

NORTH CAROLINA
DEPARTMENT OF STATE TREASURER



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INVESTMENT MANAGEMENT DIVISION

Real Estate Update

May 20, 2020



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Real Estate Team

Troy March, CCIM, MBA
Director of Real Estate

7 Years with IMD
18 Years Industry Experience

Tinh Phan, Licensed Broker
Portfolio Manager

7 Years with IMD
20 Years Industry Experience

Jack Wilson, CFA, CAIA
Analyst

2 Years with IMD
4 Years Industry Experience



Real Estate Sector Analysis

Risk: ● Higher ● Medium ● Lower

● Data/Cell Tower	<ul style="list-style-type: none"> • WFH technology, e-commerce, home entertainment, low-staffing requirements • 5G adoption
● Industrial	<ul style="list-style-type: none"> • Home delivery/e-commerce/e-grocery - higher demand for cold storage • More inventory buffer, less JIT, thus increasing warehouse space demand
● Multifamily	<ul style="list-style-type: none"> • Necessity-based • Housing shortage, high occupancy going into downturn, unlike GFC
● Self-Storage	<ul style="list-style-type: none"> • Need for temporary storage: retailers, students • Resilient in crisis, performs through the cycle
● Office	<ul style="list-style-type: none"> • Slower leasing, impact to small businesses • Impact to markets/assets with exposure to co-working, energy and tourism
● Student Housing	<ul style="list-style-type: none"> • Campuses closing and structural changes with remote learning • Significant operational challenges remain
● Senior Housing	<ul style="list-style-type: none"> • Properties are on lockdown to protect residents • Labor and supply challenges compounding issues
● Retail	<ul style="list-style-type: none"> • Neighborhood, necessity based retail likely more resilient • Struggling malls and apparel-based retail facing further pressure
● Hotel	<ul style="list-style-type: none"> • Travel restrictions, stay-at-home mandate • Widespread shutdowns and layoffs



Role and Objectives

Core Thesis

“To generate durable income and stable returns through strategic investments, with prudent use of leverage, in assets with long-term fundamental drivers that will endure for generations”

Investment Strategy
High Quality
Well-Located
Strong Risk-Adjusted Returns

Non-Core Thesis

“To achieve attractive risk-adjusted net returns through appreciation and income from a diversified portfolio, planning for strategic exit optionality”

Core

Inflation hedge

High current income

Stabilized occupancy

Credit tenancy

Long-term return > fixed income

Minimal risk/downside protection

Non-Core

Growth diversifier

Opportunity to add value

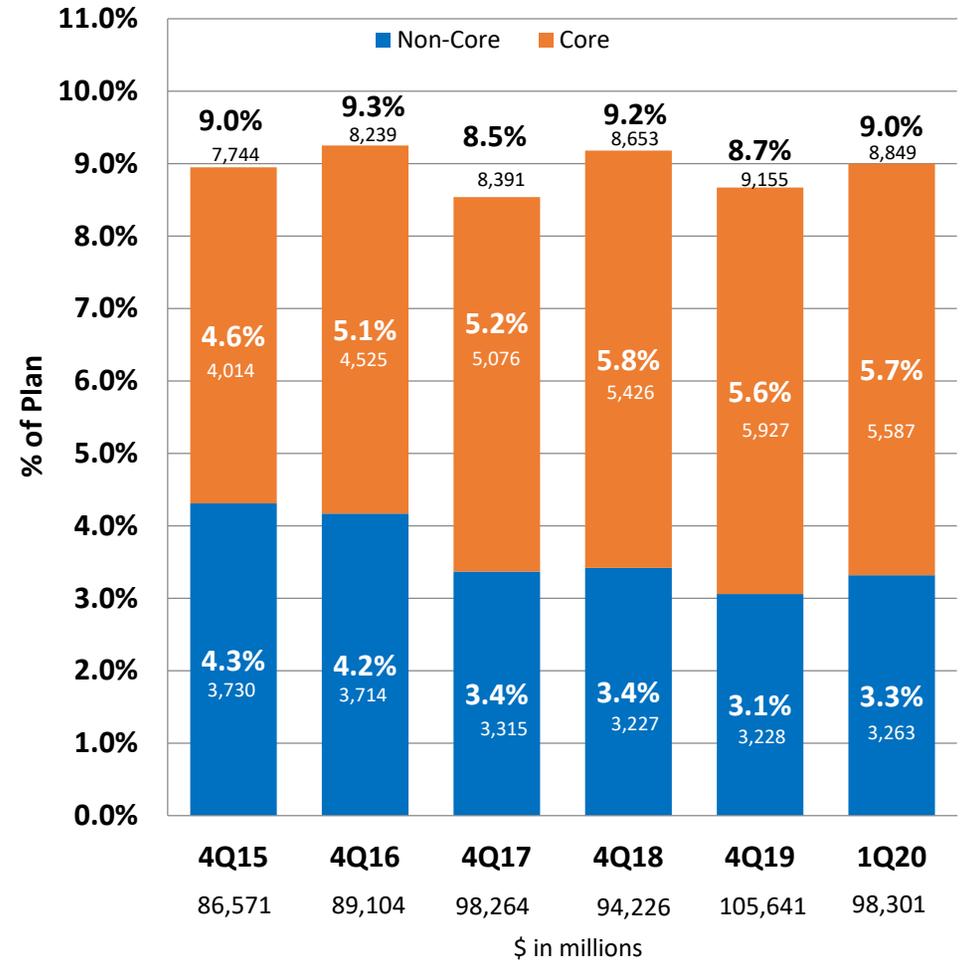
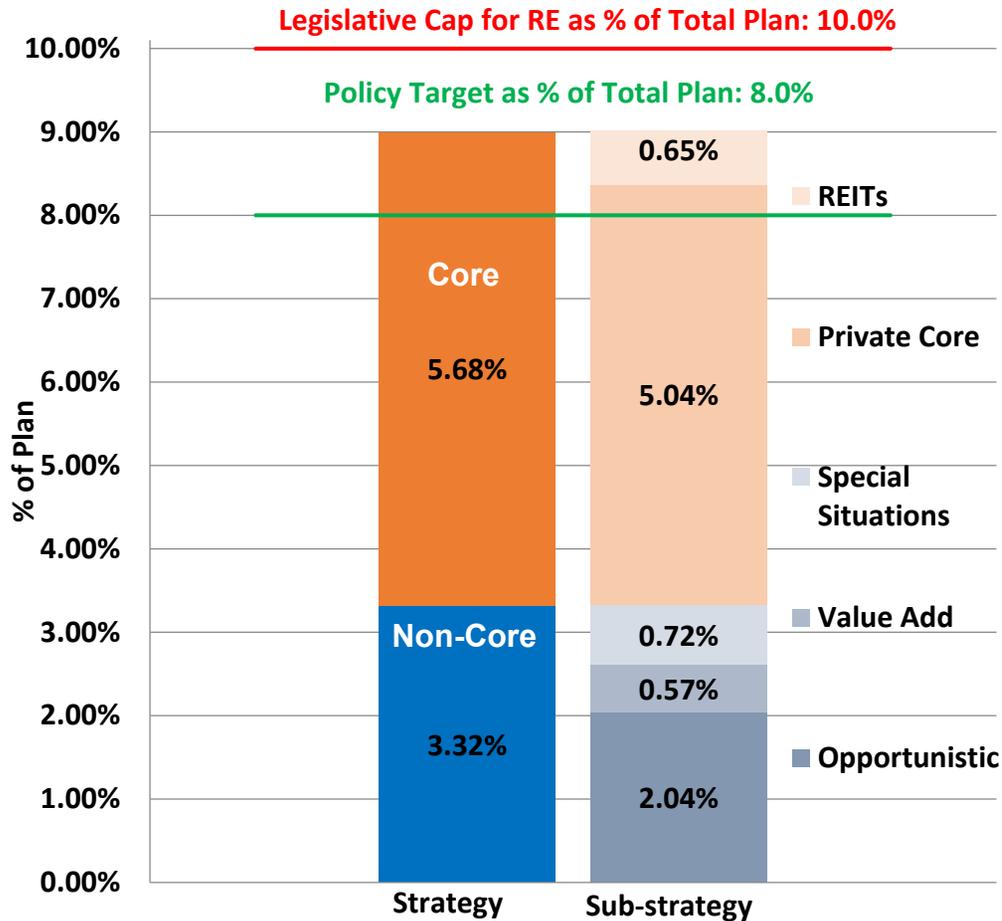
Renovation, development, leasing

Stabilized upon completion

Long-term appreciation and returns

Low correlation to fixed income

Real Estate Allocation

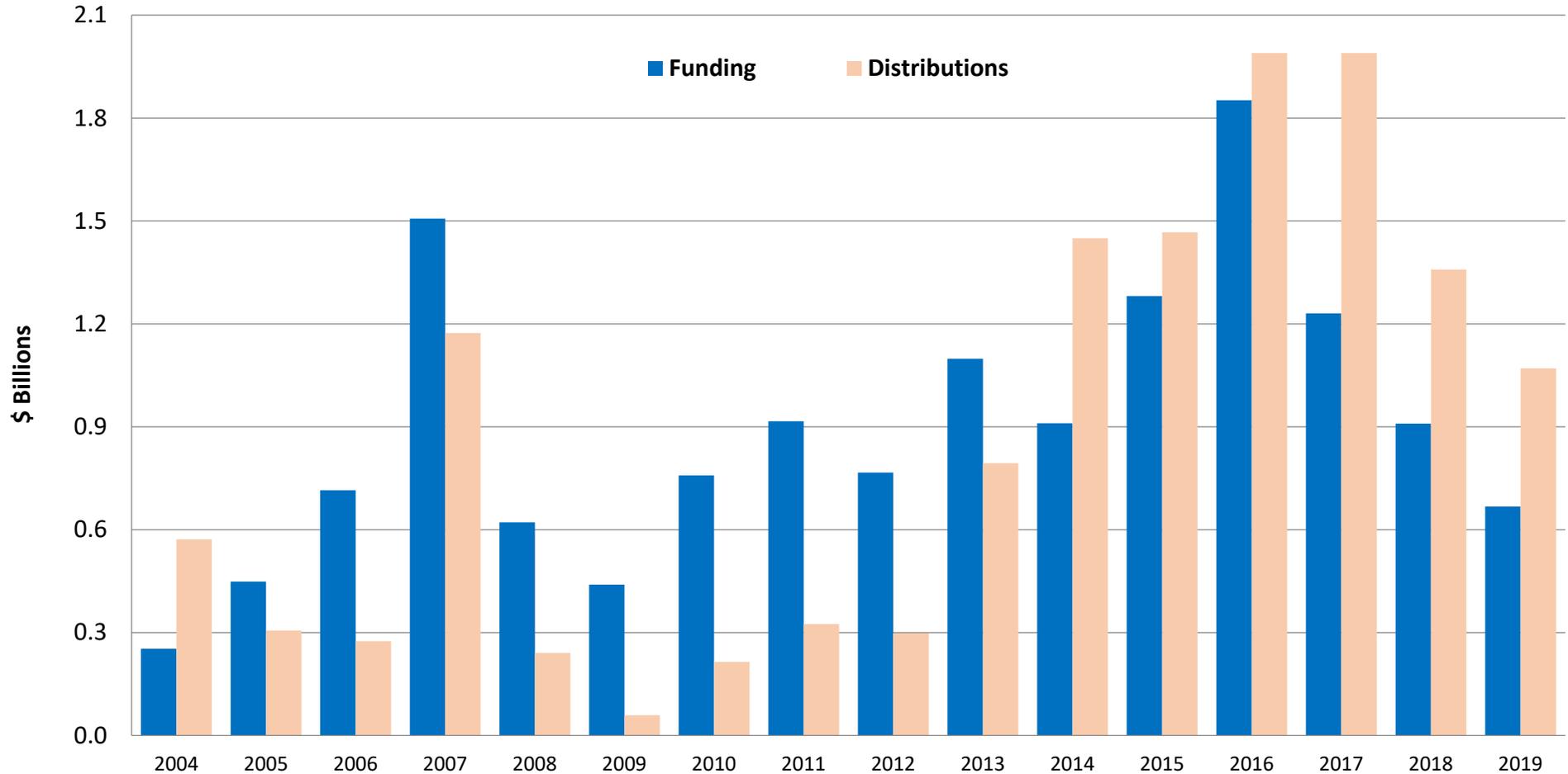


NCRS data as of 3/31/2020
Special Situations – Build-to-Core Strategy

As a defensive measure in anticipation of the end of the cycle, we increased exposure to Core from 44% to 65%



Real Estate Cash Flow



Commitments (\$M):	430	1,567	1,077	1,641	1,057	0	653	1,052	695	1,417	1,769	1,367	2,265	0	300	300
(Vintage)*																

NCRS data through 12/31/2019

*Commitments are considered "Vintage" the year in which the first \$ of capital is drawn

Net distributions for 2019 were \$403 million. 2020 YTD (as of 4/24), contributions were \$75 million and distributions totaled \$314 million

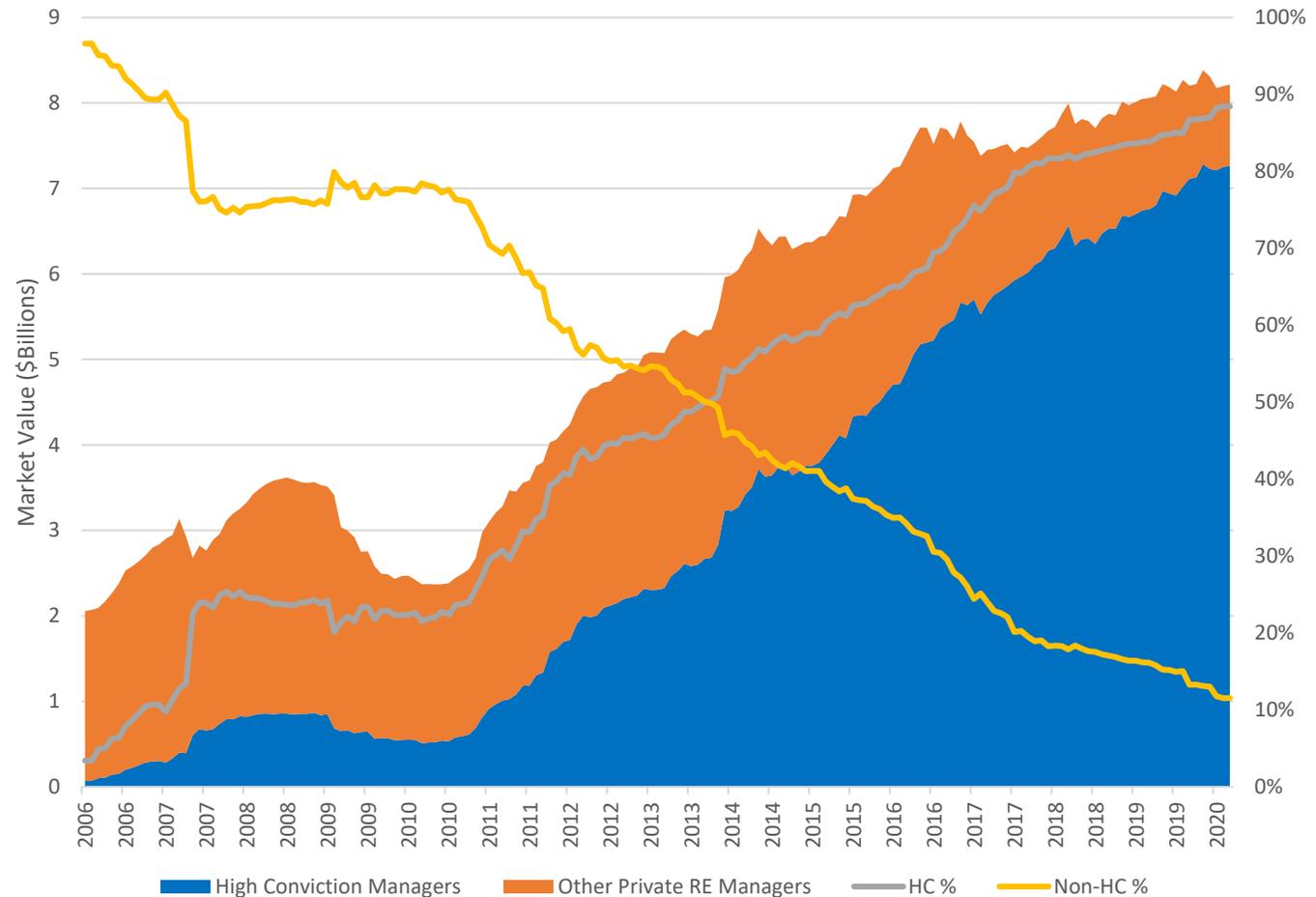


Manager Concentration (excludes REITs)

Contribution to Return			
	3 Year	5 Year	7 Year
Private Core	7.8	8.4	9.3
High Conviction	6.2	5.6	5.1
Others	1.6	2.8	4.2
Non Core	11.8	12.5	13.7
High Conviction	9.9	10.5	10.8
Others	1.9	2.0	2.9

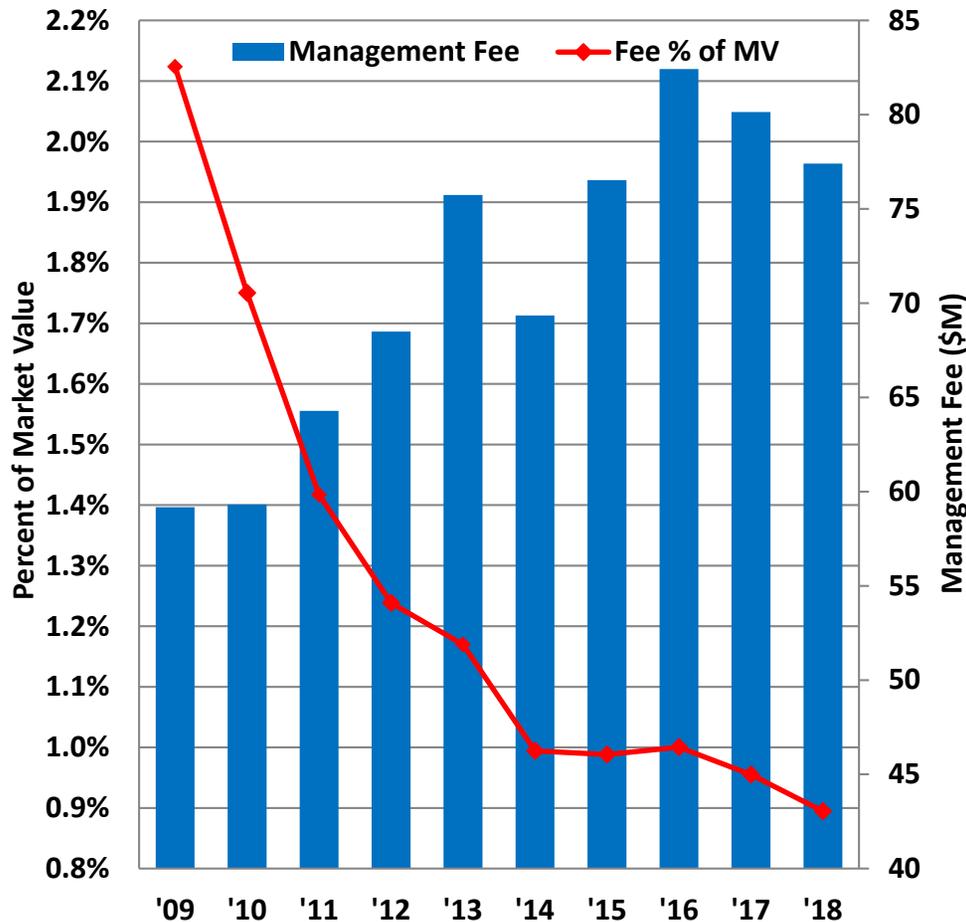
* "High Conviction" Managers are identified by the Real Estate Team as General Partners with the highest probability of meeting/exceeding expected fund-level returns

NCRS data through 3/31/2020

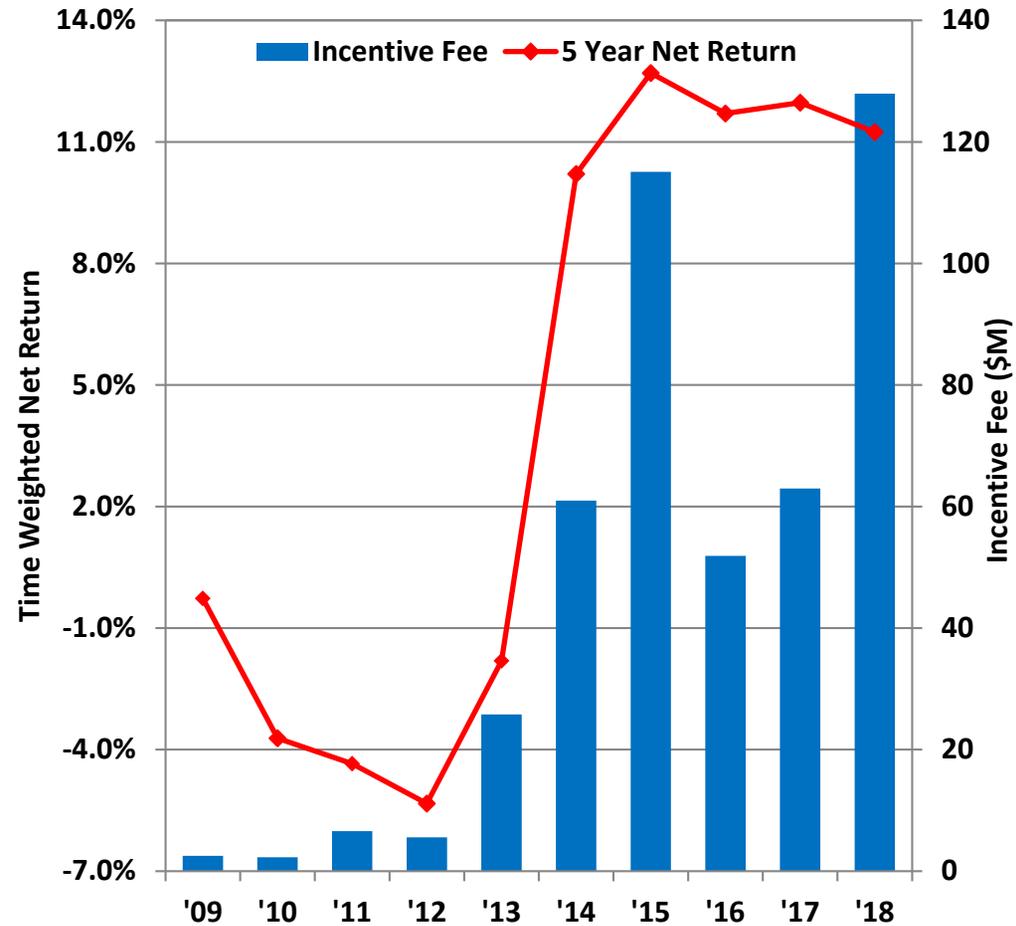


88% of private market value is with high conviction managers –
Concentration helps reduce complexity and fees, increases transparency and maximizes returns

Cost Efficiency



NCRS data through 12/31/2018



2015: Convergence of delayed realization of GFC funds, early realization of post-GFC funds, and an Industrial manager selling their entire platform

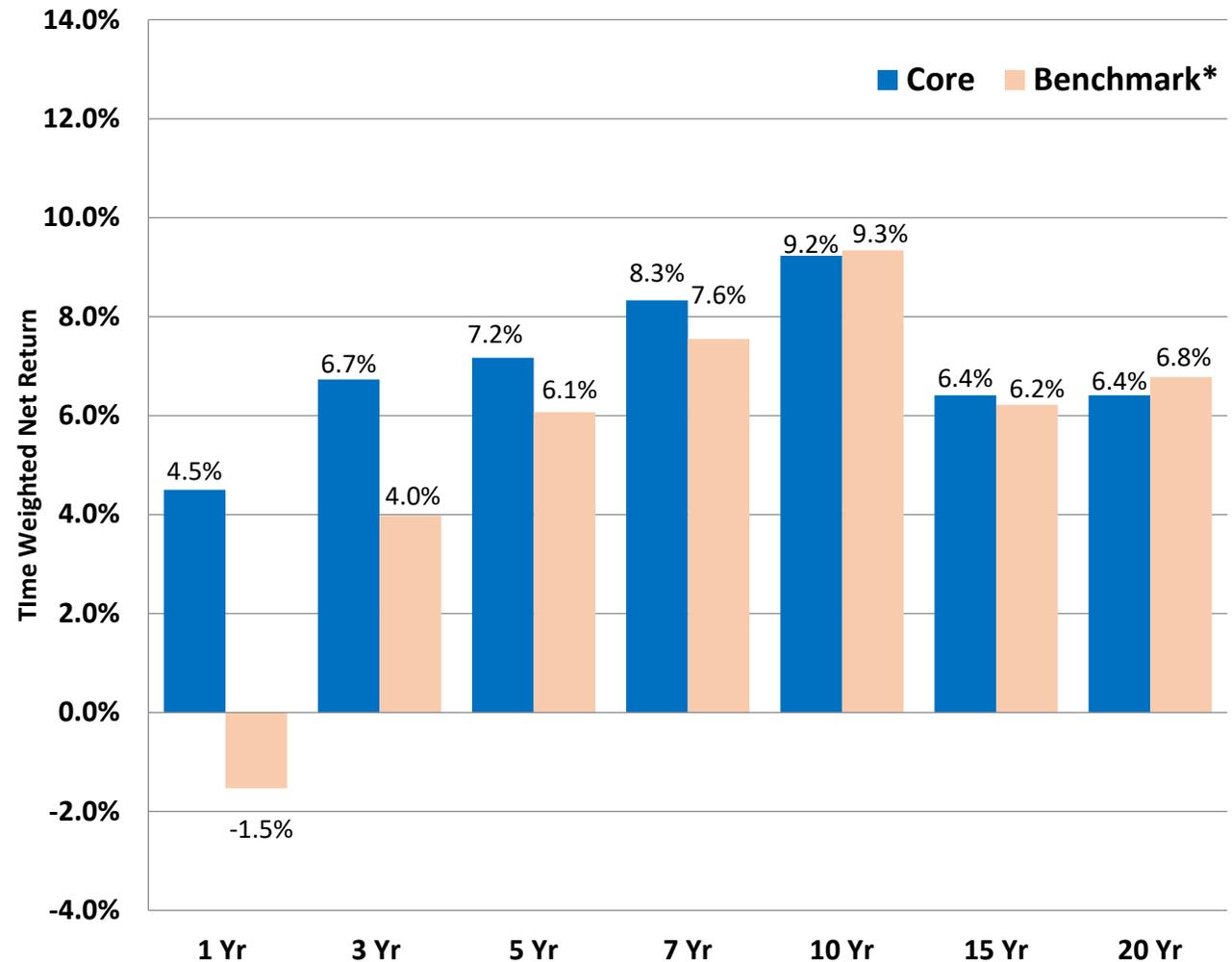
2018: Realization of a large, successful, platform investment

Leverage relationships and scale to minimize costs and enhance alignment



Performance: Core Real Estate

Core Contribution to Return		
3 Year	Contribution	
Private Core RE	6.5	
REITs	0.2	
Total Core	6.7	
<u>Major Drivers</u>	<u>Vintage</u>	
PC NorthRock Core	2008	1.3
PC NorthRock IV	2015	0.8
LBA NC Core		
PC Industrial	2016	0.7
5 Year		
	Contribution	
Private Core RE	7.0	
REITs	0.2	
Total Core	7.2	
<u>Major Drivers</u>	<u>Vintage</u>	
PC NorthRock Core	2008	1.4
PC BREP Edens	2013	0.9
PC JPM SPF	1989	0.8



NCRS data through 3/31/2020

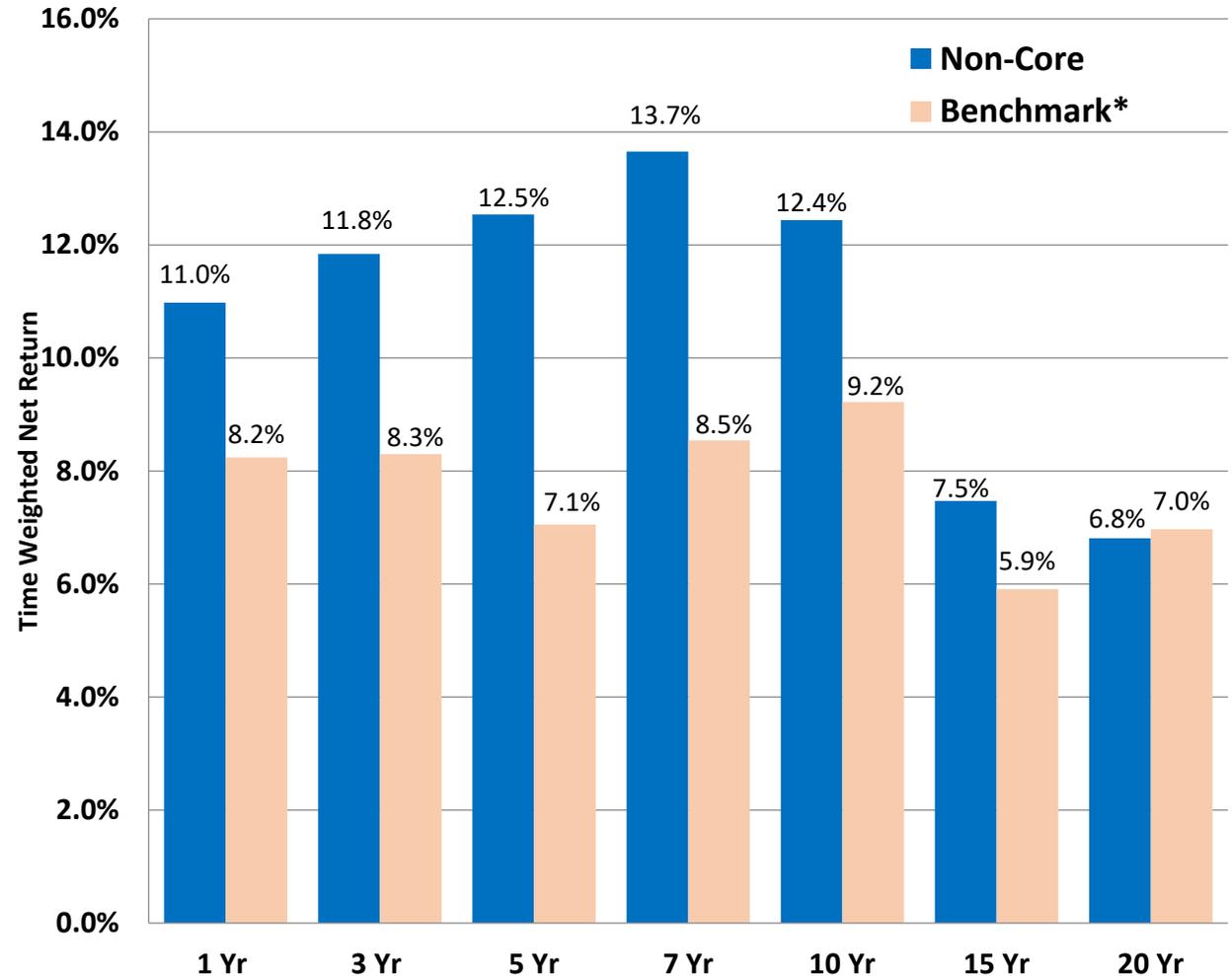
* The Core Real Estate Benchmark is comprised of 80% NCREIF ODCE Net and 20% FTSE EPRA NAREIT Global Index.

Private Core outperformed its benchmark by 456 bp for the one-year period, led by strong performance in separate account investments



Performance: Non-Core Real Estate

Non-Core Contribution to Return		
3 Year	Contribution	
Opportunistic	8.2	
Value Add	3.7	
Total Non-Core	11.8	
<u>Major Drivers</u>	<u>Vintage</u>	
O NorthCreek	2011	1.5
O BREP Europe IV	2013	1.2
V DRA GIF VII	2011	0.9
5 Year		
	Contribution	
Opportunistic	8.1	
Value Add	4.5	
Total Non-Core	12.5	
<u>Major Drivers</u>	<u>Vintage</u>	
O NorthCreek	2011	2.0
V NorthRock II	2012	0.9
O BREP VII	2011	0.9



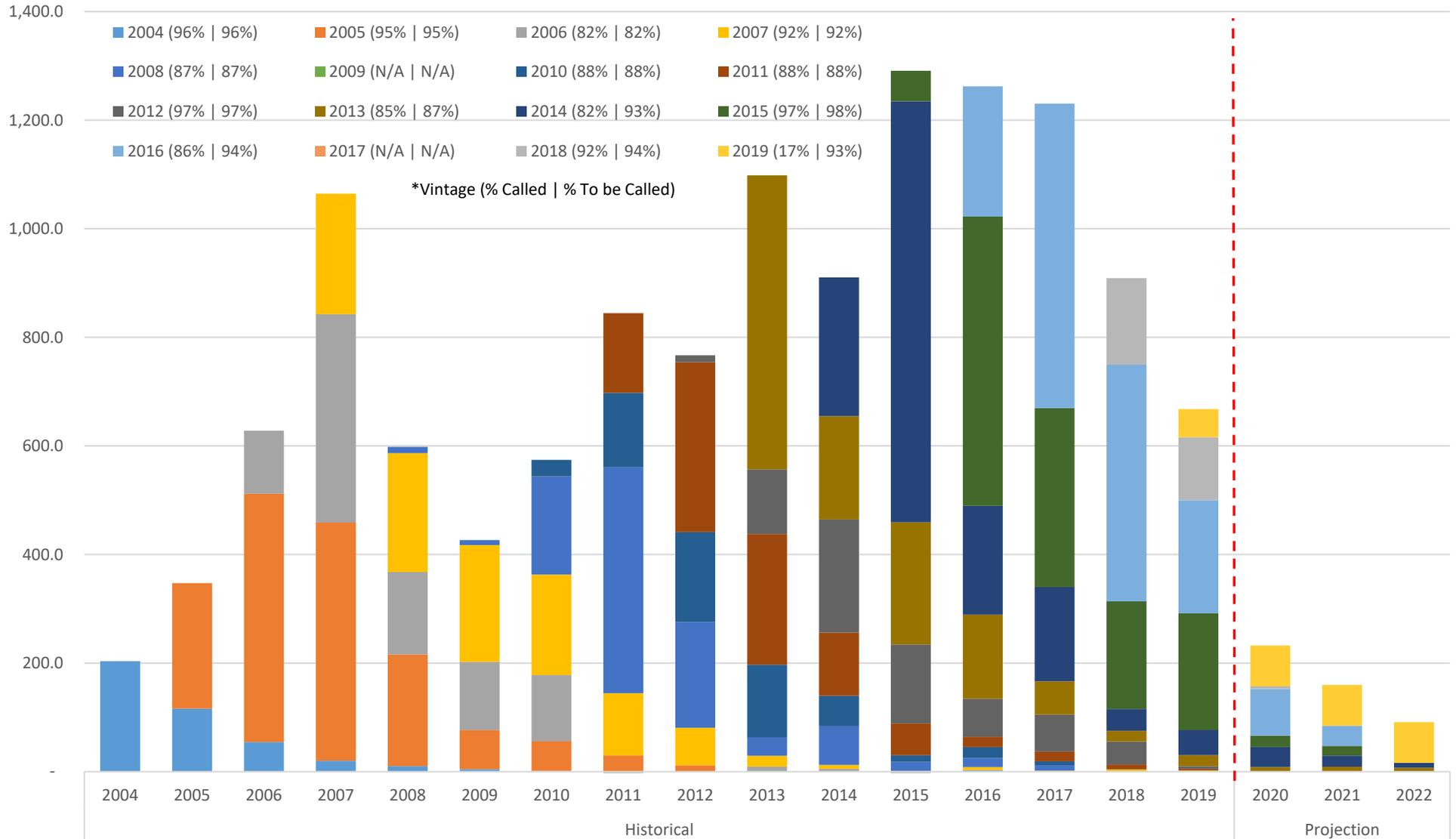
NCRS data through 3/31/2020

* Non-Core Real Estate Benchmark is comprised of the following Burgiss Group Private iQ indices: 80% U.S. Non-Core Real Estate (Opportunistic and Value-Added) and 20% Non-U.S. Non-Core Real Estate (Opportunistic and Value-Added).

Non-Core portfolio continues to outpace the benchmark by a significant margin but will contribute less to the overall pension plan going forward as it shrinks in absolute and relative size



Unfunded Commitment Pacing by Vintage Year (excludes REITS)



Of the \$1.3 billion in unfunded commitments at 2/29/20, we project ~\$500 million will be called by 2022 and ~\$600 million will be held as reserves and is unlikely to be called



Investment Strategy Initiatives

- Continued focus on high conviction managers and reducing manager count
- Minimize costs and maximize returns by favoring partnership structures that optimize alignment of interests
- Increase exposure to public real estate through common and preferred equities
 - “Completion portfolio” concept for public REIT investment will help gain exposure to sectors where we are underweight and in which gaining diversified exposure is difficult
- Secondaries, both buying and selling through the secondary market
- Increase exposure to high growth sectors: Industrial, Data Centers, and Cell Towers
- Increase exposure to low capex sectors: Industrial, Multi-family, Self-Storage, and Manufactured Housing
- Decrease exposure to high capex and higher fee sectors: Office, Retail and Hotel



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Investment Approach

Stay the course with our investment strategy...do not reach for yield

- Downside protection
- Eye toward current income for Core or “speed to income” for Opportunistic strategies
- Moderate leverage levels

Use thoughtful & deliberate portfolio construction

- Stabilized Core portfolio
- Diversify by strategy, property sector, size, vintage year and location
- Balance asset risk and market risk by insisting on the highest asset quality and location
- Target specific submarkets and streets

Leverage the size of our plan & skill set of our team

- Better terms & fees
- More transparency and control
- Ability to move quickly to capitalize on opportunities & dislocations
- Be the founding investor for new strategies with high conviction managers

Invest meaningful amounts with fewer best-in-class managers

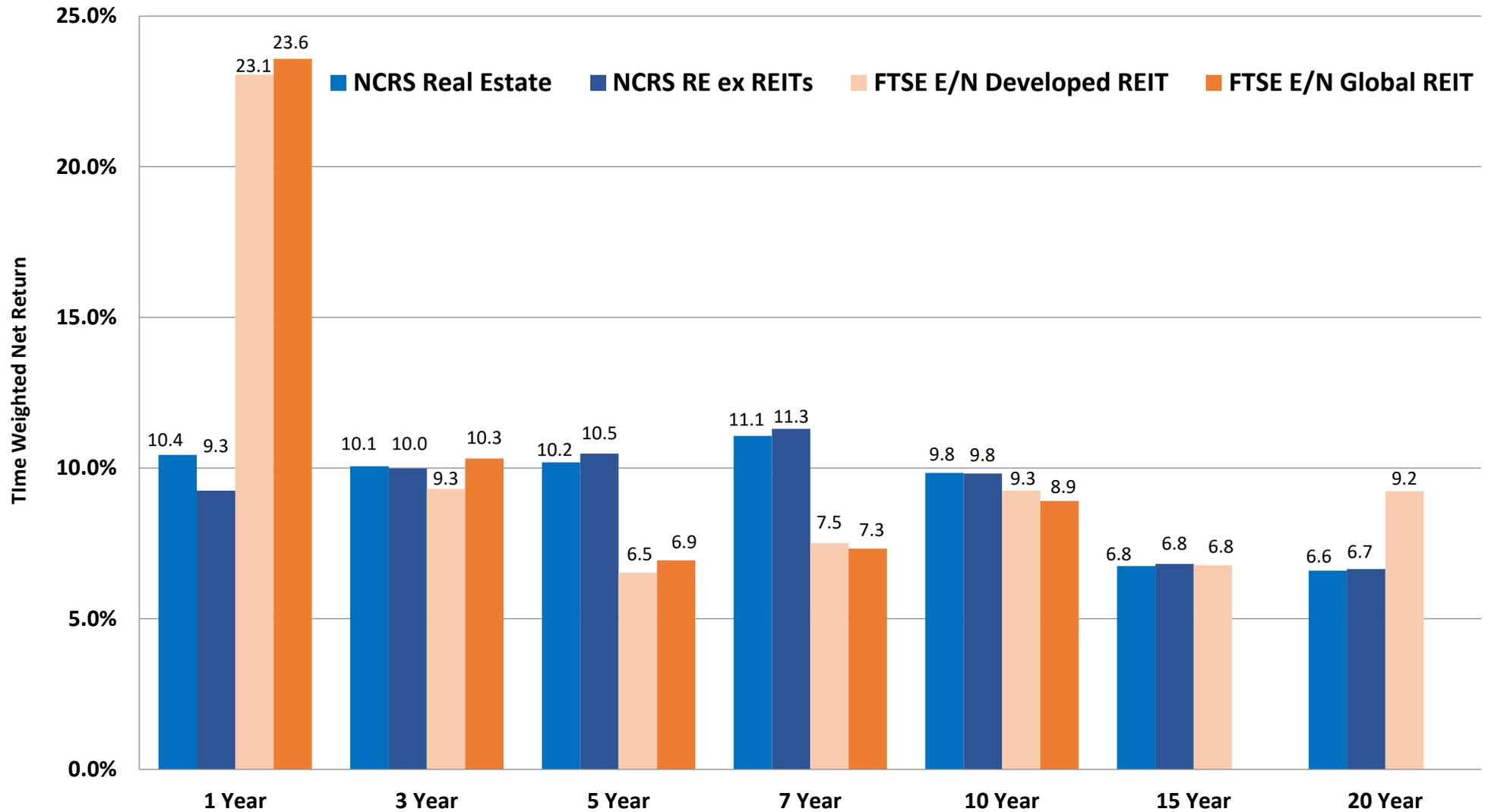
- Separate accounts
- Multiple strategies with single manager
- Fee benefits

Take a long-term view toward investments and manager relationships

- Be involved, nimble and follow through
- Deliver results
- Be a leader among Limited Partners



Performance: Total Real Estate vs. REITs as of 12/31/2019



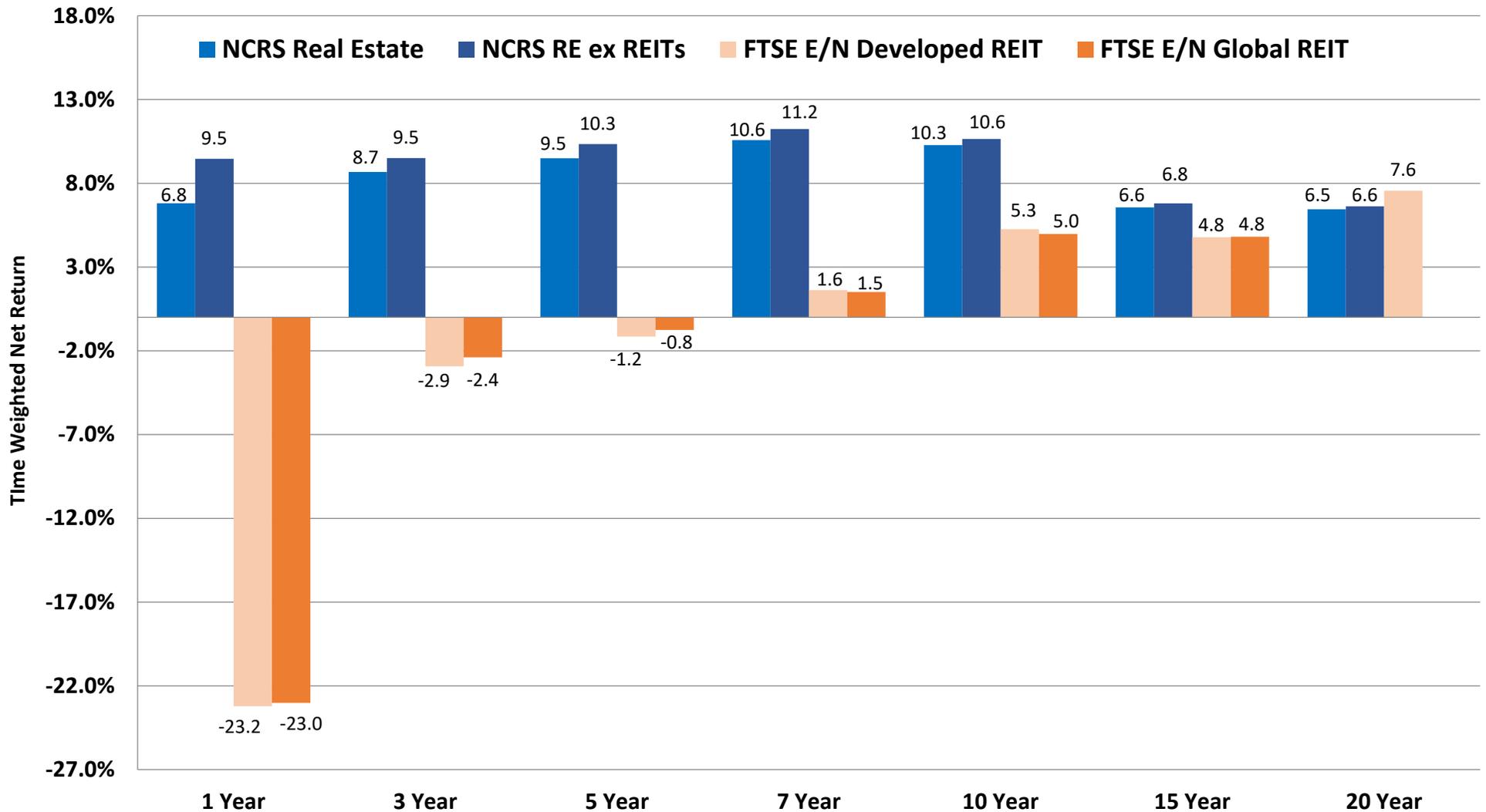
NCRS data through 12/31/2019

FTSE EPRA/NAREIT Developed Index: The index serves to represent real estate equities across developed markets of North America, Europe and Asia.

FTSE EPRA/NAREIT Global Index: The index is designed to track the performance of real estate equities in both developed and emerging markets.



Performance: Total Real Estate vs. REITs as of 3/31/2020



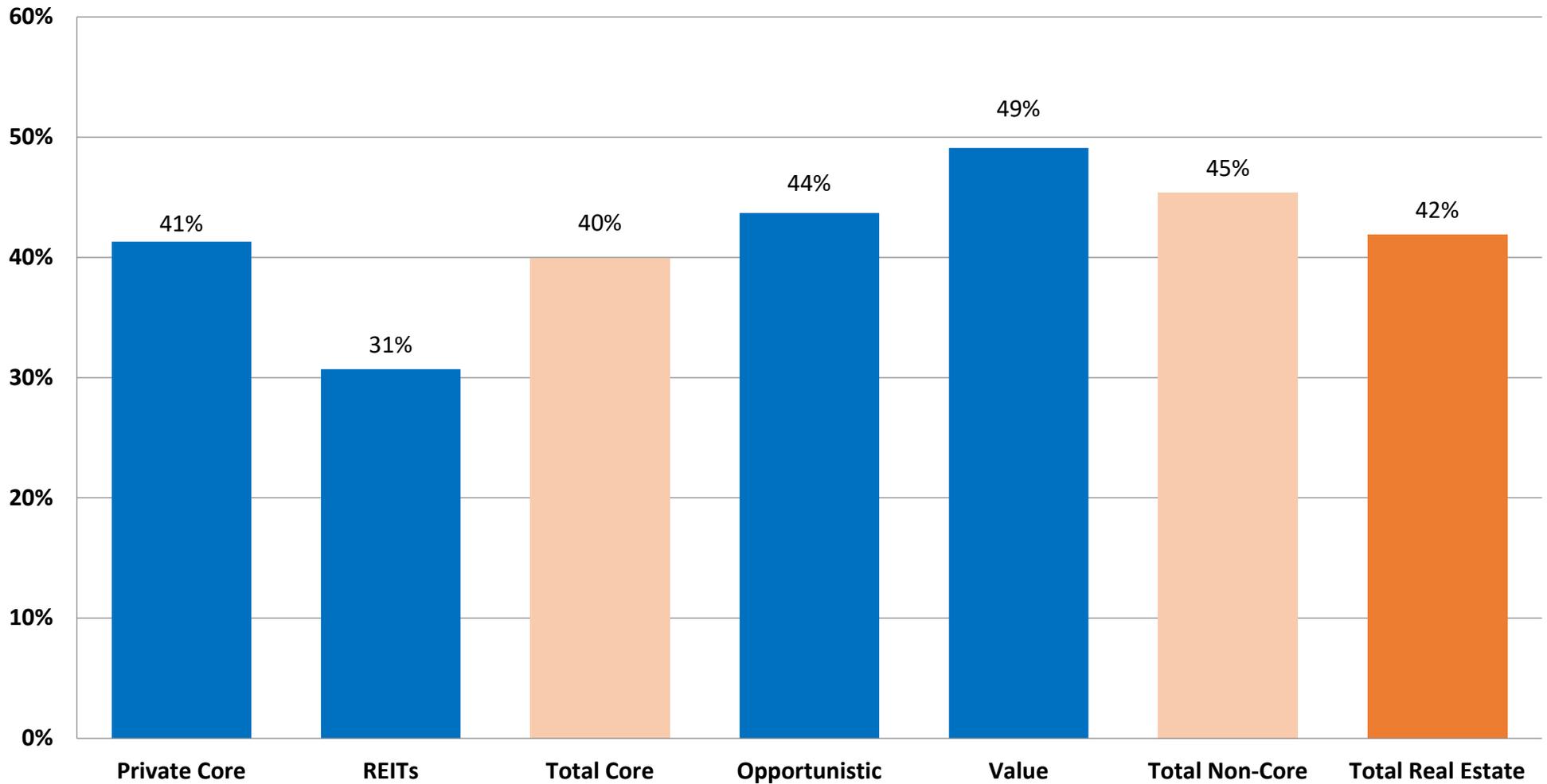
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Leverage

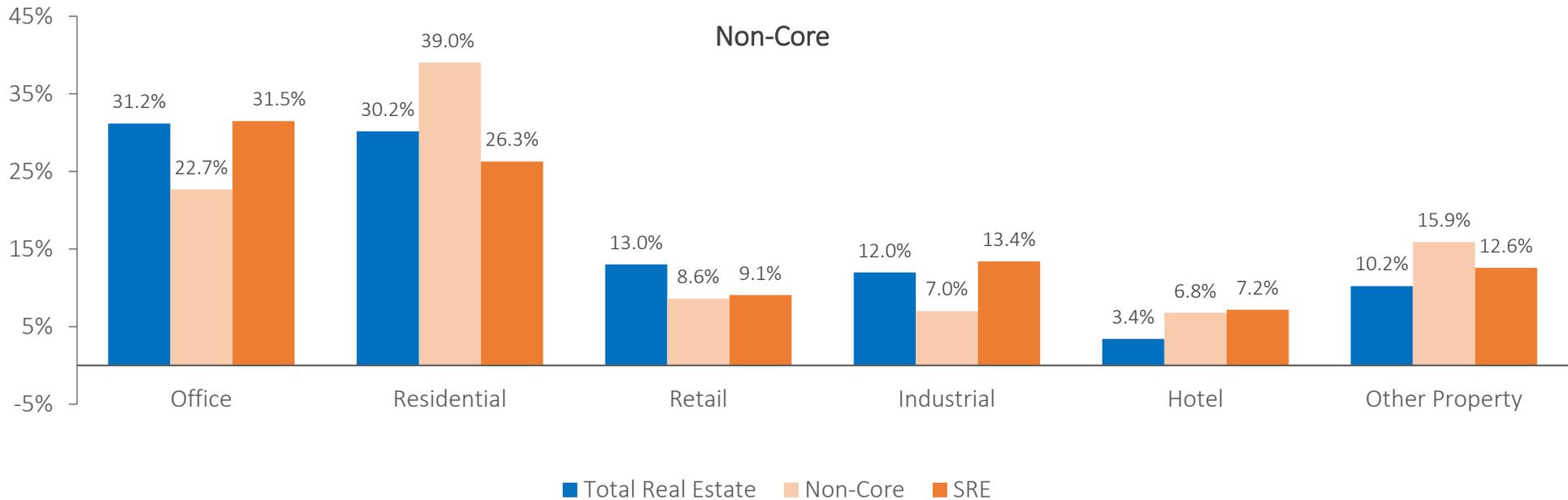
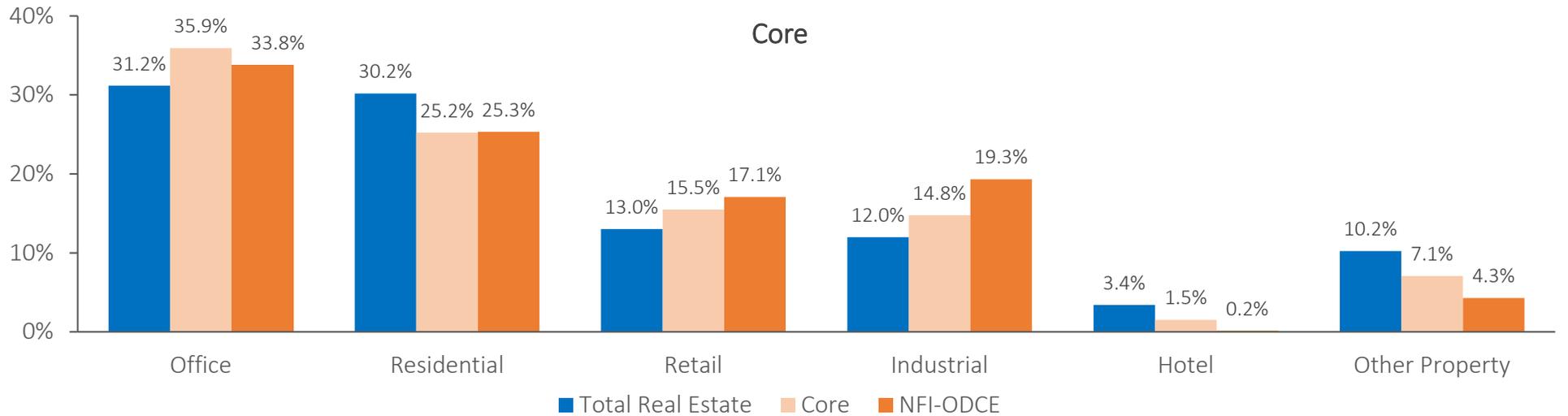


Source: Stepstone NCRS 3Q19 Portfolio Monitoring Report

Maintain prudent levels of leverage and retain ability to adjust through our separate accounts

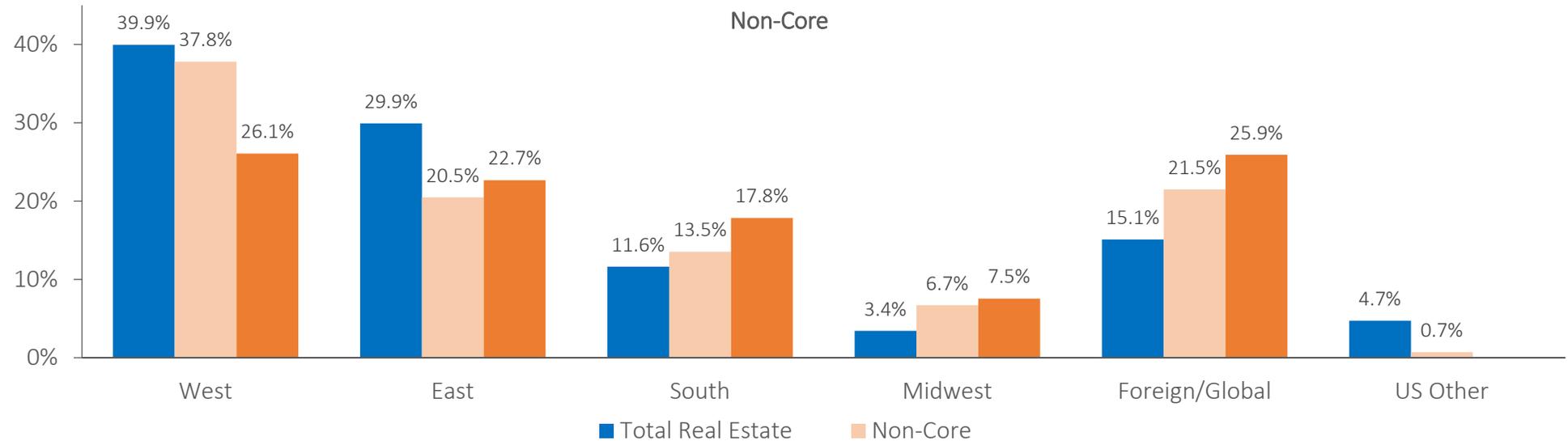
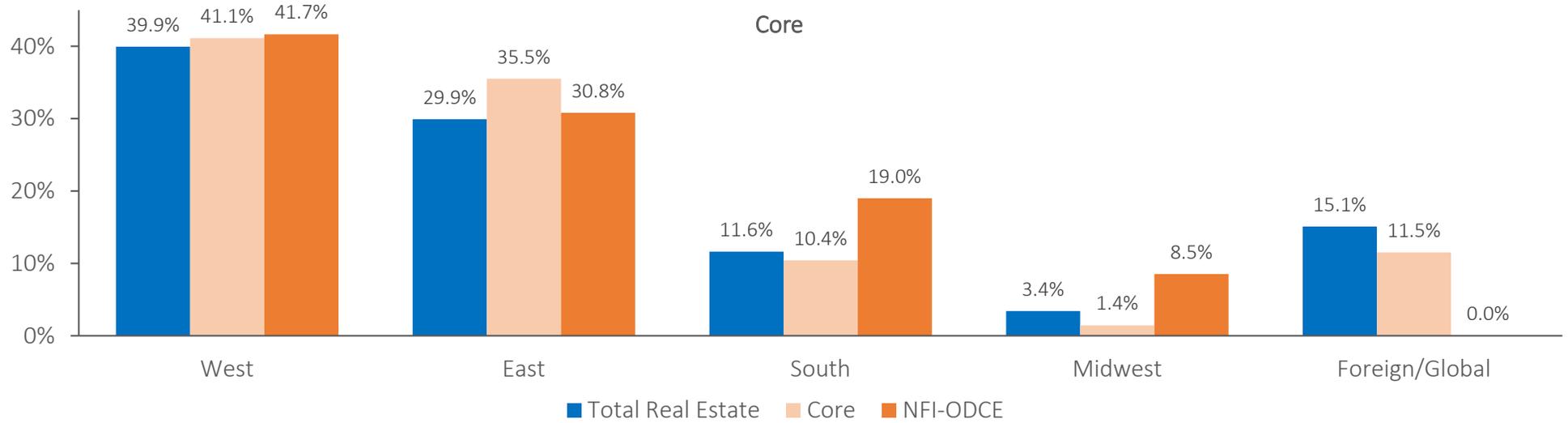


Property Type Diversification





Geographic Diversification





Example Investment Characteristics

Strategy	Total Gross Return	Distribution Income/Appreciation	Leverage
Core	7 - 9%	80/20	< 40%
Core Plus	9 - 11%	70/30	< 50%
Value-Add (Non-Core)	11 - 16 %	30/70	up to 60%
Opportunistic (Non-Core)	> 16%	10/90	up to 75%