



Investment Committee

California Public Employees' Retirement System

Agenda Item 9a

December 15, 2014

ITEM NAME: Responsible Contractor Program Annual Report

PROGRAM: Targeted Investment Programs

ITEM TYPE: Program Review – Information

EXECUTIVE SUMMARY

This agenda item provides the required annual update on the Real Assets program's compliance with CalPERS' Responsible Contractor Program (RCP). For fiscal year 2013-14, 99.9% of payments under qualifying contracts were made to qualifying responsible contractors. This includes both Core Real Estate managers under the Neutrality Trial RCP Policy and non-core and Housing managers under the RCP Policy. This annual report also includes information on staff's engagement on labor issues across the Total Fund.

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. This agenda item also supports Investment Belief 3 in which CalPERS' investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries.

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.

This agenda item is the second report under the RCP Policy that was revised in 2012. As reported by Pension Consulting Alliance (PCA) in the December 2014

CalPERS RCP Peer Survey Report (see Item 9b, Attachment 1), the RCP and Neutrality Trial RCP Policies represent the most comprehensive responsible contracting policies of CalPERS' U.S. public pension peers. The RCP Policies seek to secure the condition of workers employed by CalPERS and investment managers without adverse effect on investment returns, access to investment opportunities, or significant cost impacts.

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, 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.

ANALYSIS

Annual Report

For the Fiscal Year 2013-14, Real Estate, Infrastructure, and Housing Program managers paid in excess of \$950 million toward RCP contracts for the reporting period with a combined compliance rate of 99.9%.

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% (Attachment 1).

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 2013-14, Housing Program investment managers awarded 99.8% of the qualified capital expenditure contract payments to responsible contractors (Attachment 2).

Responsible Contractor Certifications

For the Fiscal Year 2013-14, all Real Estate and Infrastructure investment managers subject to the RCP and Neutrality Trial RCP 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 RCP Policies and, more specifically, with the roles and responsibilities stated within the Policies.

Manager Responsibilities

The RCP Policy includes increased manager responsibilities and reporting. Under the Policy, managers provide an Annual Report on these heightened responsibilities. For Fiscal Year 2013-14, 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 maintained written policies and procedures for implementing and complying with the RCP Policy. Thirteen managers provided employee training on administering the Policy.¹
- 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 contractors.
- Thirteen managers reviewed lists of current and pending RCP Contracts provided by each of their contractors.²
- Thirteen managers monitored and enforced their and their contractors' compliance with the Policy, including the investigation of potential violations.²
- Four managers reported expanding into new areas during the reporting period. These four managers notified trade/service unions of their expansion.
- All managers that bid contracts during Fiscal Year 2013-14 reported using or causing contractors to use a 30-day pre-bid procedure when appropriate under the circumstances.
- Nearly half of managers provided comments regarding additional activities administering the RCP Policy. Some managers reported they communicated to all interested parties on appropriate RCP opportunities. One manager reported providing over 70 RCP opportunities to labor representatives. Several managers reported specific outreach to Responsible Contractors and labor representatives on RCP contracts.
- 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 contractor costs. Several managers estimated the cost of developing and maintaining RCP websites to be approximately \$10,000. One manager estimated total cost of the RCP Policy was approximately \$225,000 for a full-time employee to administer.
- All 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. One manager stated concern that additional time and effort placed on joint venture partners as a result of policy compliance could impact joint venture partners' desire to continue to bring additional investment opportunities to the manager.

Additional Manager Activities

SEIU developed Responsible Contractor Principles (Principles) and a related website. Staff engaged with SEIU on the website and Principles, and sent information

¹ One manager sent memorandums to employees and delegates outlining the policy, its requirements, and compliance.

² The remaining manager is a Housing Program manager that complies with the RCP on a voluntary basis.

on both to CalPERS' external Real Estate managers. The website became fully operative this year and some real estate managers have used it as a resource when reviewing Responsible Contractors.

Notification

Investment managers and staff have been working to improve the bidding opportunity notification process. All managers and contractors use websites or email communication to notify potential bidders of bidding opportunities. Seven managers have established automatic email notification features, which the RCP Policy encourages.

The RCP Bidding Notification Method and Contact Sheet (Attachment 3) includes names of managers, notification methods, and email addresses. In addition to being publicly available on the Targeted Investment Programs website, staff emails this list to all interested parties whenever it is requested.

RCP Policy Formal and Informal Complaints

No formal complaints have been filed during this calendar year. There have been a number of informal complaints and labor representatives have considered filing formal complaints. However, staff has worked to resolve complaints proactively through engaging managers and labor representatives. Investment Office staff continues to devote significant resources to these matters, they include:

SEIU and LiUNA/Starwood NYC

In May 2014, staff met with representatives of LiUNA regarding labor concerns on specific Starwood properties in New York City, where CalPERS has a minority interest via a commingled real estate fund investment. Staff engaged Starwood on these issues including meeting with Starwood Chief Executive Officer, Barry Sternlicht. CalPERS sent Mr. Sternlicht a letter requesting additional information on issues at two properties and asking Starwood to meet with labor representatives.

Starwood replied to all the issues raised including that it had not hired the contractor with legal and ethical issues, but had in fact removed the contractor from the project. At CalPERS' request, Starwood met with labor representatives to discuss their concerns. Both Starwood and the unions involved have stated that the talks were productive. In September 2014, Starwood provided an update to CalPERS that stated intentions for continuing dialogue with unions on New York City projects.

Unite Here/CIM

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 negotiations between

CIM and Unite Here have been productive, deal points approved, and a contract is being finalized.

Update on Additional Labor Engagements

The following is information on staff engagement on labor issues throughout the Total Fund. Staff engages with external managers and labor representatives on these issues in accordance with the CalPERS Investment Beliefs.

Unite Here/TPG and Apollo

In early 2013, Unite Here brought upcoming labor contract negotiations with Caesars Entertainment in Las Vegas to CalPERS' attention. CalPERS has a minority position in Caesars Entertainment through Private Equity external managers TPG and Apollo. CalPERS corresponded with TPG and Apollo encouraging them to engage with Caesars Entertainment and stressed the importance of remaining at the negotiating table and negotiating in good faith. Caesars Entertainment and Unite Here continued to negotiate and came to agreement in January 2014. On January 28, 2014, Caesars workers in Las Vegas voted to ratify a new five-year contract which will cover about 13,000 workers in the food and beverage, housekeeping, cocktails, and bell departments.

Cambodian Apparel Workers/Carlyle

In April 2014, SEIU and the Asian Pacific American Labor Alliance, AFL-CIO informed CalPERS of labor issues and the Cambodian government's suppression of labor protests that took place in front of Yakjin Trading Corporation (Yakjin). CalPERS Private Equity unit holds a minority investment in Yakjin through a commingled fund managed by The Carlyle Group (Carlyle). Staff reached out to Carlyle to better understand the issue.

After several communications with Yakjin and the Cambodian Apparel Workers, Carlyle hired a consultant specializing in human rights impact assessments to conduct an independent investigation into labor issues at Yakjin. The investigation is complete and a final report on findings is in process. Staff has been and will continue to be in regular communication with Carlyle and SEIU regarding this labor issue, and will update the Investment Committee as needed. Communication included the October 27, 2014 letter CalPERS sent to Carlyle (Attachment 4).

Teamsters/Grosvenor

In August 2014, the Teamsters wrote a letter to CalPERS regarding labor issues at two Southern California trucking firms.³ CalPERS' Private Equity unit has a minority position in Saybrook Capital, a fund in the Capital Link fund of funds managed by Grosvenor Capital Management (Grosvenor). Saybrook has invested in Total Transportation Services Inc. (TTSI).

³ CalPERS does not have control or an economic interest in Green Fleet Systems, one of the trucking firms in the letter, and thus does not have a basis for engagement.

At staff's request, Grosvenor met with the Teamsters, SEIU, and Saybrook. After that meeting, Grosvenor asked for an update and specific information in writing regarding the labor dispute at TTSI. Saybrook provided a written response largely refuting the allegations made against TTSI. Staff has communicated with the Teamsters and Grosvenor regularly and will continue to monitor and report to the Investment Committee as needed.

Iron Workers/Millennium Reinforcing

In August 2014, workers from Millennium Reinforcing in Southern California and representatives of the Iron Workers Union gave public comment to the Investment Committee citing health and safety violations and unfair labor practices at Millennium Reinforcing. At their request, CalPERS sent letters to public companies notifying them of the labor issues brought up by workers and the union.

Unison/Bridgepoint

In August 2014, Unison, a British union representing public sector and health care workers, wrote CalPERS a letter regarding a labor dispute at Care UK. CalPERS has a minority exposure to Care UK through Private Equity external manager Bridgepoint. SEIU California requested CalPERS communicate to Bridgepoint the importance of Care UK workers and their representatives at Unison negotiating to reach an agreement. After numerous communications with Bridgepoint and Care UK, staff was informed that an agreement was reached and the union would vote on the agreement by mid-November.

Unite Here/Chatham

CalPERS had a minority interest in Revel Hotel and Casino (Revel) through Chatham Asset Management (Chatham), a hedge fund manager. In September 2013, staff met with Unite Here to discuss labor issues at Revel in Atlantic City. At staff's request, Chatham met with Unite Here in late 2013 and the union continued to communicate with Chatham on issues of mutual interest. Revel closed on September 1, 2014 and all workers were terminated. The property was recently sold for \$110M at bankruptcy auction.

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 2013-2014, the approximate cost to support the RCP Policies and engage on labor issues was \$270,000 (which included staff costs of \$176,000 and consultant services of \$94,000). This was an increase from the Fiscal Year 2012-13 costs of \$178,000.

Costs have risen from the \$50,000 estimated in 2012 as more resources have been devoted to implementing and reviewing the RCP Policies and engaging on labor issues. For Fiscal Year, 2014-15, PCA required an additional \$150,000 to pay for the RCP Policy Review process, which has required more resources than originally

estimated. Staff anticipates that costs for administrating the Policies will continue to rise should the current level of engagement and Policy revision continue.

In addition, there is a minor ancillary fiscal impact to the CalPERS Legal and Executive Offices and the Board of Administration that the Investment Office is not able to quantify. Real Estate and Infrastructure investment managers also incur costs to administer the 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 total approximately \$600,000. Most managers state that the actual cost to administrate the RCP Policies is not quantifiable, but is minimal. Those that estimate state costs range from \$10,000 to implement a website to \$225,000 annually.

BENEFITS/RISKS

Not Applicable.

ATTACHMENTS

- Attachment 1 – Investment Manager Combined Compliance Report
- Attachment 2 – Voluntary Participation Report: Housing Program
- Attachment 3 – RCP Bidding Notification Method and Contact Sheet
- Attachment 4 – October 27, 2014 Letter from CalPERS to Carlyle

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