

NORTH CAROLINA
DEPARTMENT OF STATE TREASURER



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INVESTMENT MANAGEMENT DIVISION

Real Estate Update

November 16, 2017



Agenda

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- III. Role and Objectives
 - Core and Non-Core Comparison
- IV. Real Estate Allocation
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 - Total Performance vs. REITs
 - Leverage
 - Example Investment Characteristics



Real Estate Team

Vacant
Director of Real Estate

Troy March, CCIM, MBA
Portfolio Manager

4.5 Years with IMD
16 Years Industry Experience

Tinh Phan, Licensed Broker
Portfolio Manager

4 Years with IMD
18 Years Industry Experience

Tessa Tanis, CPA, MSA
Portfolio Manager

2 Years with IMD
16 Years Industry Experience

Sean Incremona
Analyst

2 Years with IMD
2 Years Industry Experience/
7 Years Economist



Real Estate Market Conditions

- Growth moderated from strong levels, vacancy remains low
- Real Estate investment capital availability and pricing have held up despite reduced transaction volume
- Steady to slightly higher cap rates as income growth leads appreciation
- Debt is accessible to quality sponsors, terms are prudent

Multifamily

New completions are a near-term headwind for rent growth, but starts have slowed and long-term drivers of demand remain relevant.

Office

Maturing economic cycle and pockets of supply are having an impact on leasing, but income continues to be solid.

Retail

Challenging landscape from rise of e-commerce and evolving consumer preferences. Value is concentrated in high-quality, well-located assets.

Industrial

Top-performing sector underpinned by strong rent growth on robust demand for logistics and limited new supply, especially in the in-fill markets.

Hotel

Somewhat more balanced after dealing with pressure from elevated supply in recent years.

Other Niches

Student/senior housing and storage are producing attractive income returns. Market specific issues related to new construction and the pace of rent growth.

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

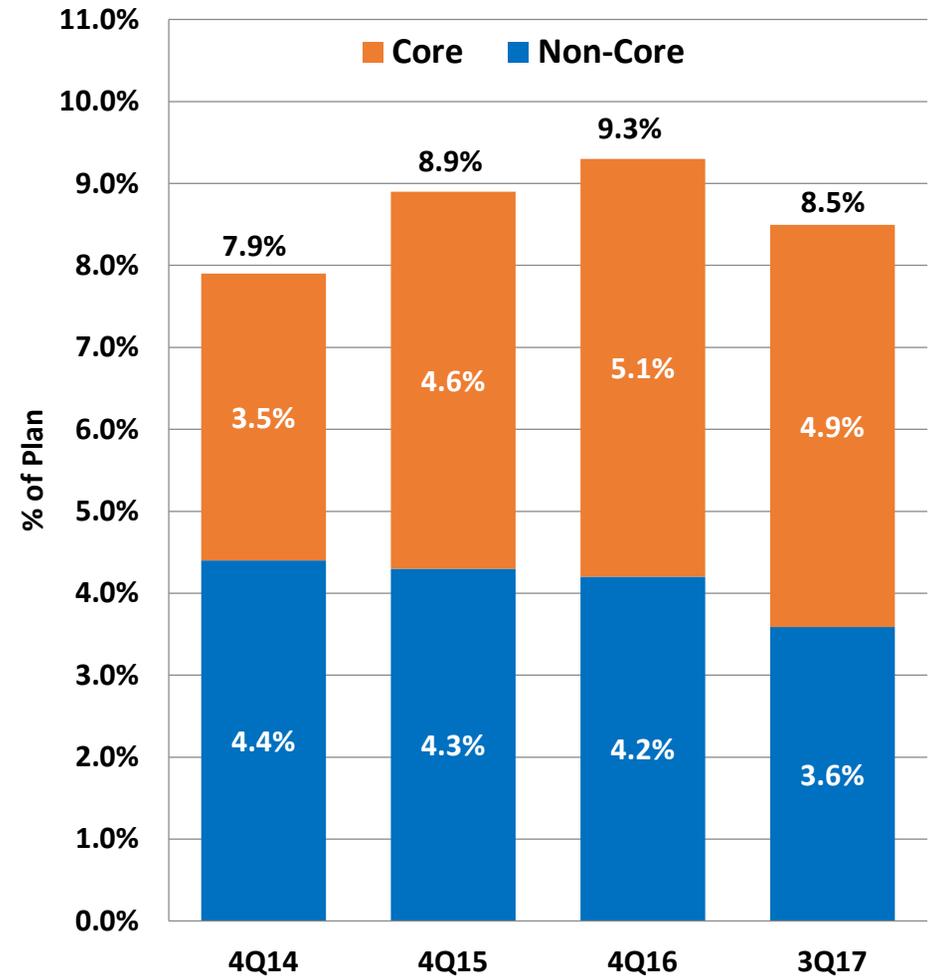
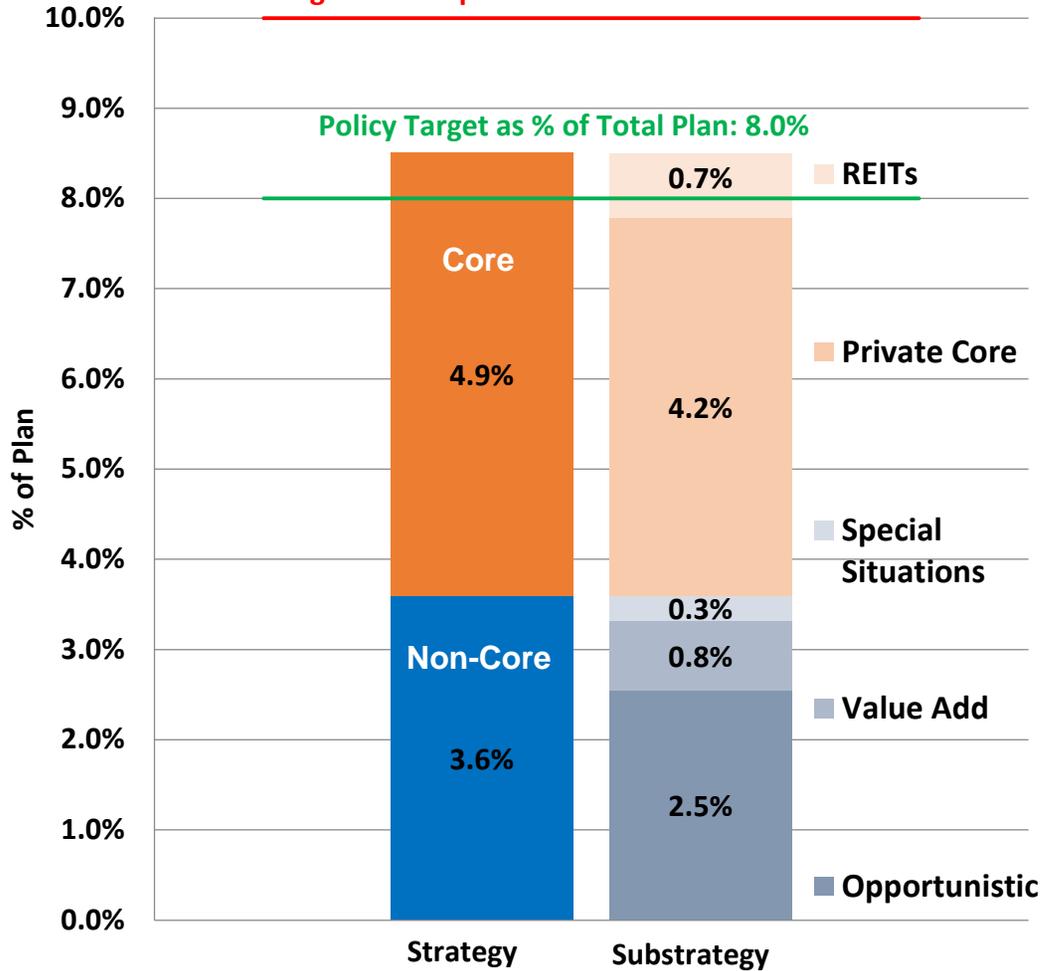
Long-term appreciation and returns

Low correlation to fixed income

Real Estate Allocation

Legislative Cap for RE as % of Total Plan: 10.0%

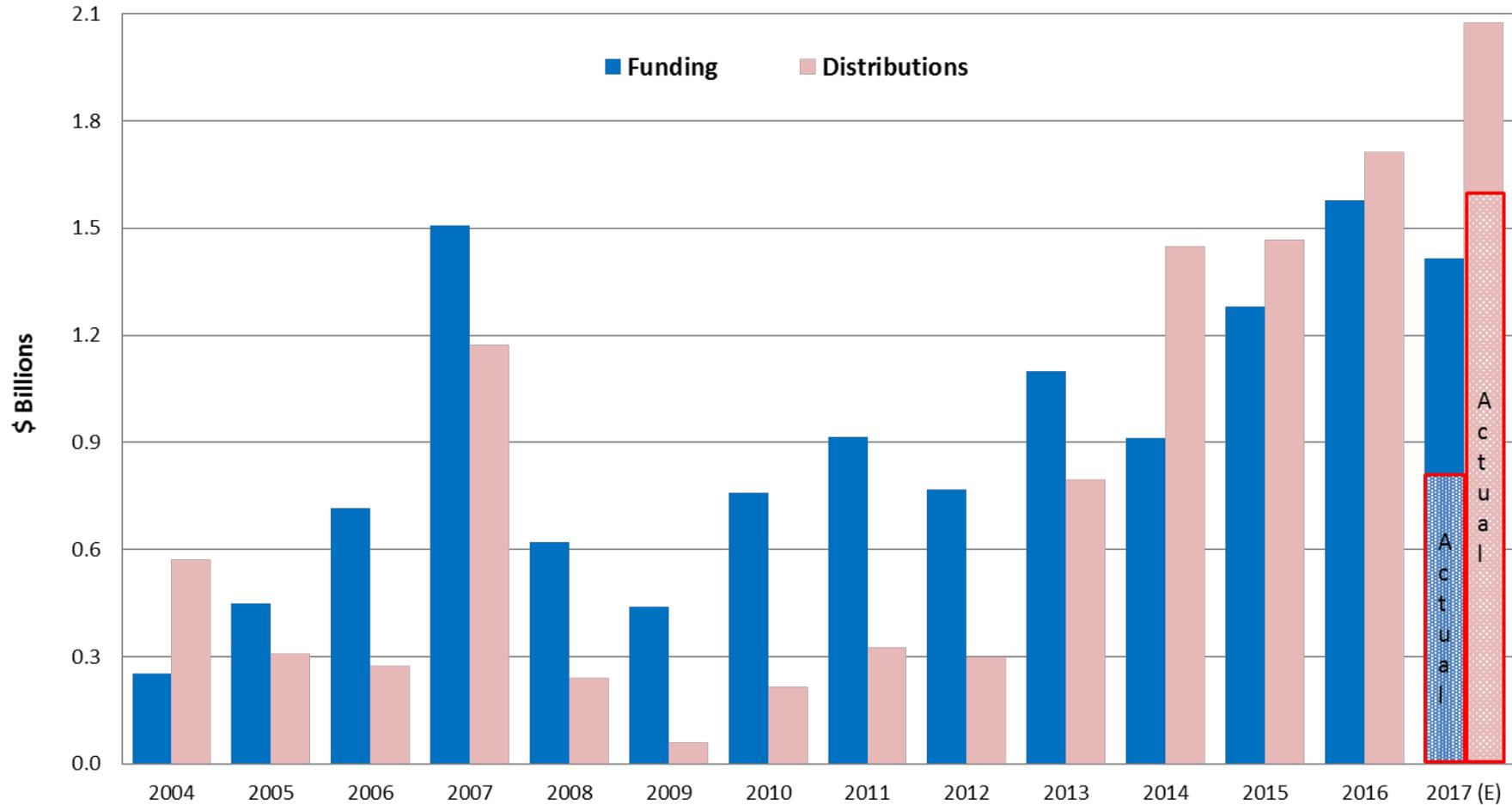
Policy Target as % of Total Plan: 8.0%



NCRS data as of 9/30/17
Special Situations – Build-to-Core Strategy

Allocation decrease is attributable to year-to-date net receipts of ~\$800 million and the growth of the overall plan.

Real Estate Cash Flow



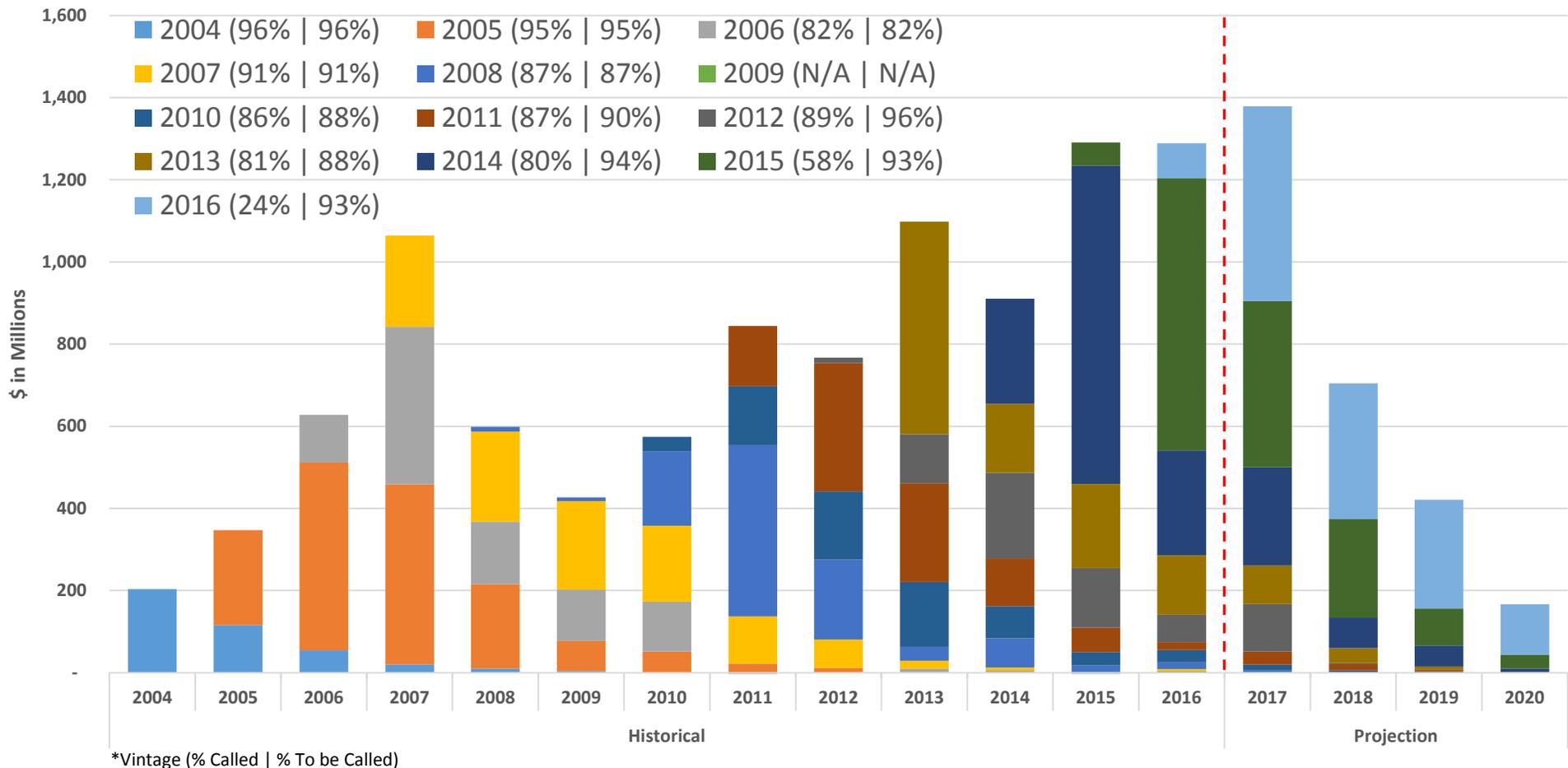
Commitments (\$M):	380	1,205	1,885	1,402	915	0	343	1,265	1,005	1,211	1,798	1,575	1,965	0
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NCRS data through 10/31/17 with Projected 2017

Net realized distributions year-to-date (10/31/17) of ~\$800 million.

Unfunded Commitment Pacing

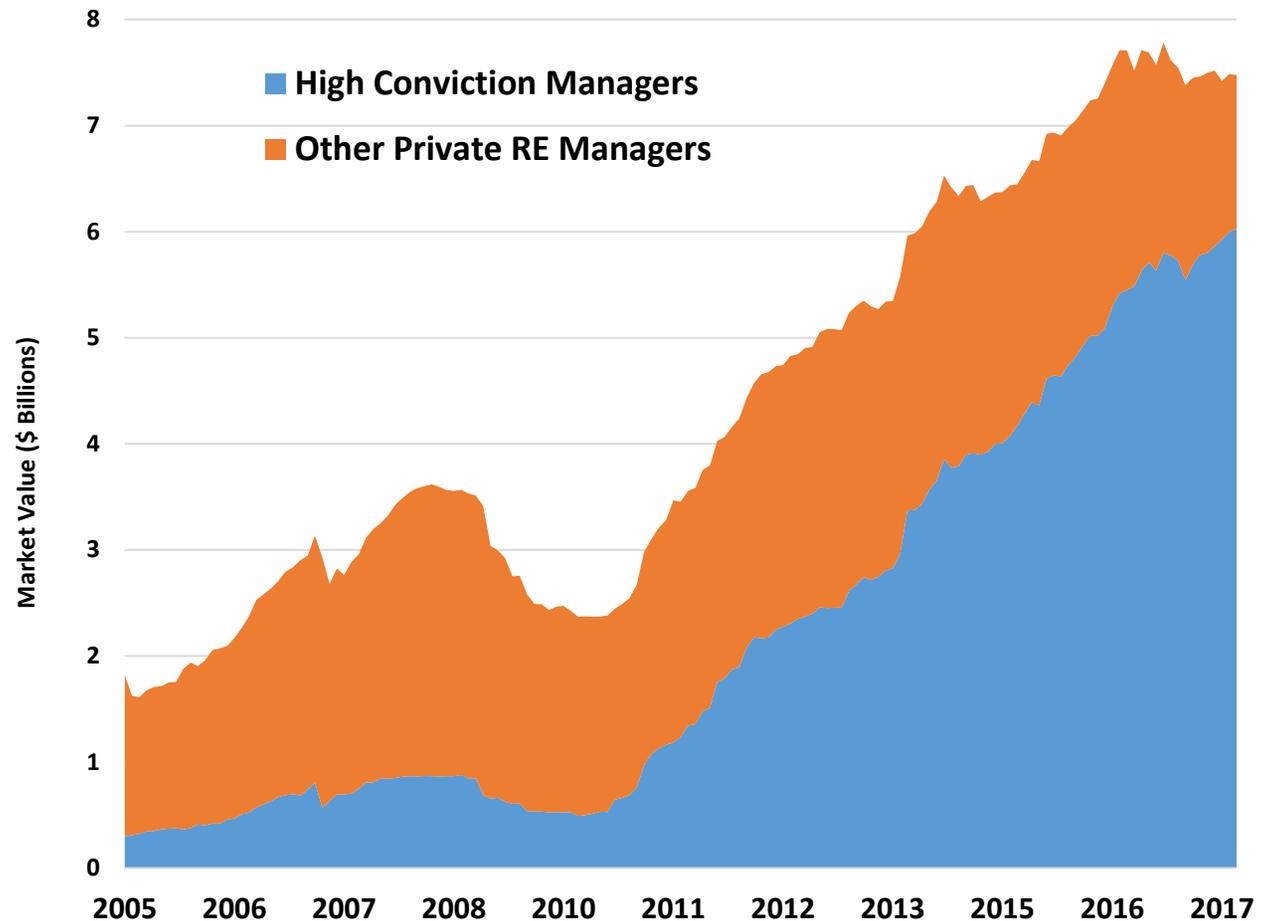
Contribution Pacing by Vintage Year (excludes REITs)



Of the \$2.7 billion in unfunded commitments at 10/31/17, we project \$1.8 billion will be called by 2020 and approximately \$900 million will be held as reserves and is unlikely to be called.

Manager Concentration (excludes REITs)

Contribution to Return		
	3 Year	5 Year
Private Core	9.0	10.0
High Conviction	7.6	7.9
Others	1.4	2.1
Non Core	13.6	14.0
High Conviction	9.8	9.5
Others	3.8	4.5

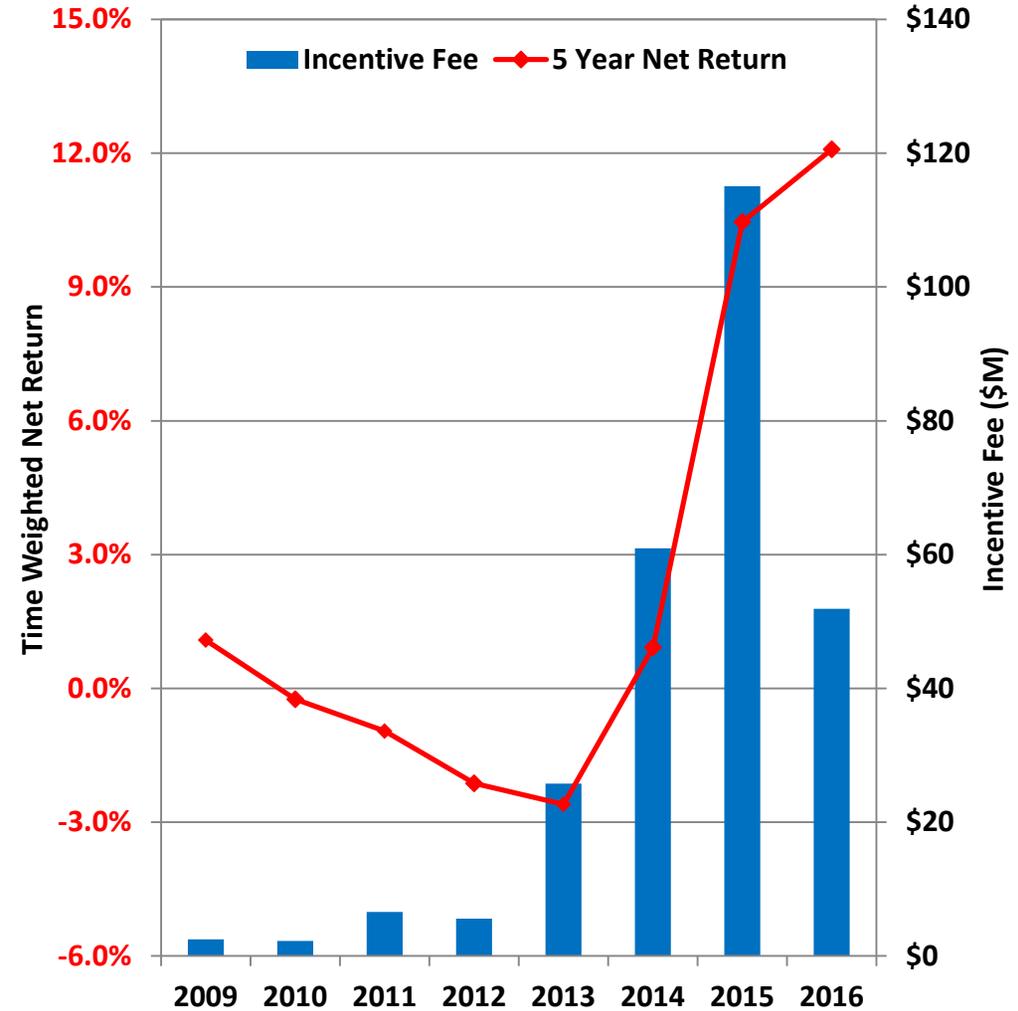
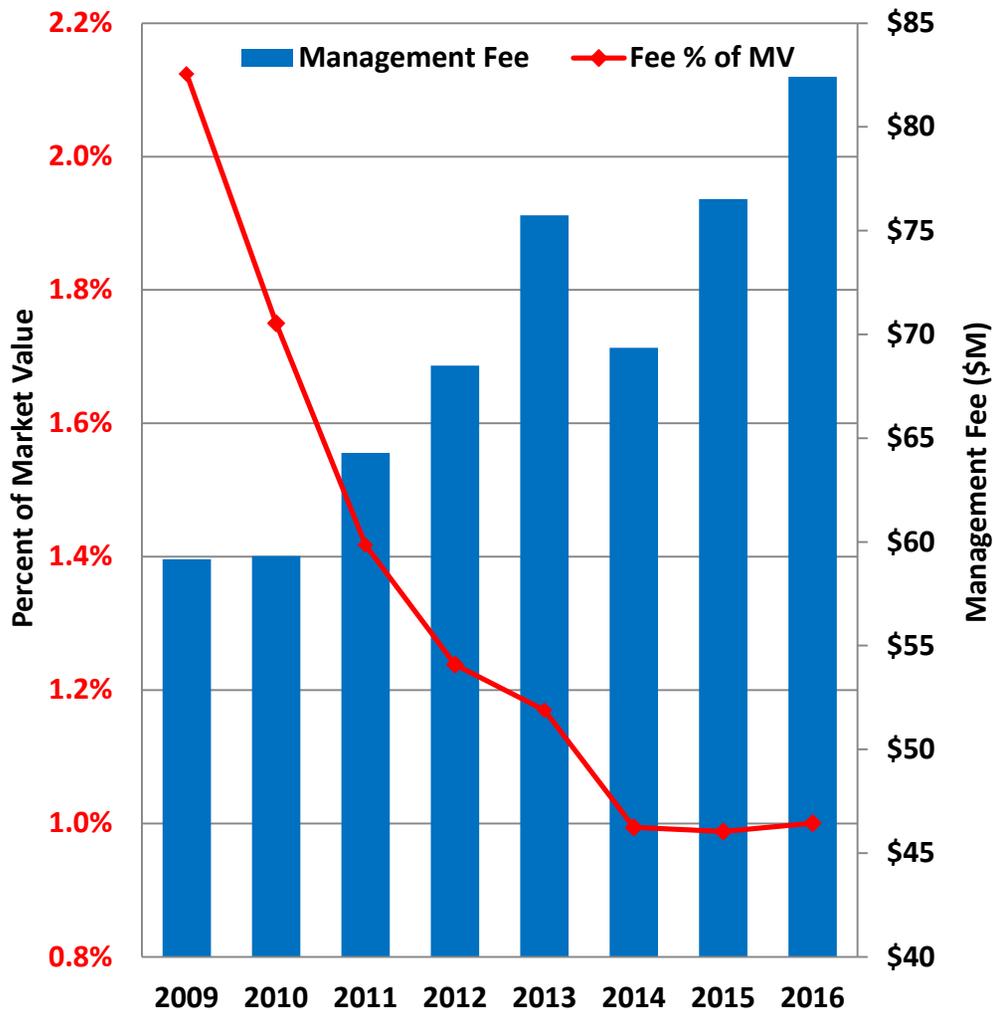


* "High Conviction" Managers are identified by the Real Estate Team as General Partners with the highest probability of meeting/exceeding expected fund-level returns

NCRS data through 9/30/17

74% of private market value with high conviction managers –
reduce complexity and fees, increase transparency and maximize returns.

Cost Efficiency



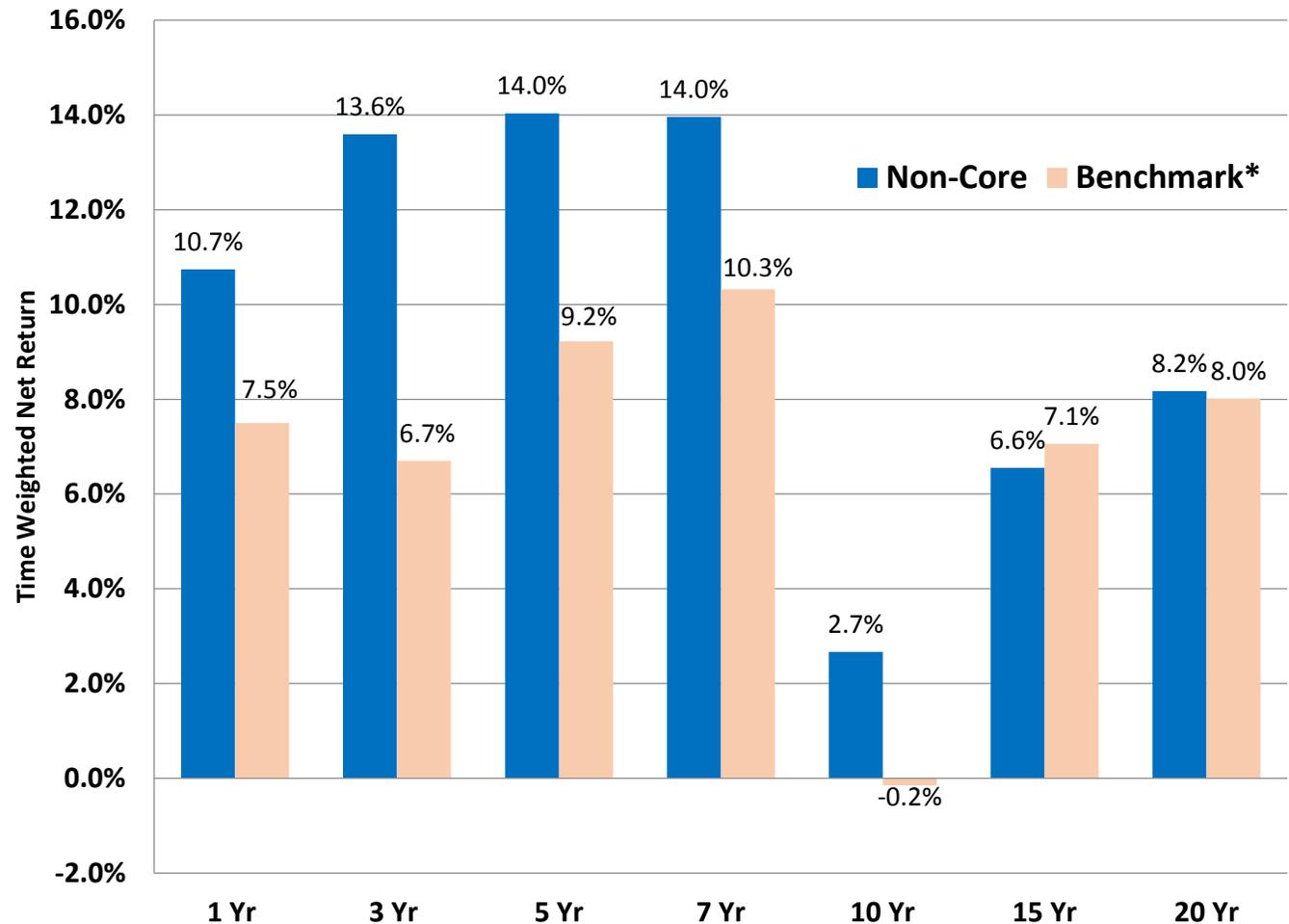
NCRS data through 12/31/16

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

Leverage relationships and scale to minimize costs and enhance alignment.

Performance: Non-Core Real Estate

Non-Core Contribution to Return		
3 Year		Contribution
Opportunistic		7.9
Value Add		5.7
Total Non-Core		13.6
<i>Major Drivers Vintage</i>		
O NorthCreek	2011	1.9
V NorthRock II	2012	1.5
O BREP VII	2011	1.0
V DRA VII	2011	0.8
O Lone Star II	2010	0.7
5 Year		Contribution
Opportunistic		8.8
Value Add		5.2
Total Non-Core		14.0
<i>Major Drivers Vintage</i>		
O NorthCreek	2011	1.5
O BREP VII	2011	1.1
O BREP VI	2007	1.0
V NorthRock II	2012	0.9
O Lone Star II	2010	0.8



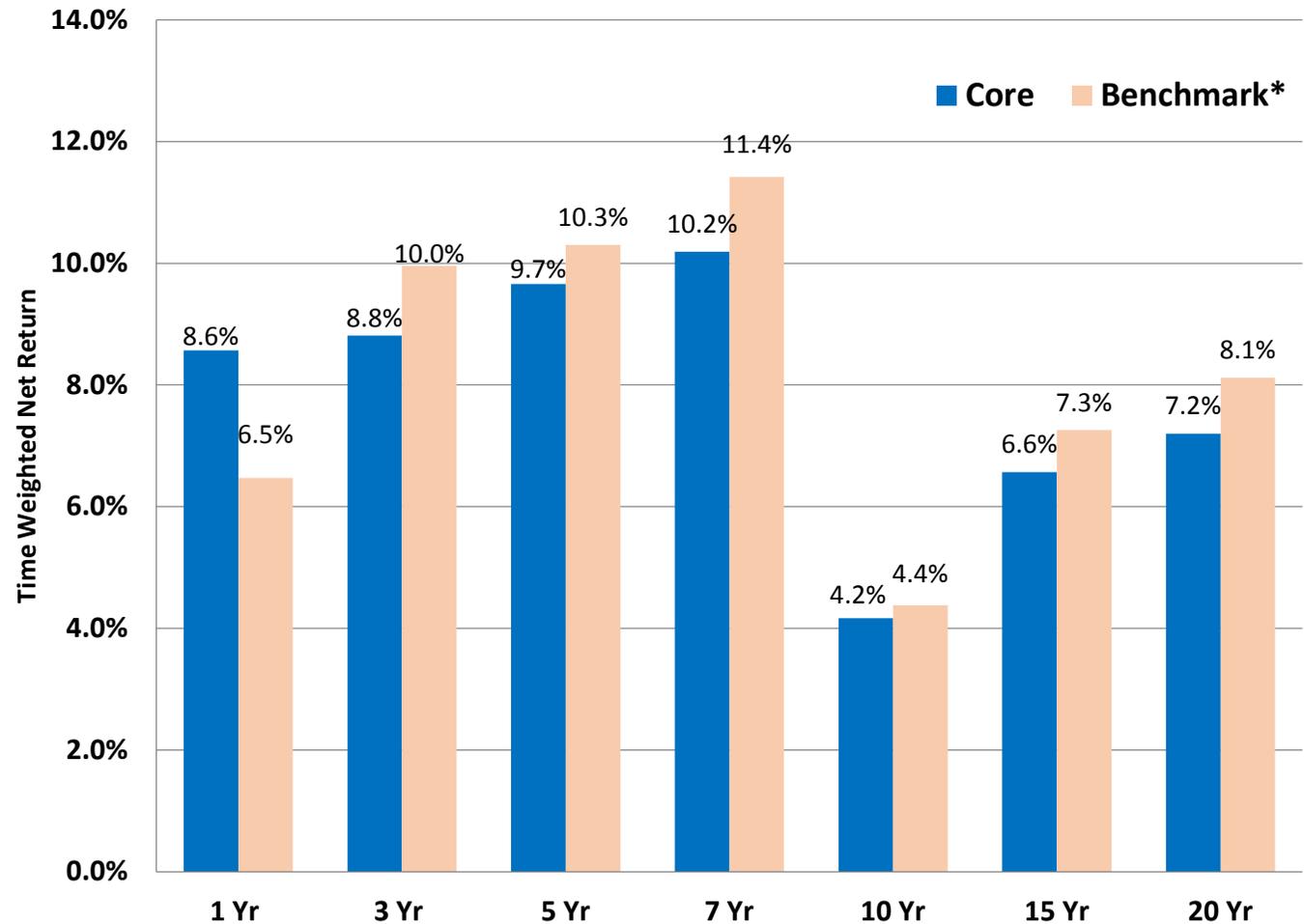
NCRS data through 9/30/17

* 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 due to strong performance in separate accounts and other high conviction managers.

Performance: Core Real Estate

Core Contribution to Return		
3 Year		Contribution
Private Core		7.5
REITs		1.3
Total Core		8.8
<i>Major Drivers Vintage</i>		
NorthRock I	2008	1.8
JPM SPF	1998	1.3
BREP EDENS	2013	1.1
5 Year		Contribution
Private Core		8.0
REITs		1.7
Total Core		9.7
<i>Major Drivers Vintage</i>		
NorthRock I	2008	2.8
JPM SPF	1998	1.8



NCRS data through 9/30/17

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

Core real estate portfolio has started to outperform the benchmark as core plus investment strategy moves through the J curve.



Investment Strategy Initiatives

High Conviction Managers

- Continue to increase allocation to high conviction managers and reduce manager count
 - More attractive terms (e.g. fee discounts for loyalty and size)
 - Greater control and transparency (e.g. Separate Accounts, custom solutions, founding Limited Partner)

Cost Efficiency

- Minimize costs and maximize returns by favoring fee structures that optimize alignment

Sector Allocation

- Target new commitments in property types that enhance portfolio construction
- Favorable long term risk/return profiles
- Diversification benefits



Appendix

- i. NCRS Investment Approach
- ii. Total Real Estate Performance vs. REITs
- iii. Leverage
- iv. Example Investment Characteristics



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

- Stabilize Core portfolio
- Diversify by strategy, property sector 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

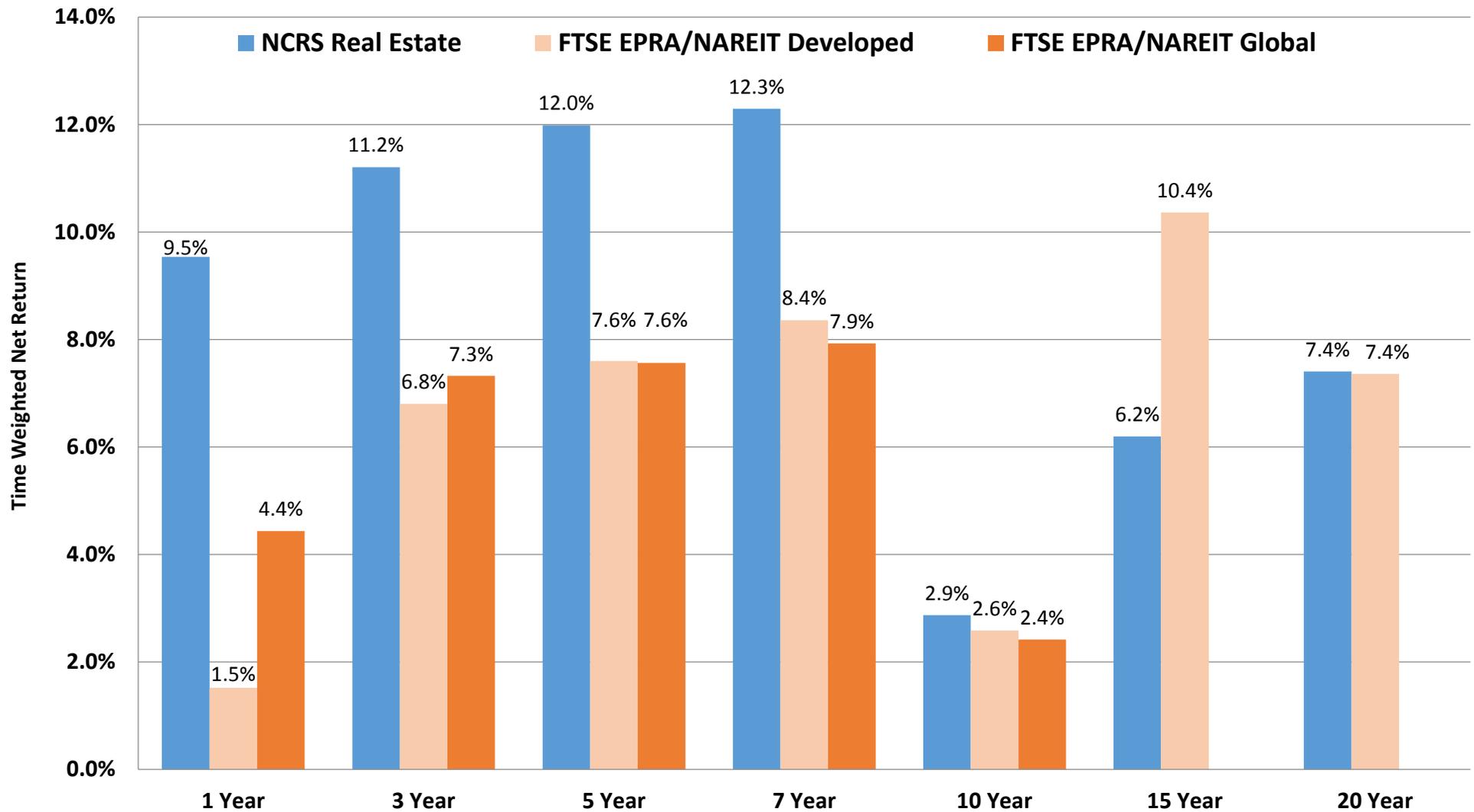
Invest meaningful amounts with fewer best-in-class managers

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

Take a long-term view toward investments and manager relationships

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

Performance: Total Real Estate vs. REITs

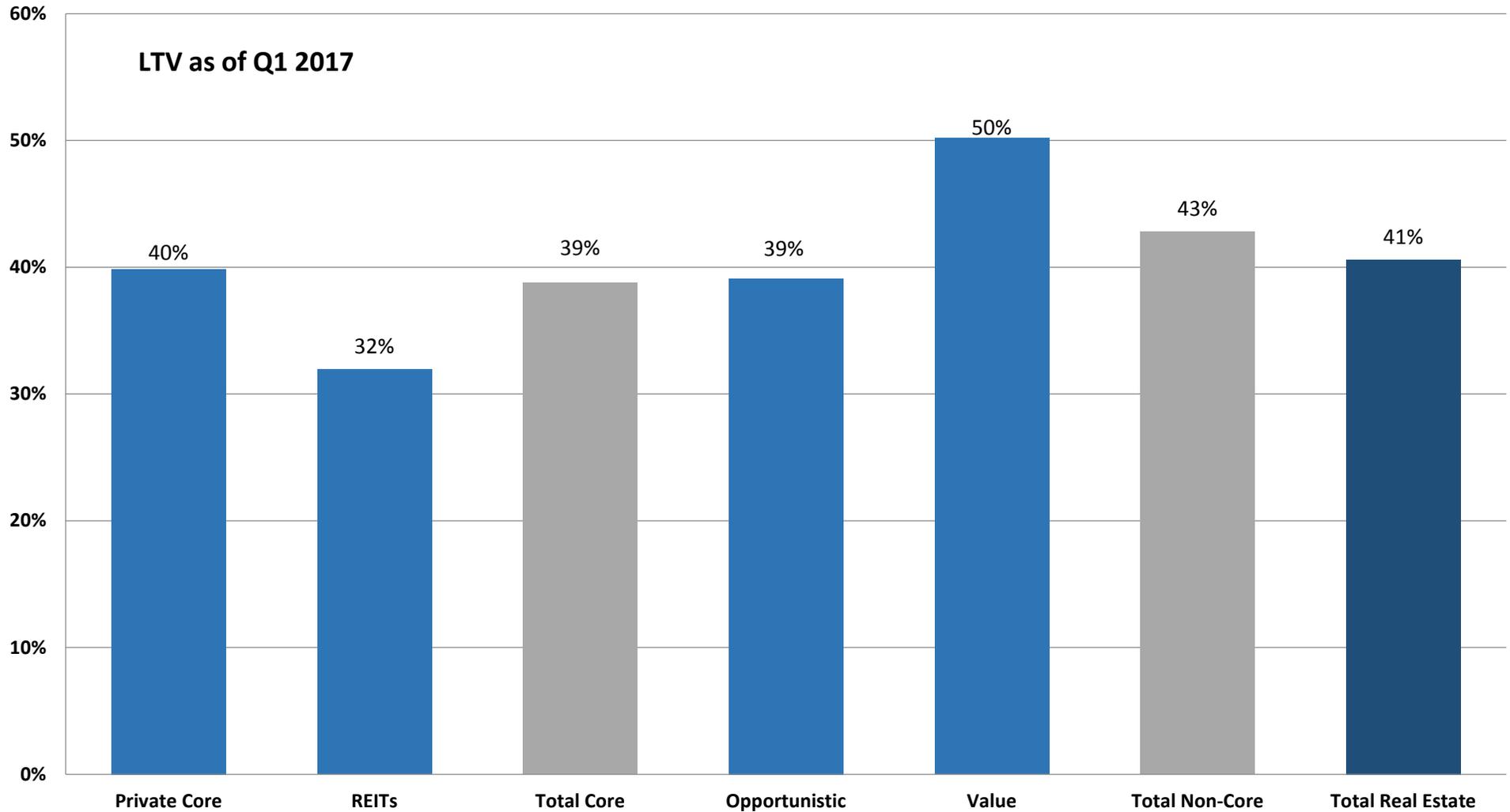


NCRS data through 9/30/17

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.

Leverage



Source: Courtland Partners NCRS PMR Q1 2017

Maintaining prudent levels of leverage and retaining ability to adjust through our Separate Accounts.



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%