EXCLUDING SOME ANGRY COUNTRIES

The Thai stock market fell 7% in just two days after the list came out. Representatives of the dropped countries howled and bused local citizens to CalPERS’ Sacramento headquarters to protest. It proved particularly embarrassing when the data used to exclude the Philippines turned out to be old and the country was reinstated.

An even bigger problem was that CalPERS was excluded from investing in such economic powerhouses as China, India, and Russia. A 2007 CalPERS report found that the fund’s emerging-market investments underperformed an index without the same screening process by 2.6% a year, costing the fund some $400 million in lost gains. In August of last year, the fund changed its policy after declaring victory over the social ills it had targeted.

"Year by year, scores are improving, and many countries have responded to our standards for investing," Rob Feckner, president of the CalPERS board, said in a press release announcing that the fund had repealed the screening policy.

CAN’T QUIT SMOKING

Next to be reinstated may be tobacco. In a June 4 report, CalSTRS revealed that excluding tobacco stocks had cost the fund more than $1 billion in lost gains over seven years. After all, shares of tobacco giants Altria (MO) and Reynolds American (RAI) had shot up threefold and sixfold, respectively, this decade. The CalSTRS staff found that the potential costs of lawsuits and increased regulation of tobacco companies were no longer as dire as they were and that a movement among state pension funds to divest themselves of tobacco stocks had waned. The report said the fund "could no longer justify" excluding the stocks on a financial basis and recommended repealing the policy.

In general the professional money managers who run the California pension funds have opposed restrictions on what they can invest in. Exiting an asset class typically costs the funds millions of dollars in transaction fees and fees to consultants to both justify the divestiture and monitor the ongoing performance. The CalSTRS board is expected to consider reinvesting in tobacco stocks at a meeting in September.

Then there’s real estate. Based to a large degree on the Angelides push, CalPERS and CalSTRS invested heavily in real estate in their home state. One big beneficiary was Victor MacFarlane, a San Francisco money manager who invested CalPERS money in low income urban areas in partnership with basketball great Earvin "Magic" Johnson starting in 1996.

At a conference on California investing co-sponsored by CalPERS and CalSTRS last September, MacFarlane noted that the definition of urban investing had since expanded to include not just investments in poor neighborhoods but luxury high-rise condos and suburban master-planned communities. He said he had earned CalPERS returns of 33% a year. "The bottom line—or the double bottom line— is that urban real estate..."
investments can help revitalize downtrodden neighborhoods and spur economic growth,” MacFarlane said. "Pension funds and others are proving you can do well by doing good.”

REAL ESTATE HEADACHES
But much has happened in California real estate markets just since last September, as home sales and prices have plummeted. In February of last year, MacFarlane directed $970 million of CalPERS land and money into a venture called LandSource Communities, which among other properties included a massive residential development north of Los Angeles called Newhall Ranch. On June 9, creditors of LandSource started bankruptcy proceedings. According to testimony in bankruptcy court, the current owners of the company, which include CalPERS, Cerberus Capital Management, and Lennar (LEN) have asked to buy out the creditors for $750 million. Last year the entire business was valued at $2.6 billion.