CHAPTER 26

EMPLOYEES' RETIREMENT SYSTEM

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"Is the State Employees' Retirement System being abused?"

I'll tell you a few things about the Hawai'i State Employees' Retirement System (ERS) and let you draw your own conclusions.

Background. Nearly all state and local governments have retirement plans for their employees, some worth billions of dollars, such as the California government's $60 billion program. Each typically is governed by a board of trustees, whose primary job is to make sure there is enough money in the kitty to cover their workers' retirement benefits.

What we now call the ERS was set up for Hawai'i government employees by the territorial legislature in 1925. Since then its membership has grown from a few hundred to about 55,000 active state and county workers and some 24,000 retirees and their families.

From 1986 to 1992, the number of working participants in the system increased 20 percent; the number of retirees rose 47 percent; and the value of ERS assets climbed 83 percent, thanks mainly to a soaring stock market. The surge in assets was a godsend because of the fund's climbing commitments. The ERS now has total assets of about $5 billion, with two-thirds invested in U.S. stocks and bonds and the remaining third divided among five other categories of investments, the biggest of which is real estate.

Direct investment in real estate offers the possibility of a comparatively high return, but at a relatively high risk. As a percentage of the overall fund, the real estate segment of investments is relatively small but has grown the fastest in recent years.

The fund had not directly invested in real estate prior to 1989. Governor John Waihee says he suggested the move then as a means of broadening the fund's investment base. His administration paved the way by convincing the legislature to double the statutory ceiling on real estate investments to 10 percent.

Run by trustees. The ERS is administered by seven unpaid trustees and a paid staff. Three of the trustees are elected by the members of the system, three are appointed by the governor, and one, an ex-officio but voting trustee, is a member of the governor's cabinet, the director of the state's Department of Budget and Finance. So the governor appoints four of the seven trustees.

The trustees have a great deal of discretion in day-to-day operations, notably in managing the system's $5 billion in assets. They do, however, get lots of help with their investment decisions. Currently, about thirty investment advisory firms—some local, some not—monitor and make buy-sell recommendations. And there is other help. ERS's data processing, legal and actuarial work, and financial audits are done by outside firms.

Okamoto, Himeno & Lum. In 1989, when the trustees made their first direct real estate investment, the purchase for $68 million of the newly built City Financial Tower in downtown Honolulu, they decided the legal advice they had been getting in-house—mostly through the state attorney general's office—was inadequate. They needed specialists. So they hired an outside law firm, known then as Okamoto, Himeno & Lum. The firm's partners were Kenneth Okamoto (whose wife, Sandra, was an assistant to then-State Attorney General Warren Price), Sharon Himeno (Sandra's sister and by November of that year Warren Price's wife), and Bettina Lum (the law firm's real estate expert).

Bettina Lum assisted the ERS in its purchase of City Financial Tower. She also helped the trustees evaluate the many mortgage loan applications that were coming in to the ERS as a result of a decision to step up that activity. Much of the $628,000 in fees earned by the law firm from the ERS account between 1989 and 1992 came from evaluating these applications.

Not all the fees came directly from the ERS. Some loan applicants paid Okamoto, Himeno & Lum directly for help in preparing and evaluating their applications. One of these applicants was Waikele Commercial Associates, a partnership seeking a $154 million loan from the ERS to develop a shopping complex on land purchased from Amfac/JMB in central O'ahu. Governor Waihee now says he had urged the ERS trustees to increase their loans to Hawai'i businesses such as Amfac/JMB and Waikele Commercial Associates "because it makes good economic sense."

Political tool. Some people complain that the governor has openly used the ERS as a political tool and improperly interfered in its decision-making. They contend that this amounts to abuse. The governor and his political allies have responded by denying any improprieties. The ERS trustees are proud of their investment record and say that's what really matters.

Though none of the advisors employed by the ERS is required to bid for their contract, nobody associated with the fund or the administration thinks that's a problem. They say the trustees selected Okamoto, Himeno & Lum, for example, for the real estate expertise of Bettina Lum, not for the political connections of her partners.

The ERS trustees used more than Lum's services in buying the City Financial Tower. They also hired the local real estate firm Marcus & Associates. That firm had been recommended by trustee and budget director Yukio Takemoto, who was a golfing buddy of its chairman, Marcus Nishikawa. Marcus & Associates was named exclusive leasing agent for the 24-story City Financial Tower and given the contract to review the leasing program for the building.

Marcus & Associates also participated in other real estate purchases. Later in 1989, it was a player in the ERS's $26 million purchase of the CentrePointe office-warehouse complex in Carson, California, and in the 1991 purchase, for $17.5 million, of Huntington Plaza, another commercial center in Southern California. In each case the real estate firm was paid a six-figure commission, not by the ERS, but by the sellers.

A quick $3 million. The CentrePointe purchase came back to haunt some of its participants. That deal began when Honolulu businessman Stanley Himeno (father of Sharon Himeno) approached the ERS trustees wanting to borrow money to buy the California property. Marcus & Associates got involved and soon it was decided the ERS would itself buy the property. CPAs Ernst & Young, who had started to work for Himeno, appraised the property for the ERS trustees at $26.2 million, and the ERS then offered Himeno's company $26 million. The offer was quickly accepted and the sale closed. The trustees later said they had no idea Himeno had bought the property for only $23 million and arranged back-to-back closings, thus making an apparent $3 million gain in a matter of minutes.

Okamoto, Himeno & Lum declined to participate in that particular purchase because of the obvious conflict of interest. Besides the family relations, Sharon Himeno and Sandra Okamoto were officers and directors of the Himeno company that bought and sold the CentrePointe property. Another law firm was hired to help out: Hoe, Yap and Sugimoto, Governor Waihee's former law firm.

Himeno's firm continued to review loan applications. One was for an $11 million loan that would have gone to Nansay Hawai'i, a Japanese-owned development company. The money was to be used not by Nansay but to shore up a failing Kona aquaculture company called Ocean Farms Hawai'i, which the administration wanted as a showcase operation and which Nansay had already been coaxed into supporting. But when the development tradeoffs of the loan became unclear, Nansay balked. The loan wasn't made and Ocean Farms folded quietly. The governor's supporters see this as a noble attempt to help a local business survive. Others call it a blatant example of government interference and misuse of the ERS's funds.

Jurist resigns. Late in 1991, the trustees voted to pay $31 million for Wood Ranch, a California golf course. That deal had been brought to them by Honolulu developer Rodney Inaba, a friend of ERS trustee Gordon Uyeda. But retired Hawai'i Supreme Court justice Edward Nakamura, who had been appointed an ERS trustee only months before, strenuously opposed the purchase. He also had grown upset over the pending $154 million loan to Waikele Center Associates. Saying he couldn't stomach such treatment of public funds, the respected jurist resigned his trusteeship when the Wood Ranch acquisition was approved by a majority of the board.

The governor then told "Yuki" Takemoto to kill the deal and the trustees reversed their decision. Another trustee later said Takemoto told the board the governor "didn't want the hassle."

By mid-1993 the ERS had made one other real estate investment, a 400-unit apartment complex in Arlington, Virginia, that cost $38 million, and it was considering two others. Both of the latter involved conversion of existing mortgage loans into equity interests. One was the $154 million loan to Waikele Center on O'ahu and the other a $31 million loan to Ka'ahumanu Shopping Center on Maui. The conversions seemed certain of approval. ERS administrator Stanley Siu considers them prime examples of what the governor meant by "investing in Hawai'i."

But in the summer of 1993 the ERS faced a State Senate special committee probe into its investment decisions and contract practices. Governor Waihee labeled the investigation "McCarthyism." The ERS met the challenge by hiring another consultant: Hill and Knowlton, a high-powered international public relations firm that specializes in crisis management. The first thing the big PR firm did was launch a newsletter for ERS members called "Safe & Sound." The first issue contained blanket denials of any wrongdoing.

"NOTHING TO BE CONCERNED ABOUT... JUST FAMILY SPATS..."


CAMPAIGN CONTRIBUTION
"THIS IS NOT A BRIBE, IS IT..."
"THIS IS NOT EXTORTION, IS IT?..."