Infrastructure Investment: A Resource for Pension Trustees

Trustee Leadership Forum for Retirement Security

Since the first meetings of the TLF in 2011, infrastructure investment has been a topic of interest to the pension trustees. As an asset class, it has the potential to provide not only appropriate returns to workers' pension funds, but also investments in communities that need good jobs and modern rail, energy, internet, roads, bridges, and damns. It also poses risks, including privatization of public jobs and assets.

In 2017, pension trustees have more questions than ever about infrastructure investment. This working document compiles some of the thinking from the past six years of trustee discussions at TLF convenings, and aims to briefly summarize the key issues and questions that have been raised. Trustees with whom we work are asking how, as institutional investors, they may signal what is of value in these investments, or, in other words, what makes an infrastructure investment a "high road" investment.

Overview

When we talk to pension trustees, there is virtually no debate that the need for infrastructure investment in the U. S. is high, even critical. Federal funding has failed to provide needed capital through the Highway Trust Fund, the gas tax or other sources. And municipalities may not always be able to finance their infrastructure needs through bonds alone due to financial hardship.

Trustees tell us that the great need for infrastructure repair and expansion, combined with a lack of public funding, has led to a search for alternative sources of capital, including private investment by pension funds. It appears that opportunities for, and pressure on, pension funds to invest in infrastructure will continue in the coming years.

Infrastructure may hold attractive qualities for institutional investors. Pension funds are well suited to provide "patient capital" to long-term infrastructure projects. And, in an ecosystem of increasingly opaque and complicated financial products, investments in the "real economy" could be a more tangible example of the productive use of workers' capital. But private infrastructure investments may also carry risks – financial, political and otherwise – that funds do not wish to take, and poorly designed infrastructure investments may be harmful to society, including the beneficiaries of the fund.

Issues to Consider in Infrastructure Investment

There are generally three types of infrastructure projects: Public, Private, or a Public-Private Partnership (also known as a PPP or a P3). In the United States, most energy and telecom projects are private. Traditionally, projects like municipal water facilities and transit have been public.

In any infrastructure project there are five phases, known as Design, Build, Finance, Operate and Maintain, or DBFOM. It is common even in public projects for the Design and Build phase to be done through private entities.

The difference with a Public-Private Partnership is that some, or all, of the Finance, Operate and Maintain phases may be privatized to some degree or for some amount of time. This is an important area for investors to ask questions, in particular how standards for workers, the environment and local communities will be achieved. Investors should understand how they are getting paid, and be aware of political risk that may exist due to user fee hikes or labor arbitrage.

While there is a clear need for investment in infrastructure, the kinds of projects that private investors find attractive, and the kinds of projects communities need, often do not match. For that reason, private investment cannot be a panacea for lack of public funding. Because pension funds are looking for large projects with relatively high rates of return, there are many needed infrastructure projects that will never be funded through a P3.

However, there are some P3 projects that point to how long-term infrastructure investments can be well-managed. ULLICO's investment in the city of Rialto's water system, for instance, integrates reasonable long-term return expectations with a set of labor standards meant to manage political and execution risk. The Miami Port Authority Tunnel – an extremely complex and technical project – was built as part of a labor partnership, and integrated quality job standards such as family health benefits with on time delivery.

Unfortunately, when P3s aren't thoroughly vetted, communities and investors may be gouged. The 99-year privatization of parking meters in Chicago has come to exemplify the kinds of red flags investors should look for, including rushed deals meant to cover budget holes, long leases that effectively privatize public resources, hidden costs and escalating user fees.

Can Pension Funds Make Infrastructure Investment Better? Some Questions Trustees Can Ask

Pension funds are in a position to demonstrate that there is demand from institutional investors for a stream of deals that bring community benefit and high standards along with return on investment. By taking a close look at infrastructure deals, demanding high standards throughout all phases of the deal (and for all contractors), and asking hard questions, pension trustees may help signal that there is demand for better deals. Here are some questions trustees might ask:

Issue: Return on Investment

Investors have to know how the infrastructure investment makes money (user fees, opportunity payments, labor arbitrage, etc.), and how investors will be paid. Many infrastructure assets are public goods and should have no revenue stream. Schools, roads (without tolls), or types of infrastructure that can't support a user fee (like a rural bridge) are examples of infrastructure that is better supported by direct federal spending.

Trustees can ask:

- Does the infrastructure asset have a revenue stream? Should it?
- What are the risks and uncertainties attached to the revenue stream? Does private finance exacerbate or mitigate those risks?

Issue: Risk

Private equity capital costs more than the municipal bond market. If a government agency is choosing to bypass less expensive capital, trustees may want to consider why that is, and what risks may be involved. Public agencies may want to transfer construction risk, development risk, or operations risk to the private sector. Investors should understand and analyze those risks.

Trustees can ask:

- If a public agency has a lower cost of capital in financing infrastructure, why is the public sector seeking out private sector investors with higher cost financing? Are they paying for a transfer of risk to private investors?
- Is there a clear explanation for what the private sector brings to developing the asset? To financing it?

Issue: Worker Protection

Since the cost of capital is higher in a P3 than in a publicly funded project, investors may reasonably wonder how the investment is making a return. One line of inquiry to examine has to do with whether the return on investment is coming from cheaper labor costs, or labor arbitrage, and what that means for jobs, workers and safety.

Trustees can ask:

- Is the return on investment coming from labor arbitrage?
- Are labor standards and regulations, from occupational safety to Davis-Bacon, being applied as they would be to a purely public project?

Like pension funds, infrastructure managers can adopt wage and benefit protections for workers so workplace standards aren't undermined.

Trustees can ask:

- Has the investment manager adopted robust worker protections for construction, operations, and maintenance personnel?
- Does this project provide good jobs to our community with collective bargaining agreements and/or a project labor agreement?
- Does this project erode current bargaining units?
- How does this project provide training and workforce development?

Issue: Know What You Own

As important as due diligence on future allocations is understanding the ownership interests in current infrastructure allocations. As fiduciaries, knowing what you own is key to avoiding investment in "low-road" projects which may undermine the long-term health of the plan.

Trustees can ask:

- What infrastructure projects do we have exposure to through our current allocation?
- What is the track record of these projects/asset managers on labor, training, safety and health, and use of responsible contractors?
- How does the fund collect and review information about this performance?

Issue: Privatization of Public Assets or Jobs

P3s can involve a sale or long-term lease of public assets, like toll roads, water systems, prisons, or parking meters. If the P3 includes privatized operation and maintenance, it could involve privatizing public jobs and erosion of public bargaining units. Not all P3s involve privatization. Some infrastructure fund managers are focusing on specific subsectors, like energy, where there are no government sponsors and risks are quite different.

Trustees can ask:

- Does this project sell off public assets?
- Does this project privatize public jobs?
- Is the infrastructure manager doing private sector deals where assets already sit in the private sector?
- What are the risks for the project associated with privatization of public resources?

Issue: Public Oversight

Many private infrastructure deals have concession agreements that govern the terms of the deal for very long periods of time (30 year + leases). Investors may be concerned with how public interests are balanced with investor interests during long term concession agreements.

Trustees can ask:

- What control and governance does the government sponsor retain during the terms of the concession agreement?
- What kind of user fees are involved, and how do fees increase over time?
- Are the short-term gains coming at the cost of the long-term benefits of members, beneficiaries, their families and communities in the form of selling of public assets or privatizing public jobs?
- Does this project increase or decrease inequality in our community?
- Does this project decrease the carbon footprint of our community?

Infrastructure Investment Standards

A number of good policies and standards are in use now by asset managers, pension funds and unions. Here are some of the policies already in place which may be of use to trustees who wish to strengthen their fund's policy on infrastructure investment:

The ULLICO Infrastructure Fund's Responsible Contractor Policy is widely considered the "gold standard" of responsible contractor policies, and provides good language on preserving *collective bargaining rights* at all phases of the project.

The AFL-CIO's Standards for Pension Fund Investment in Infrastructure also provides helpful guidance to trustees and funds with support for *maintaining public assets and jobs*, as well as initiatives like Build America Bonds and pension fund letters of credit.

AFL-CIO President Trumka's February 2017 testimony to the U. S. Transportation and Infrastructure Committee (available at http://transportation.house.gov/uploadedfiles/2017-02-01-trumka.pdf) identifies financing considerations and overarching principles, as well as types and sectors of infrastructure investment critically needed today. These considerations provide thoughtful guidance which is applicable to pension funds considering investing in infrastructure as well as to those involved in designing public infrastructure investment programs.

Investment policies can also provide guidance for high road infrastructure investments. CalPERS' Investment Policy for Real Assets (available at https://www.calpers.ca.gov/docs/policy-real-assets-program.pdf) expresses the value they place on *preserving public sector jobs*.

CalPERS' Investment Policy for Restricting Private Equity (PE) Investments in Public Sector Outsourcers (available at https://www.calpers.ca.gov/docs/policy-restrict-private-equity-outsourcers.pdf) also has helpful language on how they *limit investments that outsource public jobs*.

Another example of high road infrastructure investment policy comes from the Dutch asset manager PGGM. Their guidance, Responsible Investment in Infrastructure (available at https://www.pggm.nl/wat-doen-we/Documents/pggm-responsible-investment-in-infrastructure.pdf) is a good example of how to incorporate *Environmental, Social and Governance factors*, or ESG, into infrastructure investments.

Further Reading

"A Guide to Understanding and Evaluating Infrastructure Public-Private Partnerships" by In the Public Interest, January 2017
https://www.inthepublicinterest.org/wp-content/uploads/ITPI_InfrastructureP3sGuide_Jan2017.pdf

"No Free Bridge: Why Public–Private Partnerships or Other 'Innovative' Financing of Infrastructure Will Not Save Taxpayers Money" by Hunter Blair, March 21, 2017 for the Economic Policy Institute
http://www.epi.org/publication/no-free-bridge-why-public-private-partnerships-or-other-innovative-financing-of-infrastructure-will-not-save-taxpayers-money/

"Taking the High Road to More and Better Infrastructure in the United States" by Douglass Sims, et al, for NRDC, 2016
http://iri.hks.harvard.edu/files/iri/files/nrdc_final_taking-high-road-more-and-better-infrastructure-ip.pdf

"A 21st Century Infrastructure for a 21st Century Economy" by North America's Building Trades Unions, April 2016
http://www.bctd.org/files/NABTU-Infrastructure-policy.aspx

"In American Towns, Private Profits from Public Works" by Danielle Ivory, Ben Protess and Griff Palmer, December 24, 2016 in the New York Times
https://www.nytimes.com/2016/12/24/business/dealbook/private-equity-water.html

"Building America While Building Our Middle Class: Best Practices for P3 Infrastructure Projects" by In the Public Interest, March 2016
https://www.inthepublicinterest.org/wp-content/uploads/ITPI_PWF_P3BestPractices_March2016.pdf

"Workers' Capital and Infrastructure: A Guide for Union Trustees" by the International Workers Federation, 2015
http://www.workerscapital.org/files/Workers_Capital_and_Infrastructure.pdf

Move: Putting America's Infrastructure Back in the Lead by Rosabeth Moss Kanter, 2015
https://www.nytimes.com/2015/06/14/books/review/move-putting-americas-infrastructure-back-in-the-lead-by-rosabeth-moss-kanter.html

"Cities Need to Weigh the Costs of Privatization" by Donald Cohen, July 23, 2013 in the New York Times
https://dealbook.nytimes.com/2013/07/23/cities-need-to-weigh-costs-of-private-partnerships/