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Abstract

Pension funds can be thought of as deferred workers wages. In many cases occupational pension funds have been established at the bargaining table through union representation. While all pension funds are established for the benefit of the pension plan beneficiaries, these deferred workers wages also have a significant impact on the communities in which they are invested. Labor friendly investments seek to direct the impacts of investment in a manner that creates strong and healthy communities and supports union or fair wage employment practices.

Labor friendly pension funds in the US are generally either Taft-Hartley pension plans (jointly trusteed or union trusteed multi-employer plans) or public sector pension funds with a significant presence of union trustees. These funds often have a range of labor friendly policies and programs aimed at building strong and healthy communities. Such programs include responsible contractors' policies, responsible investors' policies, and specific allocations for targeted (or economically targeted) investments in their investment portfolio. These targeted investments often require union built construction (in the case of real estate or fixed income mortgage backed securities) or are aimed at job creation and retention (in the case of private equity investments).

This paper explores the evolution of labor friendly US investments by pension funds in the period since the downturn of the financial markets in 2001. It argues that both pension funds and investment vehicles that bring intentional targeting to their investments are becoming increasingly sophisticated financial players. Labor friendly investments that focus on risk adjusted rates of return as the driver for investment are increasingly able to point to strong track records that encourage a wide range of pension fund investors to engage with these vehicles and practices.

Key words: pension funds, labor, targeted investment, responsible investment

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Introduction

US retirement assets totalled $17.4 trillion dollars by 2007 accounting for almost 40% of all household financial assets across the US (ICI 2007). Of those retirement assets $4.6 trillion were held in Individual Retirement Accounts (IRAs)[1] and a further $4.4 trillion were held in employer-based defined-contribution retirement plans. US Government pension plans including federal and state government plans held $4.4 trillion of assets, while private defined benefit employee plans held $2.4 trillion (ICI 2007 pp.2)

Beginning in the 1950s, US pension funds' explosive growth can be traced to three important trends. The first is the expansion of union negotiated pension fund agreements that were integral to American labour relations following World War II. The second is demographic, most notably the baby boom generation's participation in the workforce. The third is the enormous run up of the stock market through most of the 1990s. In 2006 alone, the two California public sector pension funds California Public Employees Retirement System [CalPERS] and California State Teachers Retirement System [CalSTRS], the largest and second largest public sector defined benefit pension funds in the US respectively, had annual returns on investment of roughly 20%. As a result these two funds are currently valued at $245 billion and $156 billion respectively at the

[1] IRAs are tax-deferred retirement schemes that can be started by any individual in the US who earns employment income. Individuals who earn less than a certain amount or who do not participate in their employer's retirement plan can generally deduct a part or all of their contribution to such schemes from their taxable income. Money in an IRA is taxed only when it is withdrawn. Most often these retirement accounts are held in mutual funds (BusinessDictionary.com 2008).

beginning of 2008. What started as a trickle of capital into funded pools in the 1950s became a flood.[2]

Pension funds are in effect deferred workers' wages (Fung et al 2001). What is interesting about these mammoth capital pools is that roughly half these assets have been negotiated at the bargaining table. Collective bargaining of retirement benefits exists in private sector retirement plans, public sector plans, or multi-employer plans, known as Taft-Hartley plans in the US. Both in the private and public sector, through collective bargaining or a similar process, labour has gained a voice in how many of these plans are managed.[3] For example, in the public sector, on average, roughly half the trustees are employee trustees. For Taft-Hartley plans, half of the trustees are employee trustees. Employee representative trustees are either appointed or elected to pension plans' boards. These trustees represent labour's voice.

Long-Term View of Value

Labour representation within these capital pools prompts the question, "what view should labour have of capital and how it should be deployed in the economy?" This question was posed by a number of American labour activists in the mid-1990s. Their answer was that capital should be invested with a view to long-term value (Fung et al 2001). Because pension funds must pay out benefits over a lengthy period of time, long-term value matches the time horizon that fiduciary duty requires of pension fund investors. It ensures that future retirees will have the benefits needed to secure their retirements. Long-term value also recognizes that beneficiaries want strong, vital and healthy communities in

[2] In 1985 CalPERS, the largest defined benefit pension plan in the US, had total assets of $28 billion, by 2007 it is valued at $245 billion (as of January 31st 2007).

[3] Most private sector corporate plans do not have employee representation on their boards of trustees.

which to live both today and in the future. Finally, this view of capital assumes that over time sustainable financial returns are inexorably linked to sustainable communities (Bauer Koenijk and Otten 2002; EPA 2000; Clark and Hebb 2004; Griffin and Mahon 1997; Guerard 1997; Kiernan and Levinson 1998; Monks 2001; Pava and Krausz 1995; Porter 1995; Silvers et al 2001; UNEP 2001). Such a long-term perspective on value recognizes that environmental, social and governance (ESG) factors play a vital role in how a company will perform over the long run. Valuing extra-financial information separates those who seek such pro-active, long-term investment strategies from those who believe in the efficient market hypothesis and the short-term investment strategies that theory spawns. This view of capital prompts pension funds to become active and engaged owners.

In the 1980s and 90s despite their growing size and influence within financial markets, few pension funds behaved any differently from main-stream money managers. Their investment strategies were short-term and myopic, often pushing firms for quarterly profits and frequently churning stock in their portfolios (Bogle 2005, Davis et al 2006, Bushee 1998; Jacobs 1993; Romano 2001; Shleifer and Vishny 1988). A good example of the short term view of value is the takeover of RJR Nabisco by private equity firm KKR funded by pension funds including Oregon State Public Employees Retirement System in the 1980s. As detailed in the book *Barbarians at the Gate*, RJR Nabisco was overloaded with debt, stripped of assets and sold off in pieces (Burrough and Helyar 1990). Workers lost their jobs and little of the value of this company remained.

By the early 2000s the collapse of such corporate giants as Enron and other corporate scandals, reinforced the idea that good corporate governance and long-term share value are linked (Anson et al. 2003; Bebchuk, Cohen, and Ferrell 2004; Gompers 2003; Junkin and Toth 2006; Nesbitt 1994; 1995; Smith, 1996). Additionally, increased evidence of the impact of climate change on investment portfolios has prompted many pension fund investors to shift their time horizons toward a long-term view of value (Porter 1995; UNEP 2001). Labour trustees have a significant presence on the boards of many of the early adopters and most prominent 'activist' pension funds. Their concern is for the environmental, social and governance (ESG) aspects of firms' operations and behaviour and their impact on corporate sustainability.

It is among public sector and Taft-Hartley funds where we find the majority of active owners using their financial clout as leverage to advance a long-term view of value. With only a few notable exceptions corporate funds have not become active owners. In most cases they do not scrutinize other corporations for fear of inviting the same in return (see Bogle 2005 on this point). This means a considerable amount of US pension fund assets are not used for active ownership of any kind.

Most US activist pension funds tend to be large defined benefit (DB) funds. Their activism can be traced to their boards of trustees who establish the investment strategies of the total pool of capital in the fund. As noted above, many of these DB pension boards have union representation. Despite their enormous size, defined contribution (DC) plans are composed of single accounts each with small amounts of assets held in pooled mutual

funds (the standard 401(k) model). To date the mutual funds have not become activist institutional investors (see Bogle 2005 on this point). That said, not all activist funds are drawn from DB pools. TIAA-CREF with $437 billion under management (as of 09/30/2007), is the best example of an active owner DC private plan in the US. Unlike other DC plans TIAA-CREF pools contributions to its individual accounts and manages the money internally. TIAA-CREF provides a model for other DC plans going forward.[4]

The shift toward active ownership and a long-term value as a core investment management belief continues to attract a significant number of pension funds and other institutional investors. It has been termed responsible investing, socially responsible investing, activist investing, relational investing, targeted investing, pro-active investing, double and even triple bottom-line investing. Each one of these terms captures the essence of long-term value. Examples of recent initiatives undertaken to advance a long-term view of value include the corporate governance campaigns of the Council of Institutional Investors, CalPERS, CalSTRS, New York State Common Fund, and the New York City Employees Retirement System. These pension funds are among those who target poorly governed companies in an effort to improve governance and create long-term value. The American umbrella labour organizations such as the AFL-CIO and Change to Win (CtW) unions[5] and individual unions such as the United Brotherhood of

[4] TIAA-CREF is a money manager that handles retirement savings for a number of US research, medical and academic institution as well as the general public. It has long been a corporate governance champion. More recently, building on a survey of its membership it has begun to actively promote its socially responsible investment and proactive community investing portfolio with its members (TIAA-CREF, 2007).
[5] The Change to Win unions are a new umbrella group of seven US unions including the International Brotherhood of Teamsters (IBT), the Labourers' International Union of North America (LIUNA), the Service Employees International Union (SEIU), the United Brotherhood of Carpenters and Joiners of

Carpenters and Joiners of America, UNITE/HERE, Service Employees International Union (SEIU), and American Federation of State, County and Municipal Employees (AFSCME) have been in the vanguard of the fight over excessive executive compensation, board composition and access to the proxy ballot for nomination of directors' to corporate boards.[6] Little wonder that workers and other shareholders want to have a stronger voice in how US companies are run, as the losses from Enron alone were valued $68 billion (Morgenson 2002). US workers were directly hit through losses in their defined contribution pension plans that were left holding Enron and other high tech corporate stock after these corporate giants collapsed.[7]

Corporate governance is not the only aspect of a long-term view of value. Environmental and social aspects of investment are also fundamental. Labour and pension funds with labour representation have played a key role in the Carbon Disclosure Project (CDP) representing institutional investors with over $41 trillion of assets under management. The CDP seeks information from the world's largest companies on how they are managing the business risks and opportunities presented by climate change and greenhouse gas emissions.

America (UBC), United Farm Workers of America (UFW), the United Food and Commercial Workers International Union (UFCW), and UNITE HERE.

[6] The 'Say on Pay' Campaign of 2006/2007 is indicative of the coalition of trade union organizations who have taken on excessive CEO compensation and the negative impact such practices have on workers' retirement savings. In May of 2007 a majority of shareholders passed 'Say on Pay' resolutions at Verizon and Blockbuster.

[7] Enron employees themselves were hurt first by the collapse of their company and then by the fact that their DC pension plans held upwards of 40% in Enron stock (Report of the Permanent Subcommittee on Investigation of the Committee of Governmental Affairs, United States Senate, "The Role of the Board of Directors in Enron's Collapse," (Report 107-70) July 8, 2002).

Another initiative in which a long-term view of value plays a significant role is the United Nations Principles for Responsible Investment (UNEP PRI). Signatories to this body formally recognize the importance of environmental, social and governance factors in investment decision making. The UN PRI members represent $10 trillion of assets. In most cases the pension fund members of these initiatives have labour representation on their boards of trustees. Another investor group concerned with climate change is the Investors Network for Climate Risk, a US network of investors promoting a better understanding of the financial risks and opportunities posed by climate change. The drivers of this initiative are pension funds promoting a long-term view of value.

Labour-friendly policies

In addition to being a signatory to these global ESG initiatives, many US public sector, Taft-Hartley, and union pension funds have adopted formal policies to guide their long-term view of value. These include codes of conduct for their investment portfolios and pro-active investment policies that target both financial returns and ancillary benefits that result from the investment.

Many of the codes of conduct adopted by these pension funds are labour-friendly. A Responsible Contractors Policy is one such code. The Responsible Contractor Policy expresses a preference that building service and construction contractors pay their workers fair wages and benefits. The policy encourages contractors to follow all labour laws, provide a training program and remain neutral if their workers try to organize a union. The policy applies to the real estate component of the pension funds' portfolio

both in the construction phase and in the on-going management of these buildings including janitorial services. The CalSTRS Responsible Contractors Policy describes the intent of such a policy:

"The California State Teachers' Retirement System ("CalSTRS" or "the System") has a deep interest in the condition of workers employed by the System and its advisors. The System, through the Responsible Contractor Policy ("Policy") described below, supports and encourages fair wages and fair benefits for workers employed by its contractors and subcontractors, subject to fiduciary principles concerning duties of loyalty and prudence, both of which further require competitive returns on the System's real estate investments." (CalSTRS 2003)[8] CalPERS, New York State Common Fund, New York City Employees Retirement System, Connecticut Retirement Plans and Trust Funds, Ohio State Teachers Retirement System, and Illinois State Board of Investment have all adopted similar Responsible Contractor Policies.

Several public sector pension funds have also adopted Privatization Policies as part of their investment management. CalPERS' Privatization Policy strongly discourages private equity managers from investing in a company or its affiliates, if any have "converted or replaced existing public jobs in schools, public authorities or prisons with institutions staffed by private sector employees, including units such as mailrooms, and food, waste collection, health care, and security guard services (CalPERS 2004)." CalPERS is one of four public pension funds in the U.S. with a Privatization Policy. The others include the New York City Employees Retirement System (NYCERS), Ohio Public Employees Retirement System (OPERS) and Los Angeles County Employees Retirement Association (LACERA).

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[8] The policy goes on to say, "The System endorses small business development, market competition, and control of operating costs. CalSTRS supports many of the ideals espoused by labour unions and encourages participation by labour unions and their signatory contractors in the development and management of the System's real estate investments. The System believes that an adequately compensated and trained worker delivers a higher quality product and service…. "Fair benefits" are defined as including, but are not limited to, employer-paid family health care coverage, pension benefits, and apprenticeship programs." (CalSTRS 2003)

Other labour-friendly codes of conduct recognized by many US public-sector, Taft-Hartley and union pension funds include the International Labour Organization (ILO) Declaration on Fundamental Principles and Rights at Work, the Global Sullivan Principles, and the MacBride Principles. Adherence to these codes of conduct is recognized in the investment selection process and in proxy voting decisions related to corporate governance. All three codes can have significant impacts on workers, particularly those in developing countries.

The ILO Declaration on Fundamental Principles and Rights at Work includes freedom of association and effective recognition of the right to collective bargaining; the elimination of all forms of forced or compulsory labour; the effective abolition of child labour; and the elimination of discrimination in respect of employment or occupation. The MacBride Principles are a corporate code of conduct for US companies doing business in Northern Ireland. The Principles are designed to address religious discrimination in the workplace. The Global Sullivan Principles are designed to:

> "support economic, social and political justice by companies where they do business, to support human rights and to encourage equal opportunity at all levels of employment, including racial and gender diversity on decision making committees and Boards; to train and advance disadvantaged workers for technical, supervisory and management opportunities; and to assist with greater tolerance and understanding among peoples, thereby, helping to improve the quality of life for communities, workers and children with dignity and equality." (Preamble to Global Sullivan Principles, Rev. Leon H Sullivan).

Targeted investment policies

In addition to establishing labour-friendly policies and acting in accord with codes many public sector, Taft-Hartley and union pension funds directly target investments in their investment portfolios. This form of pro-active investing is often termed economically targeted investing or ETIs. Economically targeted

investment is designed to generate both market-rates of return and corollary or ancillary benefits.

In 1994 the Employee Retirement Income Security Act (ERISA) was interpred by the U.S. Department of Labor (DOL to confirm that ETIs can be pursued in accord with the standards of fiduciary duty.[9] The DOL stated that ETIs could be lawfully undertaken by pension funds if such investment were made under the appropriate asset allocation for the fund, and geared to generating risk-adjusted market rates of return and filled a capital gap (US DOL, 1994). The most common form of ETI is investment designed to generate employment opportunities. Other benefits can include affordable housing, urban revitalization, support of small and medium sized enterprises, renewable energy, and clean technology. Most public sector pension funds with ETI, targeted investment or underserved capital market investment policies aim to invest in their own states. Many Taft-Hartley and union funds target union construction as part of their ETI program. By 2007 it was estimated that $32 billion had been invested in American labour- investment vehicles (Croft and Ghilarducci 2008).

Pension plan boards of trustees develop policies that target a wide array of ancillary or corollary benefits within appropriate asset allocation. These funds not only look for ancillary benefits; they are also savvy investors who view targeted investing as an opportunity to make superior returns in their portfolio. In most cases these policies

[9] ERISA is administered by the US Dept. of Labour. It governs all private trusteed pension funds. ERISA does not have oversight of state and local funds, but most state and local funds look to ERISA for precedence in these matters. ERISA outlined the lawful use of ETIs in its Interpretive Bulletin 94-1.

dictate that no more than 2% of the total investment portfolio will be invested in the targeted or economically targeted program.

Targeted investments are usually part of pension funds' alternative asset allocation that includes private equity, real estate, and infrastructure. Some pension funds use fixed income products for their targeted investment (discussed in greater detail below) and a few of the large pension funds such as CalPERS and CalSTRS extend credit enhancements to facilitate targeted investment opportunities. Alternative assets are often delivered through private partnership vehicles, usually brought to the pension fund by a specialist consultant in the area. Each participant co-invests in order to ensure that all parties' interests are aligned. Rates of expected return tend to dominate the partners' objectives. However the resulting deal flow is flexible enough to allow for specific covenants that can embrace a wide array of targeted objectives.

Declining returns in domestic US public equity markets in 2002 and 2003 prompted a shift in asset allocation toward alternative investments including real estate and private equity[10]. Greenwich and Associates' annual survey of pension funds found that on average 4.1% of total portfolios was invested in real estate in 2006, up from 3.4% in 2002, while private equity accounted for 3.8% of pension funds' asset allocation, up from 3.1% in 2002. In absolute dollars pension fund assets in these two asset classes were approximately $570 billion.

[10] It must be noted that alternative asset class includes hedge fund investment that has seen an explosive growth since 2005 (Pensions and Investments 2006).

Labour-friendly private equity

In recent years the increasing scale and potential impact of private equity investment has posed great challenges and some opportunities for American labour. According to one report, just in 2006 alone, 722 private equity funds were "closed", having raised $453 billion in commitments. Financial and economic conditions as of this writing point to a backing off from the frenzy of such investments in that year; but they are and will likely to remain significant. [11] For the many of such funds geared to often highly leveraged private equity buyouts – ones for which a ratio of 70% debt to 30% equity was not unusual – the financial size of transactions was, correspondingly, much larger.

Pension investment in private equity is hardly a new phenomenon, especially among public sector pension funds, though the level has been increasing: one industry source reported that the top 20 U.S. public sector pension funds with $1.8 trillion under management had allocated over $111 billion – on average, about 5.6 percent of their assets under management to private equity, with commitments of $143 billion. By contrast, Taft-Hartley or union pension fund involvement has been much more modest.[12]

American labour's attitude toward private equity has been ambivalent. On one hand it has been seen as an attractive means by which to increase financial returns for pension funds beyond those derived from publicly traded securities. (Whether the actual record of

[11] "Private Equity Spotlight," Private Equity Intelligence, April 2007. p. 5.
[12] "Public Value: A Primer on Private Equity," Private Equity Council, 2007, p. 4. Available at http://www.privateequitycouncil.org/wordpress/wp-content/uploads/pec_primer_layout_final.pdf. The same source reported that in 2006, public sector pension funds represented 26.6% of limited partner commitments to private capital investments. Funds of funds, corporate pension funds, wealthy individuals, and banks and financial services invested 13.9%, 12.3%, 10.1%, and 9.8% respectively. What were termed "union pension funds" invested 1.5%. Id. at 11.

returns in light of the accompanying higher risk has warranted that attraction is another matter.)

On the other hand, private equity firm general partners have profited very handsomely from their deals.[13] Their profits have been taxed at what are seen unfairly low rates and linked to increased income and wealth inequality in the United States. Worse yet, the taking of companies private - especially through leveraged buyouts – has been seen as a means by which predatory firms abuse tax laws relating to the use of debt, strip target corporations of cash assets, weaken those corporations with an excessive burden by virtue of the debt incurred, and engage in ruthless job, wage, and benefit cutting to increase profits and dividend payouts to investors.

American labour unions have attacked private equity firms in harsh and broad-brushstroke terms on the strength of these negative impacts. The criticism has typically been geared to corrective legislation regarding tax favouritism and abuses. But labour has also challenged particular deals and ratcheted up campaigns for the purpose and, in some cases, the impact of bringing private equity firms to the table to extract or negotiate commitments about how affected workers at firm portfolio companies should be treated.[14]

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[13] Typically pension fund investments in private equity take the form of their being limited partners in one or another partnerships created by private equity firms, with the firms becoming the general partners. It is rare for a U.S. pension fund to be involved directly in private equity investments in particular companies. CalPERS, with a reported 5% percent stake in the large private equity firm, The Carlyle Group, is closer to having such a direct role.

[14] See http://www.behindthebuyouts.org/ for reports, articles, and other materials illustrative of unions' efforts in this arena, in this case, by the Service Employees International Union.

The latter efforts implicitly acknowledge that private equity deals are not inherently or necessarily labour unfriendly. Indeed, some unions, for example, the United Steelworkers have had extensive and apparently, positive experience negotiating labour protections and opportunities, particularly in the context of takeovers of distressed companies.

That experience, in turn, points to a more systematic approach to the issue, that is, to private equity firms whose primary purpose is to achieve competitive returns but which are also committed to achieving labour-friendly outcomes. A number of such firms have emerged, though, in the aggregate, their size appears to be exceedingly modest against the large sums directed to private equity.[15] Systematic data is not publicly or otherwise readily available about the success of those firms but anecdotal reports and the persistence of such firms in the market suggest it.

What labour-friendly means and what may be required of the investment firm, the portfolio company's management, and relevant union(s) to achieve success of pursuit of that secondary goal depends on the nature of the companies in which investments are made.

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[15] Among such funds are Hamilton Lane Fund Advisors, KPS Investors, LLC, Yucaipa Companies, Landmark Partners, GESD Capital Partners, and Paladin Capital Group. See, for example, "Private Capital 2002, Investment Product Review," AFL-CIO, November 2002. Available at http://www.aflcio.org/corporatewatch/capital/upload/2002_IPR.pdf. According to that report, those and the other funds described were said to have "more than $1.8 billion in capital commitments, up dramatically from roughly $550 million in the 199 report." Id. at v. It would appear likely that the sum currently is larger. For example, KPS Capital Partners, LP, alone. describes itself as " the Manager of the KPS Special Situations Funds, a family of private equity limited partnerships with committed capital exceeding $1.8 billion." "Brochure," KPS Capital Partners, LP, p. 2. Available at http://www.kpsfund.com/brochure.pdf.

For example, for distressed companies, in part or whole unionized, where jobs are at stake, labour-friendliness might involve how many jobs are kept, what wage or benefit cuts might be avoided, what work rules or conditions might be changed, etc. In turn, that involves a willingness to conceive of the union as a conversant/partner in the process of turning the company around, and the ability to deal in a knowledgeable, sensitive, practical and constructive way with the union whatever the precise outcome. By contrast, for non-unionized companies striving to grow, there is chance to unionize existing jobs or create new ones that can be unionized. In such a case, labour-friendliness may be reflected primarily in an agreement to form of neutrality in the face of organizing efforts.[16]

These examples of labour-friendliness are closely tied to criteria or goals that private equity firms might be expected to apply to particular deals in which they are considering making an investment. Others may be more concerned with relationships and networks. For example, campaigns around corporate governance of publicly traded companies may focus on problematic behavior by senior corporate executives or the relationship between or among shareholders, the board of directors, and such executives. Such efforts may afford the occasion to engage senior corporate officials about other matters, such as labour-management practices at that company or a related one.[17] Similar opportunities might arise in the context of privately held companies.

[16] For example, the agreement may requite

(1) Employer silence on whether employees should organize;
(2) Employer agreement to certain limitations on its speech or conduct, e.g., a ban on captive audience speeches or one-on-one sessions with supervisors;
(3) Card check recognition;
(4) Union access to the employer's premises.

[17] For example, one in that company's supply chain, or a foreign branch of a domestically headquartered enterprise.

Other issues pertain to deal identification or facilitation. While that's largely a matter for private equity firms, unions may play a role as well. For example, for a distressed company, timing can be critical: the greater the distress the adverse the consequences of a turnaround – assuming one is even possible – for labour, notwithstanding the investment firm's ostensibly labour-friendly attitudes and practices. Labour may be able to early on identify companies that show signs of becoming distressed.[18] Alternatively labour, given its knowledge of an industry, may be able to identify a new product that can better be made with union labour; through educational and other efforts spur market demand for that product; design union training and other programs to enhance the union role in the making of this new product; and help garner additional needed financial support for the company.[19]

With respect to unions, this may mean not only creative union efforts in relation to deal identification and facilitation but also new thinking about collective bargaining provisions and practices that "work" both in distressed as well as growth company scenarios.

In turn, what is realistic to ask of private equity investment firms may vary. For example, cost reduction, outsourcing, and subcontracting may be seen as the first recourse in distressed and other buyout solutions. The private equity firm needs to be equipped to devise practicable, but less harmful alternatives. It must be organized and staffed to work

[18] Contact author regarding case study of KPS Special Situations Funds investment in New Flyer Industries Ltd.

[19]Contact Larry Beeferman author for information on case study of Landmark Capital Growth Partners investment in TruStone America, Ltd.

effectively with the unions involved to agree upon and implement such alternatives. While the challenges would seem to be most acute in distressed situations there may be similar ones in growth contexts. In either event, when other labour indifferent or unfriendly firms are competing for the investment, when and how can labour-friendly ones make the case that their investments are competitive financially?[20]

Clearly, there are challenges and opportunities on the "supply side" of the labour-friendly private equity side of the equation. But there are ones on the "demand side" as well. Certainly, it is encouraging that, as noted, certain pension funds have labour-friendly real estate policies, i.e., responsible contractor policies, and in at least one case, a labour-friendly policy relative to infrastructure investments (certain of which have private equity-like attributes), there appear to be no public sector pension funds that have labour-friendly private equity policies as such.[21] The barriers to establishing such policies appear to include misperceptions of on the part of gatekeepers (such as consultants and pension counsel), fund officials, and staff about the nature and performance of labour-friendly private equity investments, insufficiently informed and proactive efforts by labour pension fund trustee; claims by mainstream private equity firms that the requirements impose will impair their ability to secure promised returns; and the asserted

[20] The matter of what are legitimate benchmarks is part of broader consideration of what fiduciary duty requires as a matter of federal (ERISA) or state law, as the case may be and how investment policies or criteria can be crafted consistent with that duty. (An important related issue is how enforceable such policies are and what kinds of resources and actions are required to enforce them.) In the public sector, there are examples of responsible contractor policies established in connection with real estate investments. One question is whether and how analogous policies can be crafted for private equity investments in companies. It appears that the closest public sector plans have come to such policies is in the context of ones against investment, i.e., anti-privatization policies that seek to prevent investment in companies that will undermine public sector jobs. In the private sector there are, of course, legal issues beyond those of fiduciary duty, for example, those under labour law such as whether agreements made in connection with investments which concern union organizing and recognition run afoul of Section 8(a)(2) of the National Labour Relations Act.

[21] As discussed in the main text, CalPERS has a policy relative to privatization of public sector functions which may have some connection with private equity.

lack of pension funds' leverage over private equity firms in insisting upon their compliance with such policies.[22]

Despite these challenges, dissemination of what has been achieved to date in the area of labour-friendly private equity investment, concerted and proactive efforts of diverse kinds by unions and pension trustees in collaboration with others, and research that can help inform these efforts offer the prospect of further progress.

Labour-friendly fixed income and real estate

Labour-friendly investment vehicles are most often found in fixed income and real estate asset classes. These vehicles support union construction for housing, including affordable housing and commercial real estate portfolios. Those that offer fixed income products support union construction through the mortgage market. One of the largest and oldest of these vehicles is the Housing Investment Trust of the AFL-CIO.

AFL-CIO Housing Investment Trust

The AFL-CIO Housing Investment Trust (HIT) provides a good model of a fixed income labour-friendly investment vehicle. The Housing Investment Trust has assets under management of $3.65 billion (as of November 2007). Units of the Trust are sold to investors, while the Trust itself buys mortgage-backed securities insured or guaranteed by the federal government or other government-sponsored agencies. HIT invests solely in union built residential housing construction and is responsible for 84,000 units of housing

[22] The contention is that because mainstream private equity firms appear sufficiently confident that there are abundant sources of investment capital apart from that available from any particular pension fund, the firms are in a strong bargaining position to resist imposition of labour-friendly investment policies.

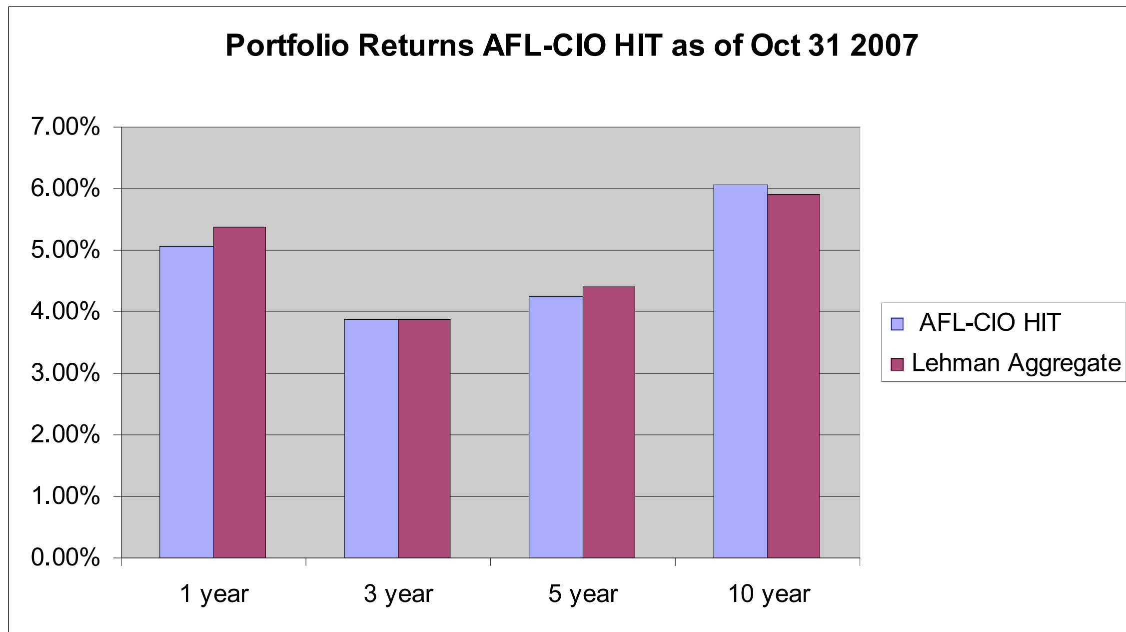
and 53,000 union construction jobs since the Trust and its predecessor, the Mortgage Investment Trust, were formed.[23] Since inception, HIT has made financing commitments of over $5 billion for multi-family housing projects valued at an estimated $6.9 billion (Croft and Ghilarducci 2008).

The Housing Investment Trust has over 350 investors including public sector, Taft-Hartley and union pension plans. Public sector pension funds such as CalPERS, NYCERS and most recently Mass PRIM all invest in the AFL-CIO Housing Investment Trust. By 2005 New York City's four pension funds' total investment in HIT was $147 million (Hagerman et al 2005). In 2007, Mass PRIM committed $50 million to the Housing Investment Trust as part of its ETI program.

HIT is a top quartile fund with strong financial returns over the past ten years. It has outperformed its benchmark, the Lehman Brothers Aggregate Bond Index, over a ten-year period to October 31st 2007 and kept pace with the benchmark in the one, three and five year time period.

[23] The AFL-CIO Mortgage Investment Trust was formed in 1965. In 1981 HIT replaced the Mortgage Investment Trust.

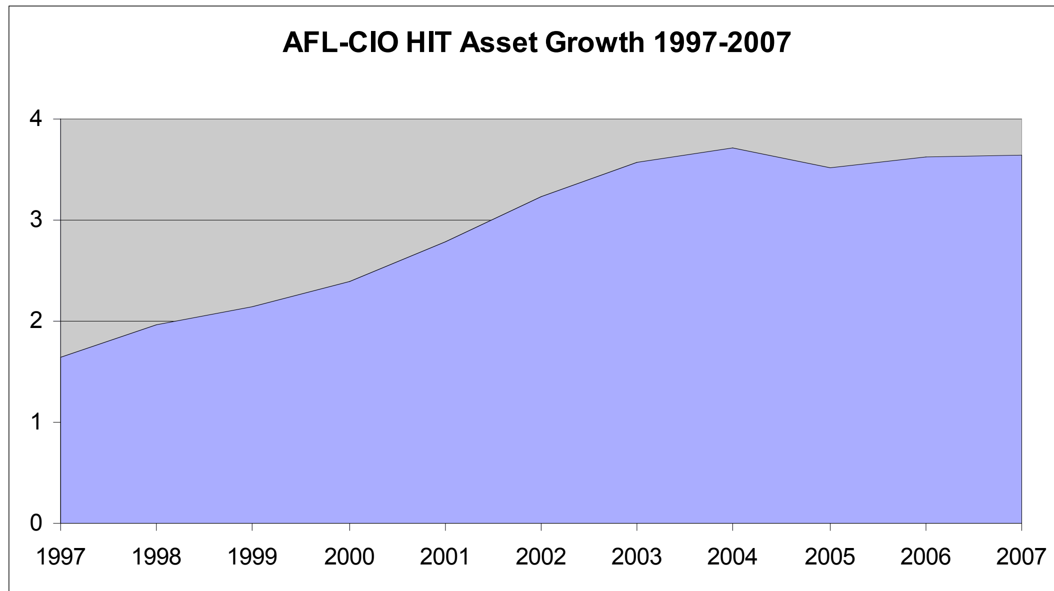
Figure 10.1 AFL-CIO Portfolio Returns



Source: AFL-CIO HIT

The Housing Investment Trust is a national, commingled fund. This means that investors are able to reap the benefits of strong returns with broad geographic diversification and support union construction jobs across the US.

Figure 10.2 AFL-CIO HIT Asset Growth



Source: AFL-CIO HIT

In addition to supporting union construction jobs, the Housing Investment Trust has undertaken a series of community investment initiatives over the past six years that have generated significant corollary benefits beyond supporting union construction. The first of these investments was made in New York City in the immediate aftermath of the 2001 attack on that city. HIT's New York City Community Investment Initiative (NYCCII) is a $750 million multi-phase investment launched in January 2002. It invested $500 million in just four years and financed the first construction in New York after the attacks of September 11th. This investment generated 3,500 union construction jobs and developed or preserved over 14,000 housing units with 87% of these units designated affordable housing (Croft and Ghilarducci 2008). Phase II will invest a further $250 million in NYC. Phase II was launched in early 2006 and includes a homeownership initiative to offer mortgage products with a five-year goal of $1 billion in mortgage loans for union members and city employees in New York City. The Housing Investment

Trust's sister fund, the AFL-CIO Building Investment Trust (BIT) is an active partner in these investments.

When disaster struck again in the US in 2005 in the form of Hurricane Katrina, the Housing Investment Trust once again stepped up as a lead investor in the region. Launched in 2006, the Gulf Coast Revitalization Program is helping to rebuild communities still coping with the aftermath of the 2005 storms and flooding. Combined investments of $700 million by HIT and BIT over a seven-year period are expected to result in $1 billion of housing and economic development activity in the region.

Not only will this investment help rebuild the region; it will also create thousands of union jobs in a state that has not had strong union representation to this point. "HIT has pledged $600 million over seven years to finance 5,000 to 10,000 units of affordable housing, increase homeownership opportunities, help finance the rehabilitation of damaged health care facilities and create good jobs for local residents (HIT 2007)" The Housing Investment Trust is deepening its impact on the region through its partnership with the AFL-CIO's Building and Trades Department to train skilled construction workers in the region.

HIT is also investing $500 million in Chicago to address the shortage of affordable housing in that city. As part of this initiative HIT is investing $250 million in multifamily housing production and a further $250 million for homeownership opportunities for working families in Chicago. The Building Investment Trust is

investing an additional $250 million in equity real estate in Chicago. "With leverage, the $750 million combined investments of the initiative are expected to result in more than $1 billion of financing to produce housing, support economic development projects, promote homeownership for working families and create thousands of union construction jobs in the Chicago area" (HIT 2007).

Most recently, the Housing Investment Trust announced it will invest $75 million in Massachusetts over the next three years to help address a shortfall of affordable homes in the state. "This new initiative focuses on housing needs not readily met by the capital markets," said Paul Barrett, Director of HIT's Boston Office. "We intend to build on our close relationships with the Massachusetts labour movement and housing finance community to support the production of low- and moderate-income housing (HIT 2007b)." HIT has already committed close to $50 million that will generate 1,072 units of housing in Massachusetts, with 1,042 of those units to be affordable. HIT's total investment is expected to generate approximately 480 union jobs.

Multi-Employer Property Trust

The Multi-Employer Property Trust (MEPT) is a commingled real estate equity fund which invests in union-built new construction properties across the US. Founded in 1982, MEPT had $7 billion in net assets under management as of December 31st 2007 (MEPT 2008). MEPT is one of the largest labour-friendly investment vehicles in the US. MEPT uses union labour to build or rehabilitate income-producing properties. It is understood that the high skill level provided by union construction means higher quality

in the finished product resulting in enhanced returns over time. The performance of the fund backs this conclusion (see Figure 10.3). The Trust currently holds 175 properties across approximately 25 major US metropolitan areas in its portfolio (Croft and Ghilarducci 2008). Between 1982 and 2005 MEPT's portfolio generated over 27,300 construction jobs, paid $1.5 billion in wages creating 52.7 million job hours for construction and special trade contractors contributing $74.9 million in state taxes (Croft and Ghilarducci 2008 quoting an ECONorthwest study of MEPT impacts). The ECONorthwest study estimates that MEPT has contributed $9.9 billion of economic activity in US communities.

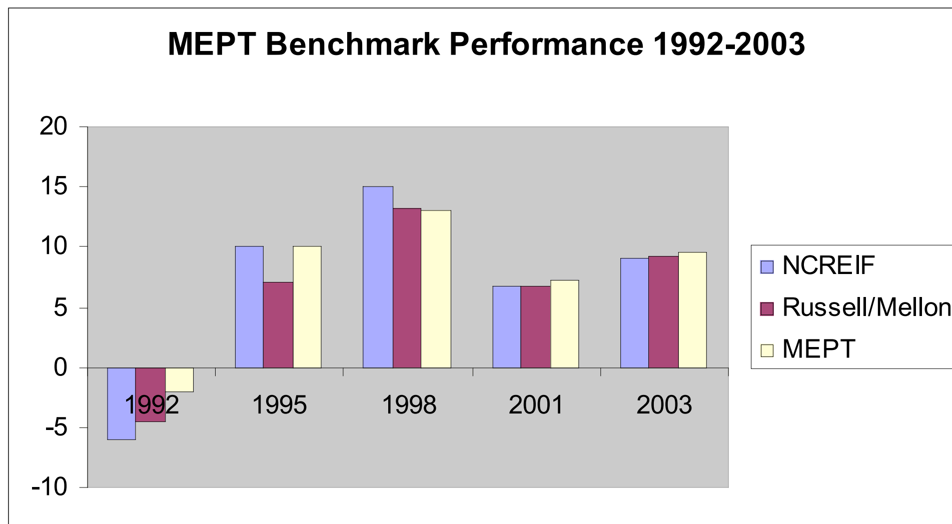
In addition to using 100% union labour in construction and rehabilitation, MEPT also adheres to a Responsible Contractors Policy (referred to earlier in this paper) in the maintenance of the properties in its portfolio. MEPT holds properties for a considerable length of time, only selling at the most opportune times in the market. All maintenance of its existing 170 properties is carried out by responsible contractors. It has been demonstrated that responsible contractors who pay fair wages add value to the property over time.

> "Increasingly managers are finding that providing top quality building services differentiates a property from its competition in the workplace, allowing the investor to optimally position the building in its portfolio... Reputable contract service firms report that high-calibre building service is achieved through retention of experienced cleaning staff and fluid labour relations in the workplace. These conditions are realized when cleaning employees are adequately compensated and trained and when their employers demonstrate a respect for workers legal rights. In an industry historically marked by low standards and workplace abuses, it is necessary for building owners to clearly stipulate their insistence on contracting only with reliable and law abiding firms. This practice helps to raise standards through the industry, allowing firms to compete for cleaning accounts on the basis of quality, stability and overall value, rather than minimum wages." (Moye and Gozan 1999).

The key to a successful labour-friendly investment vehicle is in its ability to both deliver on financial performance and on the ancillary benefit of increased union jobs. This is true whether the vehicle is in private equity, fixed income or real estate. Pension fund investors look for top quartile performers and are not prepared to invest in market laggards no matter what ancillary benefit they may deliver. That said, MEPT gross of fees returns have outperformed its US benchmarks in almost every time period over the last ten years (see Figure 10.3). The fund uses both the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index and the Russell/Mellon Equal Weighted Universe of Commingled Open-End Real Estate Funds as its appropriate benchmarks.

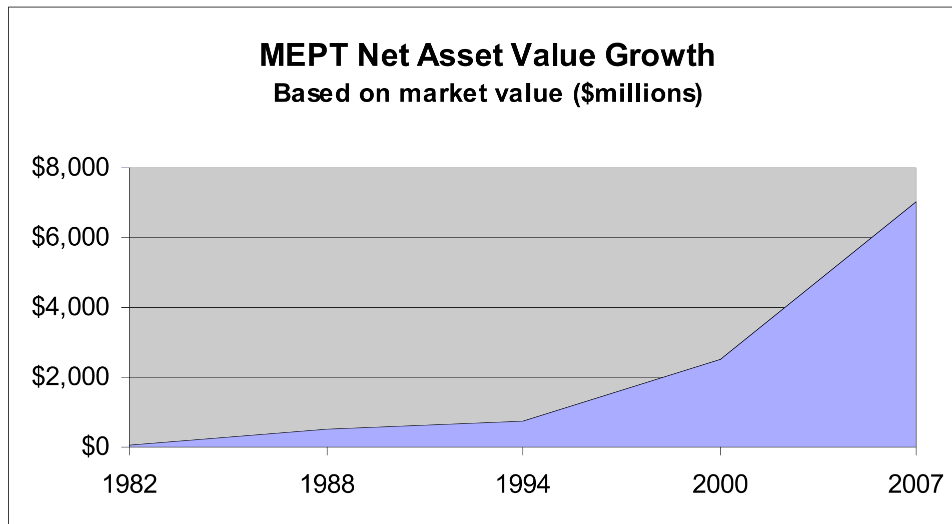
Figure 10.3 MEPT Benchmark Performance 1992-2003

Source: MEPT



As a result of this strong performance, MEPT's assets have grown considerably over this time period. Over three hundred pension plans invest in MEPT, primarily Taft-Hartley and public sector pension plans.

Figure 10.4 MEPT Net Asset Value Growth



Source: MEPT

MEPT has recently incorporated environmental sustainability into both its construction and maintenance of its real estate portfolio. Several of its recent projects have met the Leadership in Energy and Environmental Design (LEED) standards. In addition, MEPT is instituting Energy Star certification and benchmarking program in the maintenance of its buildings (Croft and Ghilarducci 2008).

Conclusion

There has been considerable integration of labour-friendly policies and programs across US Taft-Hartley and public sector pension funds in the last ten years. Much of this integration has been through pension funds' adoption of a long-term view of value that coincides with the "workers' view of capital" articulated by the American labour movement (Silvers et al 2001). This movement, known as responsible investing, posits that environmental, social and governance (ESG) factors of corporate behaviour must be

taken into account in investment decision-making. The valuing of these extra-financial factors is believed to align the interests of pension funds with those of the labour movement. Such alignment has been strengthened by the presence of labour nominated or elected trustees on the pension funds boards of US Taft-Hartley and public sector pension plans.

This alignment of interest has yielded pension fund policies and programs that reinforce the American labour movement's broader economic and indeed societal concerns. These include excessive CEO compensation; shareholders' ability to nominate corporate directors; access to healthcare and fair wages; and broad environmental issues.

Pension funds are increasingly adopting labour-friendly codes of conduct that impact corporate behaviour both in the US and internationally. These codes include privatization policies (increasingly important as pension funds consider extending their investment to infrastructure around the world), responsible contractor policies, as well as international policies such as the ILO Fundamental Principals and Rights at Work, and the United Nations Principles for Responsible Investment.

Finally, Taft-Hartley and public sector pension funds are investing directly in labour-friendly investment vehicles across a variety of asset classes including private equity, fixed income and real estate. It is currently estimated that $32 billion is invested by American pension funds in labour-friendly vehicles. The intent of these vehicles is to generate top quartile financial returns and to increase and maintain union jobs across

America. Investment patterns in these vehicles over the past ten years indicate that the investment decisions are primarily driven by the financial performance of the vehicles themselves. The impact on union jobs is a positive ancillary benefit that factors into the investment decision, but does not supersede the requirement for top quartile performance. Labour-friendly investment vehicles that are unable to met or exceed industry benchmarks are not successful in gaining new pension fund investment over time. Conversely top quartile performing labour-friendly investment vehicles have grown and prospered.

Labour-friendly pension fund policies and investments suggest that the long-term view of value and the workers' view of capital are integral to strong, healthy and vibrant communities and economies and provide positive rewards for investors over time.

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