



Investment Committee

California Public Employees' Retirement System

Agenda Item 6d

December 16, 2013

ITEM NAME: Responsible Contractor Program Policy Annual Report

PROGRAM: Targeted Investment Programs

ITEM TYPE: Program Review – Information

EXECUTIVE SUMMARY

For Fiscal Year 2012-13, Responsible Contractor Program (RCP) Policy compliance totaled 98.6%. Real Estate, Infrastructure, and Housing Program managers paid in excess of \$726 million toward RCP contracts for the reporting period. This includes both Core Real Estate managers under the Neutrality Trial Responsible Contractor Program (Neutrality Trial RCP) Policy and non-core managers under the RCP Policy.

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability through actively managing business risks.

INVESTMENT BELIEFS

This agenda item supports CalPERS Investment Belief 4 to create long-term value through effective management of financial, physical, and human capital. Effective management of human capital increases the likelihood that companies will perform over the long-term and manage risk effectively.

BACKGROUND

CalPERS has a deep interest in the condition of workers employed by CalPERS and investment managers at its real estate and infrastructure investments. CalPERS, through the RCP Policy, supports and encourages fair wages and benefits for workers employed by its contractors and subcontractors, subject to fiduciary principles. CalPERS believes that an adequately compensated and trained worker delivers a higher quality product and service.

In 2009, staff initiated the RCP Policy revision process. This process included seeking input from labor stakeholders and real estate investment managers through conversations and a series of roundtable discussions. These discussions worked to highlight issues of concern and areas for policy revision. The process identified the following as key areas in need of policy revision: employer neutrality, bidding notification, and enforcement. Staff focused on neutrality first, working with labor representatives and investment managers in a process that resulted in the creation of the Neutrality Trial RCP Policy in February 2010. The development of the Neutrality

Trial RCP was intended to assist CalPERS and stakeholders in understanding the impacts, if any, of requiring employer neutrality in CalPERS Real Estate portfolio.

In August 2010, staff continued the RCP Policy revision process, focusing on bidding notification and enforcement. The draft revised RCP Policy was developed with a team of labor representatives, investment managers, fiduciary counsel, and Investment and Legal Office staff. The draft revised RCP Policy addressed bidding and enforcement; clarified the roles and responsibilities for managers, unions and staff; and established heightened annual reporting requirements. In February 2012, the Investment Committee approved the revised RCP Policy.

This agenda item is the first report under the revised RCP Policy. As reported by Pension Consulting Alliance (PCA) at the February 2012 Investment Committee meeting, the RCP Policy represents the most comprehensive responsible contracting policy in US public pension investment today. The RCP Policy seeks to secure the condition of workers employed by CalPERS and investment managers without adverse effect on investment returns, access to investment opportunities, costs to administer the RCP Policy or access to cost-effective contractors.

The compliance information presented is limited to contracts of \$100,000 and above, and applies to all domestic real estate and infrastructure investment managers, joint ventures, and partnerships where CalPERS has greater than 50% ownership interest and the standards of the RCP Policy are met.

This item also reports compliance under the Neutrality Trial RCP Policy, which applies to investments by Core investment managers where CalPERS ownership interest is greater than 50%. Compliance is limited to contracts of \$100,000 or greater.

Contract and payment information provided herein is based on annual reports submitted by investment managers.

ANALYSIS

Real Estate and Infrastructure Investment Managers Compliance

Domestic Core investment managers paid 100% of their total qualifying contracts to responsible contractors, while domestic non-Core investment managers paid 99.8% of their total qualifying contracts to responsible contractors. This represents a combined compliance of 99.9%. The successful compliance rate is calculated using all qualified operating expenses and qualified tenant improvements and other capital expenditures. Please see Attachment 1 for partnership level reporting of compliance with the Policy.

Housing Program Investment Managers Voluntary Report

Under the current RCP Policy, compliance for existing Housing Program managers is not mandatory, though strongly recommended. All Housing Program managers have voluntarily submitted annual compliance reports. For Fiscal Year 2012-13, Housing Program investment managers awarded 97.4% of the qualified capital expenditure contract payments to responsible contractors. Please see Attachment 2 for Housing Program partnership level reporting.

Total Real Estate and Infrastructure Compliance

For the Fiscal Year 2012-13, Real Estate, Infrastructure, and Housing Program managers paid in excess of \$726 million toward RCP contracts for the reporting period with a combined compliance rate of 98.6%.

Total contract payments and total contract payments to qualifying responsible contractors for the reporting year were up approximately 8% from the year prior due to improved market conditions. Contracts for the Housing Program were also up approximately 57% as Hearthstone and Resmark increased contracting. This was offset by a decrease in contract payments by Core managers. Tenant improvement and capital expenditure contracts account for over 90% of RCP contracts while operational (service) contracts account for less than 10%.

Responsible Contractor Certifications

For the Fiscal Year 2012-13, all Real Estate and Infrastructure investment managers subject to the RCP and Neutrality Trial Policies, and all Housing Program managers voluntarily complying, have certified in writing that, to the best of their knowledge, they have complied with the RCP and Neutrality Trial Policies and, more specifically, with the roles and responsibilities stated within the RCP and Neutrality Trial Policies.

Manager Responsibilities

The revised RCP Policy includes increased manager responsibilities and reporting. Under the Policy, managers provide an Annual Report on these heightened responsibilities. For Fiscal Year 2012-13, all fourteen of the managers that have assets subject to the RCP Policy submitted the additional information. The following is a summary of their responses.

- All managers with active RCP contracts communicated the RCP Policy, and its own written policies or procedures relating to the RCP Policy, to all of their Delegates.¹
- All managers maintained written policies and procedures and provided employee training for implementing and complying with the RCP Policy.²

¹ The RCP and Neutrality Trial RCP Policies refer to contractors and subcontractors as Delegates and Sub-Delegates.

² In lieu of written policies and procedures, one manager sent memos to employees outlining the Policy, its requirements, and compliance.

- Thirteen managers reviewed a list provided by each of their Delegates of current and pending RCP Contracts.³
- Thirteen managers monitored and enforced their and their Delegates' compliance with the Policy, including the investigation of potential violations.⁴
- Only three managers reported going into new trade areas during the reporting period. These three managers notified trade/service unions of their expansion.
- All managers that bid contracts during Fiscal Year 2012-13 reported using a pre-bid as outlined in the Policy.
- Two managers provided detailed comments regarding additional activities administering the RCP Policy. Staff will engage managers on this question for future reports.
- Most managers reported the actual costs to administer the program are not quantifiable or cannot be tracked, generally because RCP implementation is included in their staff duties or Delegate costs. Several managers estimated the cost of developing and maintaining RCP websites to be less than \$10,000. One manager estimated total cost to administer the RCP Policy was approximately \$200,000.
- Twelve managers reported the RCP Policy has little or no impact to CalPERS investments. One manager reported a generally positive impact; another stated that the revised RCP Policy has increased costs.

Staff will continue to engage with managers and labor stakeholders to understand outcomes related to the revised RCP Policy.

Notification

The Real Estate and Infrastructure investment managers and stakeholders have been working to improve the bidding opportunity notification process. All managers and Delegates use websites or email communication to notify potential bidders of bidding opportunities. Six managers have established automatic notification features and the revised February 2012 RCP Policy encourages managers using websites to offer automatic notification.

Please see Attachment 3, the RCP Bidding Notification Method and Contact Sheet, which includes names of managers, notification methods, and email addresses. Staff emails this list to all interested parties whenever it is requested.

Responsible Contractor Formal and Informal Complaints

LiUNA: On July 15, 2013, staff received a formal complaint from the Laborer's International Union of North America (LiUNA) on behalf of LiUNA Local 242 and

³ The remaining manager is a Housing Program manager that complies with the RCP Policy on a voluntary basis.

⁴ See above.

Ironworkers Local 86. On October 14, 2013, Investment Committee members received a letter from LiUNA regarding the formal complaint.

Investment Office staff devoted significant resources to this matter and closely followed the Complaint, Investigation and Dispute Resolution Process (Complaint Process) in the RCP Policy. Staff evaluated and responded to the complaint within the terms and spirit of the RCP Policy. Staff provided LiUNA with a formal response on October 23, 2013.

During the Complaint Process, LiUNA brought up a number of additional matters outside of the formal complaint. Staff discussed these concerns with LiUNA to better understand the issues and provide feedback. LiUNA provided a subsequent letter summarizing their concerns. Staff will meet with external managers on December 10, 2013 to discuss these and other RCP related issues.

Holiday Inn LAX: CalPERS held a minority interest in a commingled fund known as the CIM Urban REIT. The CIM Urban REIT held debt on the Holiday Inn LAX. Unite Here tried to organize the hotel, which was owned by McSam Hotel Group and operated by the Packard companies. The owners went into a foreclosure process and the hotel is now owned by CIM. Workers at the hotel voted to join the union and contract talks are underway between CIM and Unite Here.

Labor Issues Unrelated to RCP Policy

Caesar's Las Vegas: Early this year, Unite Here brought upcoming contract negotiations with Caesars Entertainment in Las Vegas to the attention of CalPERS. CalPERS Private Equity unit has an investment in Caesars Entertainment through Apollo Global Management and TPG Capital. Letters have been sent to these companies encouraging them to communicate to Caesars Entertainment the importance of remaining at the negotiating table, and of negotiating in good faith.

On October 28, 2013, Unite Here provided updates on contract negotiations with Caesars Entertainment and raised new issues regarding working conditions and health code violations at Caesars Entertainment Las Vegas locations. Unite Here states that contract negotiations with Caesars Entertainment are not progressing. Staff is continuing to monitor this issue.

Revel: On September 17, 2013, staff met with Unite Here to discuss Revel, a hotel and casino in Atlantic City. Discussion included union organizing efforts and working conditions at Revel. Since that time, Unite Here and Chatam have engaged in additional discussions regarding employee organization, wages, and benefits. Staff will continue to monitor this situation.

Responsible Contractor Engagement

SEIU: SEIU is in the process of creating Responsible Contractor Principles (SEIU Principles) and a related website. Staff has discussed the SEIU Principles and website with SEIU, and sent information on both to CalPERS external Real Estate managers.

BUDGET AND FISCAL IMPACTS

Existing budgetary resources fund the ongoing costs for implementation, administration and management of the RCP and the Neutrality Trial RCP Policies for the CalPERS Investment Office. During Fiscal Year 2012-2013, the estimated cost to support these policies was \$178,000 (which included staff costs of \$145,000 and consultant services of \$33,000).

In addition, there is a minor ancillary fiscal impact to CalPERS Legal and Executive Offices and the Board of Administration which the Investment Office is not able to quantify. Real Estate and Infrastructure investment managers also incur costs to administer these RCP and Neutrality Trial RCP policies. As of February 2012, investment managers estimated administrative costs to comply with the RCP and Neutrality Trial RCP policies to be about \$600,000.

ATTACHMENTS

Attachment 1 – Investment Manager Combined Compliance Report: Core and non-core

Attachment 2 – Voluntary Participation Report: Housing Program

Attachment 3 – RCP Bidding Notification Method and Contact Sheet

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