



## HEI and the Endowment Crisis: Communities Sacrifice for HEI's Gambles

**A Report by United Students Against Sweatshops, in collaboration with: the Notre Dame Campus Labor Action Project, Princeton for Workers' Rights, the University of Pennsylvania Student Labor Action Project (SLAP), University of Chicago Students for a Democratic Society, University of Chicago Students Organizing United with Labor (SOUL), Vanderbilt Students for Non-Violence, the Yale Undergraduate Organizing Committee.**

*Activism around university endowments is nothing new. From Apartheid to Darfur, students have pushed to use institutional clout to promote social change. The current economic crisis, however, has sparked something different on campus. Today, students continue to advocate that companies in which endowments invest behave responsibly. But, as aggressive risk-taking has led to sharp cuts in university budgets, students are also grappling with how investment decisions impact their own education. Activists are increasingly recognizing the complex interconnections between how university investments perform in the wider world and how they affect campuses locally. This could lead to a new focus on endowment reform.*

### Introduction

In recent months, there has been a great deal of debate about the extent to which university endowments have exposed themselves to risky investments. Before the financial crisis, many endowments took the attitude that universities could afford a very long horizon on investment returns, and therefore should invest heavily in long-term, illiquid assets. But now, confronted with massive losses (particularly in their private equity and real estate portfolios), analysts have been reexamining this thinking.

Declines in endowment valuations have been severe. Harvard, for example, saw a drop of 30% during 2009. Yale lost 29%. Princeton's endowment fell 23%.<sup>i</sup> Yet in the face of criticism of their investment strategies, many responsible for these decisions continue to defend their long-term, illiquid investment models. Yale President Levin went so far as to say regarding Yale's investment strategy that he "would not have changed it the slightest bit"<sup>ii</sup>.

Nonetheless, these precipitous losses have had extremely disruptive effects. Because many institutions peg their annual budget directly to endowment funding, campuses have been forced to slash spending on staff and faculty, on facilities, and even on such things as student dining. Moreover, these cuts have come at precisely the time when (because of high unemployment and turnover in the economy) the need for institutions of higher learning is at its highest.

The wisdom of endowments' aggressive risk-taking has been well debated, in a range of publications.<sup>iii</sup> To our knowledge, however, none of these has scrutinized any particular private equity investment. This is in large part because of the great secrecy with which endowments guard the identity and performance of such investments. Still, the fact that university endowments have become such major players in a large and risky sector of the economy, makes it troubling that so little information is publicly available.

In this paper, we examine a private real estate company that between 2004 and 2008 drew in over \$1 billion in endowment equity placements: HEI Hotels & Resorts. We look at how the company sold itself to endowment decision makers, how it invested heavily in real estate assets (specifically, hotels) during price-boom of the late 2000's, and how the nature of this investment puts pressure on university budgets. We also touch upon the wider social and economic effects that HEI – in effect, an extension of academic institutions – has had in the local communities where it has bought properties.

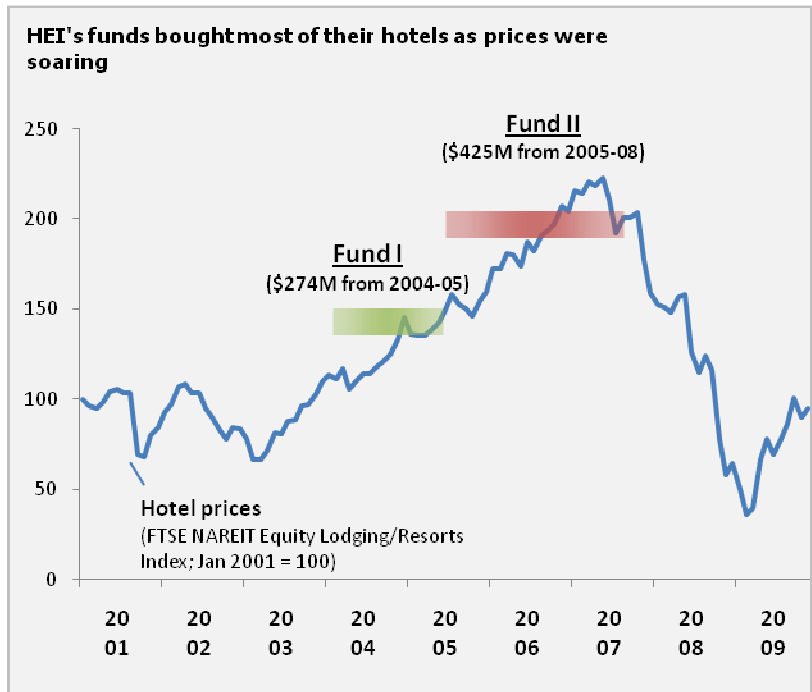
## HEI's Real Estate Funds

HEI Hotels & Resorts is a hotel company funded in large part by university endowments. Between 2004 and 2008, HEI raised over one billion dollars from approximately two dozen schools, including many of the nation's largest endowments – such as Yale, Harvard, Princeton, University of Chicago, and others.<sup>iv</sup> Using these funds (plus commercial mortgage debt), HEI has purchased around 30 upscale hotel properties around the US, and continues to hold several hundred million dollars liquid for future purchases.

The company raised money from endowments through three private real estate funds – HEI Hospitality Funds I, II, and III. In part, HEI's success in attracting campus investors might be attributed to the way in which it claimed to align its investment strategy with that of endowments. The company's executives claimed to have “uniquely aligned interests”<sup>v</sup> with their investors. Playing to the argument that endowments can take a very long view to investment returns, HEI describes itself as a “long-term” investor (with an 8 to 12 year investment horizon), “patiently wait[ing] for the optimal time to invest and sell”<sup>vi</sup>.

Despite HEI's claims to have created “an efficient, risk-averse business model designed to grow at an unprecedented, disciplined rate,”<sup>vii</sup> many of the company's acquisitions seem to have been ill-timed. Funds I and II, in particular, purchased most of their assets just as hotel prices were spiking, in 2005-2007 (see chart).

Because of confidentiality agreements signed as a condition of participating in these funds, no university has yet disclosed the actual performance of its investment in HEI. Nevertheless, a look at some of HEI's acquisitions hints at what has happened to their values.



For example, the company purchased the Le Meridien hotel in San Francisco near the peak of the real estate bubble, in May 2006. HEI paid close to \$129 million for the hotel (more than \$350,000 per room, and one of the highest prices ever paid for a hotel in that city), and also leveraged the property with over \$99 million in debt. Since that time, asset prices have cratered. In September 2009, HEI reported to the City & County of San Francisco that the assessed value of the property was just \$43 million.<sup>viii</sup> And in December, the San Francisco Business Times reported the property was either in the early stages of default or had been referred to a special servicer.<sup>ix</sup>

Other hotels acquired by HEI's funds have also experienced similar difficulty. The company has stated the value of its Embassy Suites hotel in Irvine is \$40 million<sup>x</sup> – far less than the \$55 million it paid in June 2006<sup>xi</sup>. And the recently-opened W Hotel and Residences in Los Angeles has struggled with sales of condominiums far below levels anticipated when the company bought into the project.<sup>xii</sup>

## Locked in

We do not know precisely how the drop in HEI's real estate valuations has affected its endowment investors. However, HEI's funds are just the sort of investment that has attracted attention from critics of universities' headlong leap into private equity placements. The HEI Funds' business model comes with many of the characteristics that have wrought havoc on university budgets: illiquid and risky real estate assets; long-term commitments (for example, Brown University reports a contractual commitment through 2020)<sup>xiii</sup>; prohibitive conditions to limit withdrawal of funds; and shares that are tradable only on secondary markets, if at all.<sup>xiv</sup>

As a consequence, capital that is locked up in funds like HEI cannot easily be drawn upon when the university needs cash most urgently. Harvard, for example, has had such difficulty meeting capital commitments to its various investments that in February 2010 it expressed interest in selling any part of its real-estate assets and accompanying future capital commitments. The Wall Street Journal, however, points out that Harvard may have a hard time unloading these investments because "a number of its investment funds were launched around the top of the market, and they have been hit hard in the downturn."<sup>xv</sup>

When assets purchased during the peak years of 2005-07 will regain their original value is unknown. However, it is difficult for us to imagine that HEI's Funds I and II will deliver the level of returns that endowments were anticipating when they entered into those investments. Restrictive partnership agreements mean that it is not easy for a university to revisit its decision to place millions in these funds – whether for the purpose of rebalancing an endowment's portfolio, or for the purpose of liquidating much-needed cash for campus budgets.

Ironically, while universities have confronted a liquidity crisis as a result of private equity investments, HEI's Fund III has experienced the opposite dilemma. Having raised over \$500 million from endowments in early 2008, HEI didn't purchase any new hotels with those funds until late in 2009. As HEI's President, Steve Mendell stated: "We were fortunate we raised the money before the crash occurred in the market so that was good news, but we did find that once we had the money, there was a big gap between what sellers would accept for their properties and what we were willing to pay. So we basically did almost nothing in '08 and just in the latter part of '09 we did buy two hotels."<sup>xvi</sup>

### HEI Hotel Funds

#### HEI Hospitality Fund L.P. ("Fund I")

Year established:	2004
Equity commitments:	\$274,300,000
Additional debt:	\$525,000,000 (approx)
Acquisitions to date:	12 hotel properties
Major (10%+) investors:	Yale University Harvard University

#### HEI Hospitality Fund II L.P. ("Fund II")

Year established:	2006
Equity commitments:	\$425,000,000
Additional debt:	\$1,100,000,000 (approx)
Acquisitions to date:	14 hotel properties
Major (10%+) investors:	Yale University Harvard University Princeton University

#### HEI Hospitality Fund III L.P. ("Fund III")

Year established:	2008
Equity commitments:	\$515,350,000
Additional debt:	\$1.0 - \$1.5 billion (expected)
Acquisitions to date:	2 hotel properties
Major (10%+) investors:	Yale University Princeton University University of Chicago

## Beyond the Campus Gate

The effects of such an investment model extend far beyond the campus gates. Under pressure to boost returns to investors, HEI has been very focused on minimizing operating costs and to offload certain costs to local governments. This in turn has sparked opposition from hotel workers, university students, and others.

Workers at several HEI properties have testified to the company's practice of cutting back staffing levels and increasing workload for those who remain – in some cases as much as doubling the number of rooms housekeepers must clean daily. In an industry that is already physically demanding,<sup>1</sup> this could have serious results. A survey at one HEI property (the Sheraton in Crystal City, VA), found 100% of housekeepers reported work-related pain, and 80% reported suffering serious work-related injury.

HEI employees have also reported that the company has cut inventories of basic cleaning supplies and equipment. At the Hilton in Long Beach, CA, for example, workers recently petitioned management to buy the bare minimum level of supplies needed to perform their jobs – even going so far as to offer to raise funds themselves to help buy linens and cleaning supplies. Workers in that city have also spoken publicly about having to resort to government assistance in order to make ends meet for themselves and their families.

Workplace issues like these have led many HEI workers to demand publicly that the company change its operational practices – particularly with respect to the process by which workers would decide whether to join a union. The company has spend a considerable sum – nearly \$100,000 in 2008 alone – to retain consultants for the purpose of avoiding unionization<sup>xvii</sup>. And in recent months, the Office of the General Counsel of the National Labor Relations Board (the federal agency charged with overseeing employment relations) has issued a complaint alleging that HEI made unlawful threats against pro-union workers.

As a result of these business practices, workers at three HEI properties have called on customers to boycott their hotels until the dispute is resolved – leading numerous customers to relocate their events elsewhere. Moreover, students at nearly a dozen HEI-invested campuses have rallied to workers' support, and called on endowments to intercede. In February, President Ruth Simmons of Brown University took the unusual step of writing to HEI to express her institution's concern about the company's behavior.

***“We remain concerned about actions of management that may be seen to infringe upon the rights of workers”***

Ruth J. Simmons  
President, Brown University

In addition to cutting operating costs, HEI has sought public assistance boosting returns for its investors. For example, HEI approached the Community Redevelopment Agency of Los Angeles late in 2009 seeking \$16 million in public funds to make up for shortfalls in sales of condos at the W Hotel & Residences in Hollywood.<sup>xviii</sup> In other municipalities (such as San Francisco), HEI has sought significant reductions in property tax assessments, which if approved would have untoward effects on local government budgets.

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<sup>1</sup> A study by Dr. William Marras, Professor and Director of the Institute for Ergonomics at Ohio State University, found that risk of injury from the hotel housekeeping job is greater than any of the 20 manufacturing jobs—including auto and truck assembly—that he also studied.

## A New Perspective on Endowment Activism

In 2008, students at numerous universities began a campaign to demand that HEI Hotels change its business practices, particularly around the question of workers' rights. With the onset of campus budget crises, however, this campaign has taken on new urgency. Activists working on the HEI campaign have recognized that some of the same investment decisions that led universities to place hundreds of millions in the trust of HEI also led to disaster for their own academic institutions.

At Brown University, students have organized an "Open the Books Coalition" to press for greater transparency and accountability from the school's endowment. At Yale, the Responsible Endowments Project is likewise pressing for transparency, while graduate students are challenging the steep budget cuts that administrators have implemented in response to endowment declines. Similar student organizing efforts are occurring in numerous other HEI-invested universities, including Princeton, Harvard, University of Chicago, Notre Dame, University of Pennsylvania, Vanderbilt University, and elsewhere.

It remains to be seen what these organizing efforts will mean for endowments, and for companies such as HEI Hotels. It is clear, however, that the student movement calling for investment transparency and responsibility is gaining strength and urgency - fuelled by both awareness of workers' rights issues in such companies, and the impact of risky, private equity investments on campuses where they study and work. This new twist on student activism could herald a silver lining to the crisis that today confronts institutions of higher education.

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### Who We Are:

Formed in 1997, United Students Against Sweatshops (USAS) is a grassroots organization of youth and students who believe that a powerful and dynamic labor movement will ensure greater justice for all people. We use our unique roles of students as consumers, workers, and members of the campus community to win victories that set precedents in the struggle for self-determination of working people everywhere, particularly campus workers and garment workers who make collegiate licensed apparel.

[www.usas.org](http://www.usas.org)

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<sup>i</sup> 2009 NACUBO-Commonfund Study of Endowments

<sup>ii</sup> "Yale's Swensen Model Unbroken by 30% Endowment Drop, Levin Says," Bloomberg, 7/16/2009

<sup>iii</sup> See: Wall Street Journal (2/25/2009; 2/17/2010); Business Week (1/9/2010); Forbes (3/16/2009); The Daily Princetonian (December 2009).

<sup>iv</sup> SEC Form D: HEI Hospitality Fund LP; HEI Hospitality Fund II LP; HEI Hospitality Fund III LP.

<sup>v</sup> [http://www.heihotels.com/managed\\_funds/strategic\\_partners.cfm](http://www.heihotels.com/managed_funds/strategic_partners.cfm) (2/23/2010)

<sup>vi</sup> [http://heihospitality.com/about\\_us.htm](http://heihospitality.com/about_us.htm) (6/25/2007)

<sup>vii</sup> [http://www.heihotels.com/about\\_us/growth.cfm](http://www.heihotels.com/about_us/growth.cfm) (2/23/2010)

<sup>viii</sup> City and County of San Francisco, Assessment Appeals Board (9/12/2009).

<sup>ix</sup> San Francisco Business Times, December 11 2010: "Four Seasons close to foreclosure"

<sup>x</sup> Orange County Property Assessment Appeals, HEI Irvine LLC (9/1/2009).

<sup>xi</sup> "Slightly Fewer Orange County Hotels Sold Last Year," Orange County Business Journal, 3/19/2007.

<sup>xii</sup> Stephen Mendell, 11/24/2009.

<sup>xiii</sup> Correspondence from Brown Investment Office.

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- <sup>xiv</sup> “Valentines for Labor Rights,” The Daily Pennsylvanian, 2/16/2010.
- <sup>xv</sup> “Harvard Tests Market for Its Property Bets,” Wall Street Journal, 2/17/2010.
- <sup>xvi</sup> Interview with Jeff Higley, Hotel News Now (2/4/2010)
- <sup>xvii</sup> Merritt Hospitality LLC, LM-10 (2008).