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Real Estate Investment Bill Risks Slippery Slope for Thrift Savings Plan

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H.R. 1578, introduced by Rep. Jon Porter (R-NV) with 177 cosponsors, would require the Thrift Savings Plan (TSP), a part of the federal government's employee retirement system, to offer a stock index fund based on Real Estate Investment Trusts (REITs). Forcing TSP to include a real estate investment fund would set a very dangerous precedent that could severely damage TSP's future. Decisions to include investment options in TSP should be made based on the needs of TSP members and not politics. Political imposition of investments on TSP risks losses for federal workers and retirees.

REITs are publicly traded companies that own and usually manage commercial real estate such as office buildings, apartments, hotels, shopping centers and warehouses. Currently, the approximately 200 REITs own about $400 billion worth of commercial properties. During the period between 1988 and 2004 REITs have, on average, outperformed stocks and bonds. However, REITs have often been more volatile than stock indexes and carry comparatively higher administrative fees than TSP's current funds do.

TSP and How it Operates

TSP is one element of the Federal Employees' Retirement System and manages almost $175 billion of retirement savings for almost three-and-a-half million federal civilian employees and military service people. Since its creation in 1986, TSP has grown from one fund that invested in federal government bonds to five individual funds and a "lifestyle portfolio" that includes investments in all five funds. TSP members control how their retirement savings are invested in the funds and have the ability to move their savings at will.

At the end of 2005, almost 40 percent of TSP's assets were invested in an S&P 500 stock index fund, while 38 percent were invested in government bonds, 8 percent each in an international stock index fund and a small and medium sized company fund, and 6 percent in a bond index fund. Funds have been added to TSP slowly, with the government bond fund opening in April 1987, the stock and bond index funds in January 1988, and the international stock index fund and the small cap fund in May 2001. The lifestyle portfolios incorporating various proportions of the five funds appeared in August 2005.

TSP administrative fees are extremely low, averaging about 60 cents for every $1,000 invested. While these fees are artificially low because federal agencies absorb some of the cost, federal employees receive one of the best bargains in retirement investing. Management of the funds is contracted

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out to private sector investment managers based on a periodic bidding process. Currently, all of the funds except for the government bond fund are managed by Barclays Global Investors.

A key factor in TSP's success is the limited number of funds that it makes available to members. Recent research shows that many participants in 401(k) plans become confused when the plan offers too many investment choices. Too many funds can actually reduce participation. TSP probably has room for a couple more funds, but it should choose them carefully and only after careful consideration. Its next changes should probably be to make the lifestyle fund (L Fund) the automatic investment choice for members who do not choose to actively manage their funds and to move to an automatic enrollment process by which a federal worker enrolls in TSP at a certain investment amount unless he or she actively choose not to join.

Congress Should Not Interfere in TSP Governance

While REITs are appropriate as part of larger retirement portfolio, H.R. 1578 opens the way for TSP's investments to be determined by political pressure instead of by the needs of federal workers. Until now, funds have been added to TSP only after being recommended by the Federal Retirement Thrift Investment Board (FRTIB), which manages TSP and has a fiduciary responsibility to ensure that it operates solely for the benefit of federal workers. The FRTIB opposes the addition of a REIT fund at this time, as does TSP's Employee Thrift Advisory Council.

This is not the first time that the FRTIB has opposed congressional efforts to create new TSP funds. It has also opposed attempts to politicize TSP investment policies by urging TSP not to invest in companies that do business in particular countries. Wisely, the FRTIB has retained its exclusive focus on the retirement needs of its members, and it should continue to do so in the face of pressure to accept H.R. 1587. In return, Congress should not force TSP to include any specific funds.

If Congress successfully forces a REIT fund on TSP, the balance of power will shift from FRTIB's focus on the needs of TSP members to political interests dedicated to advancing the interests of a particular industry or interest group. This would eventually lead to efforts to force TSP to invest in certain "worthy" projects that might or might not earn adequate returns. Many state and local government employee retirement plans have been forced to make investments for political reasons, and most of them have sustained serious losses as a result.

This is not to imply that TSP is beyond criticism. A January 2005 Government Accountability Office report, "Federal Thrift Savings Plan: Customer Service Practices Adopted by Private Sector Plan Managers," makes a number of constructive suggestions for ways that TSP could improve customer service and better measure members satisfaction. However, the FRTIB is much better positioned than Congress to focus on the plan's structure and services. Except in extreme situations, Congress should defer to the FRTIB's expertise and approve additional investment options only if they are requested by that agency.

Conclusion

TSP is one of the most successful retirement investment vehicles ever created. In a large part, it has succeeded because its governing board only considers the need of its members to build adequate retirement savings. As a result, federal employees can have full confidence that their interests will come before whatever political winds are currently blowing in Washington. Funds should be added to TSP only if they are recommended by the FRTIB. There is no compelling need to add a REIT-based fund to TSP at this time, and the potential damage to TSP if one is imposed could be serious. Congress should drop efforts to dictate which investment choices TSP can offer and continue the tradition of leaving TSP's guidance to the FRTIB.

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