



CEO Brief

Responsible Property Investing and Property Management: Exploring the Impacts of Good Labour Practices on Property Performance

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Investors, owners and managers of commercial real estate are demonstrating a growing interest in responsible real estate. Green real estate has received special attention to date, but labour, employment, and human capital issues are equally important aspects of responsible real estate.

Responsible Property Investing and Property Management examines the labour and human capital aspects of responsible real estate. It assesses the applicability of responsible contracting policies and fair labour practices in the Canadian market by exploring the use of such policies by real estate investors and managers in the United States. The authors reviewed academic, industry, and government sources in both Canada and the United States and consulted with industry experts, property service workers, commercial cleaning companies, non-governmental organizations, and unions. Semi-structured interviews were used by senior academics from Boston College (US) and Carleton University (Canada) to elicit the views of real estate industry practitioners, pension funds, investment managers and key stakeholders on the applicability and use of fair labour practices and responsible contractor policies in the property sector.

Precarious Employment and the Property Sector

“Precarious employment” refers to insecure, temporary, contract, and part-time work. The growth of precarious employment has been driven by the desire for more flexible, mobile workforces. Precarious workers are predominantly women, minorities, immigrants, and youth. Workers in precarious employment situations tend to earn less money (up to 40% less), on average, than their permanently employed counterparts. They experience significantly higher rates of poverty and lower incomes. They have limited access to extended health benefits and suffer increased levels of stress, mental health disorders, addiction, and heart disease. Precarious workers are often unaware of, or unable to access, regulatory grievance and complaints mechanisms; they are under-represented by unions and they tend to under-report labour rights violations.

Employees hired as subcontractors or “independent contractors” generally do not receive statutory benefits such as employment insurance, sick leave, or vacation pay. In fact, the Organisation for Economic Co-operation Development has singled out Canada as a jurisdiction where the growth of self-employment and subcontracting is particularly high, suggesting that “self-employment status may be little more than a device to reduce the total taxes paid by the firms and workers involved.”

The real estate industry relies on labour-intensive services such as cleaning, construction, security, and maintenance services in order to maintain and preserve the long-term value of real estate assets. These service suppliers are particularly exposed to precarious employment risks because of both the nature of the industry (i.e. predominantly low-wage and low-skill, except for skilled construction trades) and the nature of the workforce (i.e. commercial cleaning is dominated by women, new immigrants, and visible minorities). Subcontracting and precarious employment tactics are known to be used within the property industry in Canada; however, the extent of companies’ reliance on precarious employment strategies varies. Some property workers enjoy relatively stable employment and wage rates, while many others face highly variable weekly working hours,

higher contract turnover and job loss, greater work intensity and productivity pressures, and poor wages and benefits.

Industry experts believe that workforces based on short-term, low-wage workers are inherently unstable and inefficient and tend to suffer from high incidences of absenteeism and staff turnover. On the other hand, companies that have established high labour and employment standards report significant business benefits, including reduced turnover and absenteeism, improved labour relations, reduced administration costs, and better market access.

Business models that rely on precarious work in order to sustain profits ultimately outsource employment and benefit responsibilities to society and governments, which can lead to additional, broad-based consequences such as lost tax revenue, higher poverty rates, and greater health and social assistance costs for governments. In addition, property investors and managers have an interest in ensuring that short-term cost savings resulting from low-wage, subcontracted, or precarious work do not jeopardize the long-term value and security of their real estate assets. Investors and property managers have responded to these challenges by implementing responsible contractor policies (RCPs), which serve as both standard-setting and monitoring mechanisms for property-service supply chains.

Responsible Contractor Policies: The United States' Experience

Responsible Contractor Policies (RCPs) have emerged in the United States as an institutional mechanism to address the potential investment and reputational risks posed by precarious work. RCPs are formal policies developed, most commonly by public pension funds, to accomplish two things: 1) Ensure that bidding processes for construction and property services are open to contractors who pay fair wages and benefits; and 2) All other things being equal, institutionalize a preference for contractors who pay fair wages and benefits. Investors who have established RCPs understand them as a means to mitigate risk and create opportunity by:

- identifying fund managers and contractors with a stable workforce able to deliver timely, high-quality work;
- reducing the risk of worker tension, underperformance, and labour strife;
- using fair labour and employment practices as a proxy for good management;
- supporting a general employment environment that prevents a downward spiral of wages, working conditions and work quality.

Observations and comments from interviewees highlight that RCPs work well as signalling devices, indicating that the property investor or manager is interested in supporting fair wages and labour practices as consistent with its fiduciary duty. Generally, the US pension fund managers interviewed do not believe that RCPs radically alter their investment practices, nor do they play a major role in either the selection of investment managers or the monitoring of investments. From the perspective of pension funds that have adopted them, RCPs create a framework for identifying and managing the relationship that investors, property managers, and contractors have with their employees during the course of the real estate investment process.

US pension funds rejected the standard critique that RCPs limit investors' ability to fulfill their fiduciary duty to their shareholders. Rather, they argued that RCPs are clearly tied to superior long-term performance and are written to explicitly affirm the duty of fund managers and contractors to earn a reasonable investment return and minimize risk. As a matter of fiduciary concern, pension funds see RCPs as a way to ensure that the bidding process is fair and that compliance with the policy is tracked through the reporting requirement. Those who use

RCPs describe them as a way to ensure a level playing field for fund managers and contractors who use fair wage practices, and also as a framework for negotiation when labour disputes occur.

Similarly, US investment managers reported to researchers that compliance with RCPs has little to no effect on their overall investment performance. Several recognize the value of combining RCPs and union-only strategies, an approach used by some labour-friendly funds in the real estate industry, such as the Amalgamated Bank ULTRA Loan Fund, AFL-CIO Housing Investment Trust (HIT), and Multi-Employer Property Trust (MEPT). At the most basic level, the RCPs provide investment managers with a tool of engagement and serve as a signal that the managers support quality work through quality jobs.

Although there is no simple way to measure the impact of RCPs on real estate financial performance, all pension fund representatives interviewed believe that the immediate impact of their RCP policies on financial performance has been minimal. The benefits of the policies accrue from the collateral support for fair labour standards and the inclusion of a conflict-resolution mechanism. US investment managers with union-only policies believe that their strategies pay off in terms of quality of work. The main concern for interviewees was not the impact of RCPs on financial returns, but rather the potential increased costs associated with compliance and monitoring. To address concerns about monitoring costs, pension funds and investment managers in the United States rely on the self-monitoring mechanisms included in RCPs, which can be effective provided that employees, unions, and worker advocates are aware of the policies and are able to report potential violations directly to the pension funds or investment managers.

Fair Labour Practices and Real Estate: The Canadian Experience

In Canada, interest in applying environmental, social, and governance (ESG) standards to Canadian real estate holdings is growing. To date, Canadian investors, property developers, and property managers have focused primarily on the environmental aspects of responsible property with less attention to the social aspects of real estate portfolios. Labour and employment practices are now beginning to play a role in the Canadian property sector's analysis of opportunities and risks.

The Canadian property managers and developers interviewed for this study generally recognize the value of fair labour practices. Some have taken steps to integrate labour standards into their contracting and investment processes by adopting union-only policies or responsible contractor policies. For example, Canadian real estate firm Concert Properties has a long-standing union-only policy for both construction and property-service workers. Additionally, real estate investment manager Bentall LP has recently adopted a responsible contracting policy, the first of its kind in Canada. Other Canadian firms, such as Great West Life Realty Advisors have started to address labour practices by monitoring the professional conduct of contracting companies through regular contract reviews and meetings with service suppliers. These moves reflect a greater awareness of labour and employment concerns within the property industry and suggest that mechanisms to introduce fair labour practices and RCPs can work in the Canadian context.

Despite some of the positive effects reported by interviewees, the explicit use and integration of fair labour practices, including the use of RCPs, is not yet the norm in the Canadian property sector. The Canadian representatives interviewed highlighted that the incorporation of fair labour practices often presents a trade-off between cost and quality for building services. While property managers desire high-quality property services, they are conscious of the price tenants are willing to pay for services. Concert Properties recognizes that, though union labour can be more expensive, the company benefits from higher-quality services that are on time

and on budget. In the company's experience, non-unionized firms are less dependable and have higher staff turnover. Concert's managers believe that the company's strong financial performance demonstrates the value of establishing high labour standards for property-service and construction contracts. Similarly, since developing its RCP in February 2008, Bentall has not experienced any negative impact on the company's financial performance. The policy has provided Bentall with an enforcement mechanism and a system for ensuring that property service contractors meet Bentall's pre-screening requirements, including labour and employment standards.

The research highlights that, though some actors in the industry see the positive outcomes of productive and proactive labour relations, others have been slow to understand the link between improved labour relations and higher-quality property management. In the absence of a broader public commitment to fair labour practices in Canada, public policy has become an important instrument for improving standards. Public policy instruments attempt to address concerns about a race to the bottom in wages and benefits. Public policy instruments include municipal fair-wage policies in cities such as Toronto, as well as province-wide decrees in Quebec that govern wages and benefits for property-service workers.

Public awareness of precarious employment is also increasing due to the activities of unions, activists, lawmakers, and academics. This is particularly the case in Ontario, where government authorities are beginning to crack down on industries noted for their use of precarious employment strategies, and where unions and social justice advocates are campaigning for better wages and working conditions in various sectors, including the property sector. As a result, investors, owners, and managers of real estate can expect to face additional public pressure and reputational risks regarding their approach to labour relations and employment practices.

Conclusion

The social aspects of responsible real estate are becoming an increasingly important consideration for investors, owners, and managers of commercial real estate, particularly as environmental, social, and governance factors play a larger and more significant role in investment and business decision-making. As stated by the Real Property Association of Canada, "Ignoring this expectation, and failing to take leadership in social and environmental accountability, could pose significant risks to Canada's commercial real property industry."

RCP models in the United States demonstrate the feasibility of RCPs within an overall property investment strategy that is consistent with investors' fiduciary duties. For Canadian property investors and managers, RCPs that incorporate fair labour practices into contractor evaluation and bidding processes can address emerging changes in public sentiment and public policy. In addition, RCPs can provide competitive advantage for firms seeking to build productive, long-term employment relations and sustainable financial returns.