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Leveraging State-Owned Assets to Fund Pensions and Meet Other Long-Term Funding Challenges

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The State of Oklahoma owns a vast array of property and other valuable assets. Much of this property is likely put to better use in the private sector, is not taxed, and requires ongoing maintenance expenses. State-owned assets are also largely illiquid, representing vast sums of stored up value held by the government but not being utilized. These assets could be leveraged to address long-term funding challenges, including filling the state's gap in public employee pension funding.

Oklahoma faces significant long-term funding challenges, primarily in the form of unfunded pension obligations. Public employee pensions, despite some recent reforms, account for approximately $7.9 billion in long-term unfunded obligations.[1] Notably, the state's largest pension, the Teachers' Retirement System, is funded below the rate considered by experts (80 percent) to be indicative of good financial health.[2]

Typically, lawmakers have two options to fund increased contributions to underfunded pensions: they can raise taxes or cut spending for other government services. Both options punish current and future taxpayers for decisions made by policymakers long ago, and are therefore undesirable.

This paper proposes an alternative. The state should establish a process to identify state-owned assets suitable for monetization and use any resulting proceeds to pay down pension debts and meet other long-term funding challenges. Taxpayers will avoid getting soaked with higher taxes, pensioners will see the promises made to them kept, government services will stop being crowded out by pension obligations (or will be less crowded out), and land and other assets will be put to more productive—and tax revenue generating—use in the private sector. Such a process would be a true win-win for the state.

Why Sell State Assets?

State-owned property is not taxed and is likely not being put to its highest, most economically productive use. Moreover, the property is illiquid, meaning the government has less ability to shuffle resources as priorities change and needs arise. Government agencies, especially in tight budget years, tend to defer needed maintenance, causing the assets to deteriorate and making future repairs more expensive.

Several salutary effects occur when property transitions from government to private ownership. First, the government receives a financial windfall, "unlocking" the stored up future value of the asset all at once. Second, the property is returned to the private economy, where it can be used to generate additional economic activity. Third, the property returns to the tax rolls, generating additional future revenue for government entities. Lastly, the new private owner of the property is strongly incentivized to protect his investment by maintaining it rather than allowing it to deteriorate. If the asset is a service provider rather than just a physical asset, the service experienced by customers is typically improved, not diminished, as a result of a transition to private ownership.

A similar process unfolds as a government leases its property holdings to private parties, with the added benefit that such leases typically generate ongoing revenue in the form of lease payments to the government-owner. The terms of such arrangements are negotiable and vary, but usually require the lessee to bear the cost of maintenance and upgrades, ensuring

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that the value of the government-owned asset does not diminish over the life of the lease.

Guidelines for Developing a Successful Monetization Process

A successful effort to monetize state assets requires an organized, deliberative process that adheres to certain principles. Several state and local governments have successfully executed such transactions, allowing them to address pressing funding needs.[3] Oklahoma can learn from their experience and from its own past attempts in this area.

First, such a process must begin with a comprehensive assessment of what the state owns. The reality of government property ownership is that all too often there is no centralized "balance sheet" to start from, making coherent decision-making virtually impossible.[4] Oklahoma has made some effort at creating such an inventory, but a more useable and effective product could be created.[5]

Second, final decision-making authority should be vested in public officials or bodies who answer to the state as a whole and who do not have a stake in continued ownership of the property being evaluated. Statewide accountability both confers legitimacy on the process and also guards against capture by local interests. Previous monetization efforts in Oklahoma have produced little action because final decision-making authority on whether to continue ownership of assets has usually resided with the agency that owns the property.[6]

Third, the evaluation process should be managed by a relatively small, centralized team so that management of the project does not become unwieldy or beset by politics. This team should have legal authority to compel recalcitrant agencies to provide necessary information and should answer to the final decisionmaker described above. It should also have access to expert consultants who can provide guidance as to items like asset valuation, transaction structure, and legal issues.

Fourth, the process should be transparent to the public and should maximize competition. The danger of cronyism in large transactions of this nature is ever present, and risks both financial damage to the government and illegitimacy to the enterprise. Sunlight and uniform procedures can help to protect against such cronyism.

Lastly, a dedicated use for any financial proceeds should be established on the front end, before monetization decisions are made. Such an approach ensures that funds realized from any sale will flow to a long-term financial need of the state rather than becoming just another revenue source used to pad operating budgets. Also, establishing a dedicated use of the funds can help inform decision-making about whether to retain or divest a particular asset. Ultimately, these decisions will require weighing competing interests, so it is helpful to know what interests are on both sides of the ledger.

Lessons For Future Reform From a Previous Divestiture Effort

A law enacted in 2011 requires the Office of Management and Enterprise Services (OMES) to compile an annual report detailing all underutilized state property.[7] The law directs OMES to designate the 5 percent least utilized properties, estimate their likely value if sold, and establish a process for selling the asset.[8]

In short, the law appears to have been an attempt to regularly compile all the information needed to make a decision about whether to keep or sell property.

The Grand River Dam Authority is anything but underutilized, but that does not mean the government should continue to own it.

Though it constitutes a laudable effort, the OMES program suffers from several design flaws. First, it is entirely focused on properties not being used or being underused by the state, so it excludes huge assets such as those described in this paper. The Grand River Dam Authority, described below, is anything but underutilized (it even has its own police force[9]), but that does not mean the government should continue to own it.

Second, the law does not give OMES guidance in how to report the information it compiles in a format that is conducive to high-level prioritization and decision-making. OMES is simply told to create a report, and the end-result is a difficult-to-follow spreadsheet containing just as much information about the worthless properties as it does about the most valuable. The data OMES compiles is thorough and would be useful as a component of a successful program, but it is limited. Moreover, modern technological tools such as GIS mapping are not fully exploited, hampering the program's effectiveness.

Third and most critically, the 2011 law fails to designate a decision-maker outside of the agency controlling the property to make the call on whether to keep or sell. Instead, the final decision on what to do with the information compiled by OMES is largely left to the agency. Unsurprisingly, there has not been a rush of such sales, despite numerous underutilized assets appearing on the 5 percent least utilized list year after year. OMES reported to a legislative committee in 2017 that since the law's inception, the program had produced $3.1 million in revenue to the state, even though the report each year includes individual properties that are themselves worth many times that figure.[10]

But there *is* one central body that already has authority for this type of decision-making and ultimately decides whether the state continues to own any particular asset, the Legislature. The Legislature may not be well-equipped for conducting the type of in-depth review of assets necessary to determine the financial wisdom of a sale or lease, but it has recently created an ideal vehicle for leading such a review. The Legislative Office of Fiscal Transparency (LOFT) was created by statute in 2019, consisting of a bicameral committee of legislators, a paid staff of experts, and the ability to require information from agencies.[11]

LOFT is a superior vehicle for leading an asset monetization process for several reasons. It answers directly to the Legislature and has tools OMES lacks, like the ability to back up information requests to uncooperative state agencies with real threats of legislative action. LOFT can contract with outside experts and consult with business leaders to assist in its duties. It would keep legislative leaders engaged throughout the process, providing ready-made advocates for any conclusions it reaches. As an

incidental benefit, placing this review responsibility with LOFT would develop deeper institutional knowledge in the Legislature regarding the true operations of state agencies, which will help with LOFT's overall mission.

Finally, though it is a political body and can be weighed down by all that comes with that, the Legislature arguably *benefits* from this fact as much as it is hindered. It consists of a diverse membership representative of all geographic areas of the state and its decisions are made in public, ideally after thorough debate and analysis. While often messy, this confers a legitimacy on the process that no appointed committee of experts can claim. For a process that will tend to feature localized interests fighting to keep their piece of the pie, such diversity and legitimacy can be an advantage.

Where Proceeds Should Be Dedicated: Shoring Up Oklahoma's Unfunded Pension Obligations

Experience from other states teaches that the most responsible way to spend proceeds from the divestiture of long-lived government assets is to redeploy them for long-term economic benefit. There should be a temporal nexus, pairing proceeds from the sale of a long-term asset with some long-term financial need of the state, rather than ongoing operating budgets.[12] As such, funds should be directed to items like long-term transportation and other infrastructure needs, bonded indebtedness, or public employee pensions. In Oklahoma, unfunded pensions present the sharpest pain point for the state's long-term budget health, and thus represent the greatest opportunity for impact.

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A state's unfunded pension obligations can properly be thought of as a form of debt, though from an accounting and legal standpoint they are not typically treated in that manner. Pension liabilities are payments the state is legally obligated to make in the future, regardless of whether the full amount of the payments is covered by assets currently in the plan. Any shortfall must be made up with appropriations from the state.

The Legislature has made positive strides in the overall financial picture for Oklahoma's pension systems, making large appropriations to several systems to get them to 100 percent funding.[13] It has even managed to take the politically fraught step of transitioning the Oklahoma Public Employees Retirement System (OPERS) from the old defined benefit model to a defined contribution plan.[14] But despite stepped up fiscal discipline in the last few years, the state still faces massive unfunded pension liabilities.[15]

Significantly, the state's largest and most consistently fretted-about pension, the Teachers' Retirement System (TRS), is both enormous and underfunded, making it perhaps the single greatest threat to the state's fiscal health.[1] The system stands at 72.4 percent funded, with approximately $6.5 billion in unfunded future obligations.[16] This means that more than 80 percent of Oklahoma's unfunded pension debt is attributable to this one retirement plan.

While the actuarial calculations of pension systems can be complicated, the basic concept undergirding any effort to make pensions fiscally sound is simple: to be healthy, the plan must be worth more (between current assets and expected future contributions) than the sum total of what it expects to pay to beneficiaries. Any serious effort to strengthen pensions, therefore, should include increased funding and should limit or eliminate benefit increases.

Accordingly, legislators typically have two options for increased funding: they can raise taxes or cut funding from other parts of the state budget. Both punish current taxpayers for decisions made by previous generations of lawmakers and the lack of incentives for beneficiaries to hold the pension system accountable.

There is an alternative. The Legislature should create a dedicated "Pension Solvency Fund," and earmark any money deposited in it for eliminating unfunded pension obligations.* Proceeds from one-time financial windfalls, such as the asset sales proposed in this paper, could be directed to the Pension Solvency Fund and used only for the purpose of fully funding pension obligations. This would lessen the burden on taxpayers and provide security to retirees.

Candidates for Monetization

The following state-owned assets should be considered top candidates for sale or lease in any monetization process the state undertakes. Taken together, divesting these seven assets would generate several billion dollars for the Pension Solvency Fund, enough to bring every one of the state's pension systems to at least the 80 percent "magic" funding ratio (several would reach 100 percent funding). Moreover, several of the items below could be monetized in a manner that produces ongoing future revenue for the state.

1. **Tobacco Settlement Endowment Trust (TSET).**
   Estimated Revenue: Up to $1.2 billion.

TSET is perhaps the lowest hanging fruit for monetizing a current state asset. Though not what most would think of when using the term asset—TSET is not a physical structure and produces nothing—it meets the definition of an asset the same way an investment account producing an ongoing stream of revenue would.

TSET is a trust fund set up by a state constitutional amendment to receive payments from the 1998 settlement the state reached with tobacco companies. It receives a guaranteed annual revenue stream that typically exceeds $50 million.[17] It is tasked with using these settlement payments to support common and higher education, health programs for children and seniors, tobacco-related cancer research, and tobacco-use cessation programs. TSET currently sits on a $1.2 billion endowment, and is due to receive annual payments in perpetuity (the settlement agreement requires annual payments so long as cigarettes are sold in the United States).[18]

All of TSET's ongoing operations are funded by investment

*While outside the scope of this paper, increased funding to public employee pensions could be paired with future-facing reforms designed to ensure solvency of pensions for future retirees. Increased funding of pensions without corresponding reforms to ensure future fiscal health might lead the state right back to the same type of unfunded liabilities it currently faces.

income, meaning that the corpus of the fund remains untouched. In the fiscal year ending 2019 alone, TSET reported more than $64 million in net investment income (and nearly $2 million in other income).[19] That same year saw total expenses for TSET operations of approximately $47 million, leaving a nearly $19 million increase in TSET's reported net position.[20] All of this is before the nearly $53 million new settlement payment for 2019 is accounted for, which by law is added to the corpus to be invested along with the existing enormous principle.[21]

Even just diverting future settlement payments from TSET without touching the corpus of the endowment would mean a significant financial boost for state pensions, and would not interfere in any way with TSET's operations. The earnings on TSET's endowment easily cover its ongoing operations, and TSET engages in questionable spending as it is.[22] If, beginning with the 2020 tobacco settlement payment, the state began dedicating settlement funds to the Firefighters Pension System, for example, the fund would likely reach the desired 80 percent funding ratio in fewer than 8 years.[23] The Firefighters' Pension currently has the state's lowest funding ratio at 70.8 percent,[24] meaning that repurposing this one state asset could solve a major pension problem in less than a decade. Likely no one—except administrators at TSET and newly-secured retired firefighters—would even notice the change.

To make a real impact on pension finances, however, the state could simply direct that TSET be funded on a "pay as you go" basis, meaning it must fund its operations each year with the annual settlement payments it receives. This would free up the $1.2 billion endowment (growing larger every year) to make a dent in unfunded pension liabilities. To comprehend the impact of this "locked up" value sitting in TSET's endowment, consider that a one-time, $1.2 billion addition to Teachers Retirement System would instantly bring the fund within less than one percent of the "magic" 80 percent funded ratio.[25] That is, the state's most pressing long-term fiscal threat would be largely mitigated in one fell swoop, without raising taxes or reducing benefits.

2. Grand River Dam Authority (GRDA).

Estimated Revenue: More than $600 million.

The Grand River Dam Authority is a monopoly electric power utility that was originally set up to ensure electricity availability in rural areas and to provide flood control for the Grand River watershed, but its continued necessity as a quasi-governmental entity deserves further study. GRDA's Financial Statement for 2018 reports a net position of approximately $622 million, and could garner well above that amount through a competitive sale on the open market.[26] Estimates over the years have varied (and have not been all that concrete), but have generally placed the sale price of GRDA somewhere between $500 million and $1 billion.[27]

The influx of money from selling GRDA could, on the high end, all but eliminate the unfunded liabilities of the Firefighters' Pension, standing at approximately $1.1 billion.[28] Even a low ball estimate of GRDA's value, $500 million, would be enough to bring the funding ratios of both the Oklahoma Law Enforcement Retirement System and the Oklahoma Public Employees Retirement System to 100 percent funded, with money left over.[29]

3. Mid-America Industrial Park.

Estimated Revenue: Approximately $200 million.

The Mid-America Industrial Park is an economically bustling place. Sitting on 9,000 acres in the heart of Mayes County, the Park bills itself as one of the largest and most unique industrial parks in the world.[30] More than 80 companies employing more than 4,500 people are housed at the facility.[31] Google alone has invested $3 billion related to its operation there.[32]

The Oklahoma Ordnance Works Authority, the state beneficiary trust which owns the Park, reported in 2019 a net position just shy of $200 million, with annual net operating revenues in excess of $13 million.[33] At a minimum, sale of the Mid-America Industrial Park would by itself fully fund the remaining obligations of OPERS (currently sitting at 98 percent funded), with money to spare.

4. Underutilized Property Already Identified by the State

Estimated Revenue: Up to $130 million.

As noted above, the Legislature enacted a law in 2011 requiring the Office of Management and Enterprise Services (OMES) to compile an annual report inventorying the 5 percent "most underutilized" properties owned by the state. The report estimates these properties' market values and the estimated taxes that would be paid on the properties were they owned privately. To make the list, a state-owned building must be less than 50 percent occupied and land must be unimproved and not under lease (meaning land that is sitting vacant, being used for nothing, and benefitting no one).

OMES estimated the total value of the 2018 list at over $130 million, but this figure is somewhat misleading because nearly one-third of that figure is attributable to one property, the American Indian Cultural Museum. OMES values the museum at $45 million.[34]

Unsurprisingly, several properties appear on the list year in and year out without any action taken. For example, the Bielston Tower at the OU Health Sciences Center has been listed for several years at 10 percent occupied and worth approximately $30 million.[35]

OMES arrives at these substantial sums just from combing the very bottom 5 percent of properties that are not being used. If every property owned by the state was subjected to an organized, professional analysis, the state would likely see significantly more revenue than that identified in the report.

5. Oklahoma Turnpike Authority Toll Roads.

Estimated Revenue: Unknown, but likely more than $1 Billion.

Valuation of Oklahoma's turnpike network is difficult to estimate, but what is known is that privatizing the turnpikes under a long-term lease arrangement would provide the state with an enormous financial windfall. The Oklahoma Turnpike Authority reports approximately $3 billion in assets in its 2018 Comprehensive Annual Financial Report, with a net position of $789 million (much of the OTA's assets were financed through the recent issuance of bonded indebtedness).[36] Oklahoma turnpikes generate more than $300 million annually in toll revenues, with net operating income reported in 2018 at approximately $125 million.[37]

Currently, profits earned via the turnpikes do not flow to the highest priority road, bridge, and other transportation

projects in the state, but by law are required to be used on the turnpike system. Accordingly, the Oklahoma Turnpike Authority continues to build new turnpikes and re-pave existing ones, often (puzzlingly) incurring debt to do so. The result is that structurally deficient bridges and potholed roads dot the Oklahoma countryside while underused luxury highways to nowhere are expanded with additional lanes. This makes very little sense.

The state would be far better off leasing operation of the turnpikes to private investors and dedicating the funding to long-term infrastructure needs. The state *could* dedicate profits realized from the lease to pensions, but given the unique history and nature of the turnpike system, it makes more sense to earmark the funding for infrastructure.

Other states have paved the road, so to speak, for this type of long-term lease arrangement. Indiana entered a lease agreement in 2006 with private investors for operation of its 156-mile toll road running through the northern part of the state (receiving traffic to and from Chicago). In exchange for the right to operate the toll road for 75 years, the investors paid the state of Indiana a lump sum of $3.8 billion, which the state then dedicated to road-building and maintenance.[38] Studies of the Indiana toll road lease have concluded that the state's infrastructure was vastly improved over what it would have been had the state continued to operate the toll road itself.[39] With shrewd negotiation, there is no reason Oklahoma could not find a similarly successful arrangement.

6. Lands Held by the Commissioners of the Land Office.

Estimated Revenue: More than $2 Billion, but Restricted Use.

The Commissioners of the Land Office (CLO) owns 750,000 acres of land in Oklahoma, which it manages for the benefit of public education in Oklahoma. The CLO traces its origins to land grants from the federal government instituted at statehood. The CLO reported in 2018 assets in excess of $2.4 billion and liabilities of only around $38 million.[40] The CLO effectively acts as a government-run investment manager for this enormous endowment. While offloading some of these properties may present legal complications and a thorough analysis of the assets would be an arduous process, both are manageable and could net large gains for the state. It also may be the case that the property could be better managed privately so as to produce better returns than have historically been achieved by CLO. In either case, education budgets would be boosted, which in turn eases other budgets across state government.

7. State-owned Rail Lines.

Estimated Revenue: Approximately $150 million.

The state has had some recent success in selling unused rail lines it acquired decades ago. As recently as 2008, the Oklahoma Department of Transportation (ODOT) held title to 882 miles of railway.[41] ODOT has returned about 650 miles of rail to private-sector interests, leaving just over 200 miles of track under state ownership.[42] Most recently, ODOT closed a transaction where it sold a section of rail stretching from Sapulpa to Midwest City for $75 million.[43] If ODOT's remaining rail inventory has a similar market value, the state could expect to take in more than $150 million through the sale of its remaining 200 miles of tracks.

ODOT should continue this process and like the turnpikes, it makes sense to dedicate any funds realized from the sale of rail lines to defray long-term infrastructure costs.

Conclusion

The State of Oklahoma can significantly strengthen its pension systems and make progress in meeting other long-term funding challenges if it properly leverages the valuable assets it already owns. Doing so will require establishing the right process and political courage, but current policymakers have a leg up because they can learn from past efforts in Oklahoma and other states.

Oklahoma can significantly strengthen pension systems and make progress in meeting other long-term funding challenges if it properly leverages the valuable assets it already owns.

Transitioning valuable assets and property from government to private ownership will have the added benefits of generating economic activity, boosting tax revenues, and shedding maintenance costs. It is a true win-win for the state.

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