonprofit intermediaries that are not affiliated with any infrastructure funds or other private-investment vehicles to disseminate to pension-fund staff, trustees, and advisors expertise in pension and infrastructure investing.
- Support small working conferences where pension-fund managers and project sponsors work jointly on products, metrics, templates, and any other necessary documents or information that can enable pension funds to review projects according to their needs and give project sponsors a well-informed approach to seeking partnerships with pension funds.
- Establish an industry-standard group that would bring pension funds together to establish benchmarks for infrastructure investment and consider prudent fee structures for public pension funds investing in projects funded in part through tax credits, public grants, or publicly subsidized debt.
- Use the training capacity of the U.S. Department of Transportation to prepare state transportation departments to work in partnership with pension funds, including through the creation of templates for responsible contractor policies and clarification about what categories of projects are likely to be approved for private financing, as well as through clarification of state performance and the earnings expectations of private investors. Tap the expertise of the U.S. Department of Labor to increase the understanding of Employee Retirement

Income Security Act-related requirements and the degree to which infrastructure investments meet those requirements for private-pension-fund trustees, managers, and advisors. Where further clarification is required, the Department of Labor should undertake releasing such guidance.

Increasing confidence in the soundness of infrastructure investments

- Fund a pension-trustee training institute that prepares materials for pension-fund fiduciaries and administrators that can build trustee understanding of infrastructure investment and separate the facts and myths about investments made in this sector. Charge the institute with creating tools to help trustees consider risks so that sound decisions can be made about the likelihood of financial or headline risks and the options for addressing these risks should they materialize.

Increasing the financial return to pension funds for investing

- Launch a new federally subsidized, taxable bond instrument that can offer pension funds sufficient return for debt investments in infrastructure. Enable infrastructure projects where pension funds are majority equity owners in order to tap the tax-exempt bond markets for the share of ownership under their control.

- Improve U.S. loan-guarantee and credit-enhancement options to improve protections available for projects in which pension funds are equity owners.

Ensuring that project financing is reliable and predictable

- Enable states to use tolling on all highway lanes where tolling is viable throughout the National Highway System.

- Increase the amount of dedicated and predictable federal revenues available for states to use to offer a reliable and competitive rate of return to investors.

This paper describes the current state of pension-fund activity in infrastructure investments in the transportation-related sectors, explains the barriers to mobilizing more pension-fund investment in the sector, and offers recommendations to address these challenges.

The Center for American Progress is a nonpartisan research and educational institute dedicated to promoting a strong, just, and free America that ensures opportunity for all. We believe that Americans are bound together by a common commitment to these values and we aspire to ensure that our national policies reflect these values. We work to find progressive and pragmatic solutions to significant domestic and international problems and develop policy proposals that foster a government that is "of the people, by the people, and for the people."

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