



# Employees' Retirement System of Rhode Island

## Real Estate Review

Presented by:

Pension Consulting Alliance, LLC

March 23, 2016



PCA

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# Real Estate: Snapshot

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## Roles of Real Estate

- Primary:
  - to provide capital preservation
  - diversification away from equity and fixed income assets' returns, and
  - reliable current and attractive, risk adjusted, total returns, including current income to meet obligations
- Secondary:
  - to provide a partial hedge against inflation
  - participate in growth opportunities

## ERSRI Real Estate Portfolio

- Target Allocation of 8% of System Assets—Primarily Domestic Properties
- Consists of Core Assets (Target 75-80%), completed and leased investment grade properties with low levels of indebtedness; most of the total return comes from income
- Non-Core Assets (Target 20-25%), both Value Added and Opportunistic, properties requiring re-positioning, re-development, operating improvements, distressed purchases and new development with medium to high leverage; almost all of the total return comes from capital appreciation
- REITs (publicly traded equities of companies in the real estate business) are permitted, but not currently part of the portfolio
- No Direct Investments—assets consist of interests in open (infinite life) and closed end (finite life) commingled funds, usually organized as limited partnerships
- Benchmark—NCREIF Open-End Diversified Core Equity Index (NFI-ODCE), a group of more than two dozen large open end commingled funds who invest primarily in core properties domestically

# Summary

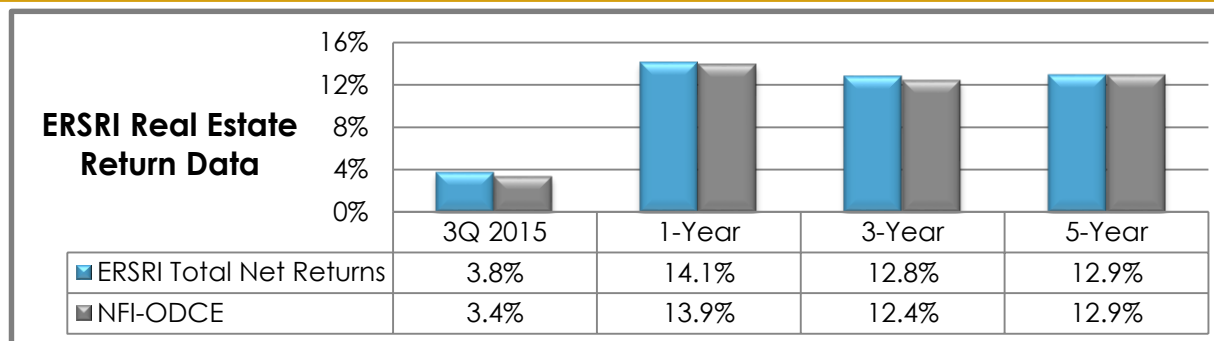
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## PCA's View

- Real estate market participants like certainty as much as financial asset market participants.
- We expect continued low interest rates and availability of mortgage financing to remain present.
- We expect another 12 months of good capital appreciation, although not as strong as the last several years.
- We continue to think the strategy of using real estate as a diversifier and an income-generator is appropriate.

# ERSRI Real Estate Portfolio

- Total Q3 Portfolio Value: \$439.5 M
- Current Committed but Unfunded: \$129.2 M
- Total Value and Unfunded: \$568.7 M
- Total Value and Unfunded Commitments as a Percentage of Q3 Total Plan Assets: 7.6%

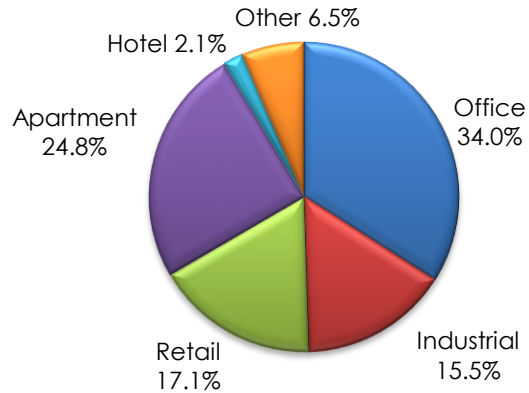


Partnership	Current Value	Unfunded Commitments	Total	GROSS (%)			NET (%)		
				3Q-15 Total	1-Year	3-Year	3Q-15 Total	1-Year	3-Year
<b>ERSRI Total Real Estate Portfolio</b>	<b>439,526,813</b>	<b>129,165,582</b>	<b>568,692,395</b>	4.1	15.6	14.0	3.8	14.1	12.8
<b>NFI-ODCE</b>				3.7	14.9	13.4	3.4	13.9	12.4
<b>Performance Under / Over Benchmark</b>				<b>0.4</b>	<b>0.7</b>	<b>0.6</b>	<b>0.4</b>	<b>0.2</b>	<b>0.4</b>
<b>ERSRI Core Portfolio</b>	<b>374,289,169</b>	<b>0</b>	<b>374,289,169</b>	<b>3.7</b>	<b>14.9</b>	<b>13.8</b>	<b>3.5</b>	<b>13.9</b>	<b>12.8</b>
AEW Core Property Trust	83,259,897	0	83,259,897	3.1	13.3	12.1	2.9	12.6	11.4
Heitman America Real Estate Trust	68,388,353	0	68,388,353	3.4	13.8	n/a	3.1	12.8	n/a
JP Morgan Strategic Property Fund	96,410,754	0	96,410,754	3.4	14.5	13.9	3.1	13.4	12.7
Morgan Stanley Prime Property Fund	56,258,766	0	56,258,766	3.9	17.2	16.2	3.6	15.9	14.8
Prudential PRISA	69,971,399	0	69,971,399	4.9	16.1	14.0	4.7	15.2	13.1
<b>ERSRI Non-Core Portfolio</b>	<b>65,237,644</b>	<b>129,165,582</b>	<b>194,403,226</b>	<b>7.3</b>	<b>20.7</b>	<b>18.5</b>	<b>6.2</b>	<b>15.2</b>	<b>15.0</b>
Crow Holdings Retail Fund	763,630	17,786,307	18,549,937	n/a	n/a	n/a	n/a	n/a	n/a
Exeter Industrial Value Fund III	14,132,447	16,500,000	30,632,447	5.9	18.3	n/a	4.5	9.7	n/a
Fillmore East Fund I	181,774	0	181,774	23.7	0.1	39.2	23.4	-0.6	37.2
GEM Realty Fund V	19,597,234	27,819,375	47,416,609	13.4	29.0	n/a	12.6	23.2	n/a
IC Berkeley Partners III	11,339,013	1,961,674	13,300,687	1.1	25.6	n/a	0.3	20.7	n/a
IC Berkeley Partners IV	n/a	30,000,000	30,000,000	n/a	n/a	n/a	n/a	n/a	n/a
JP Morgan Alternative Property Fund	215,065	0	215,065	0.0	9.6	3.2	0.0	9.6	3.2
Lone Star Real Estate Fund IV	n/a	17,660,339	24,260,817	n/a	n/a	n/a	n/a	n/a	n/a
Magna Hotel Fund III	3,687,265	612,643	4,299,908	-0.2	15.0	25.7	-0.4	14.0	24.4
TriCon Capital Fund VII	1,392,326	428,467	1,820,793	2.8	-5.2	-10.2	2.8	-5.2	-10.2
Waterton Fund XII	13,928,890	16,396,777	36,624,250	9.4	n/a	n/a	7.3	n/a	n/a

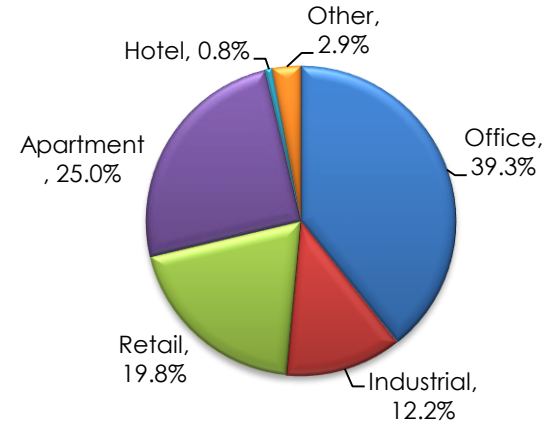
\*Commitment amounts include the February 2016 commitment of \$30 million to IC Berkeley Partners IV and subsequent capital activity through March 18, 2016.

# Diversification

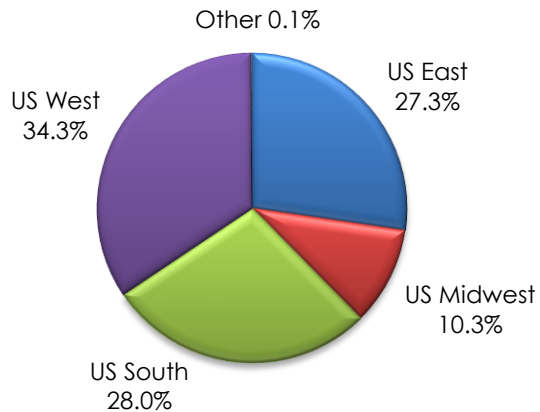
**ERSRI Portfolio  
Property Sector Diversification**



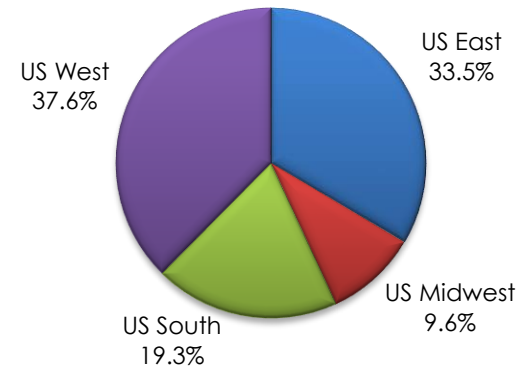
**NFI-ODCE Property Sector  
Diversification**



**ERSRI Portfolio  
Geographic Diversification**



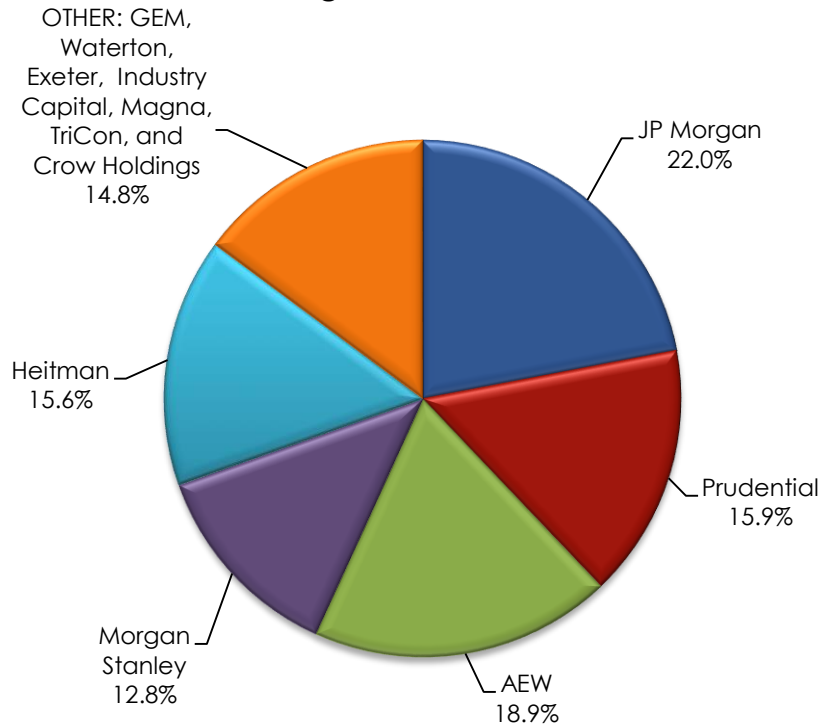
**NFI-ODCE  
Geographic Diversification**



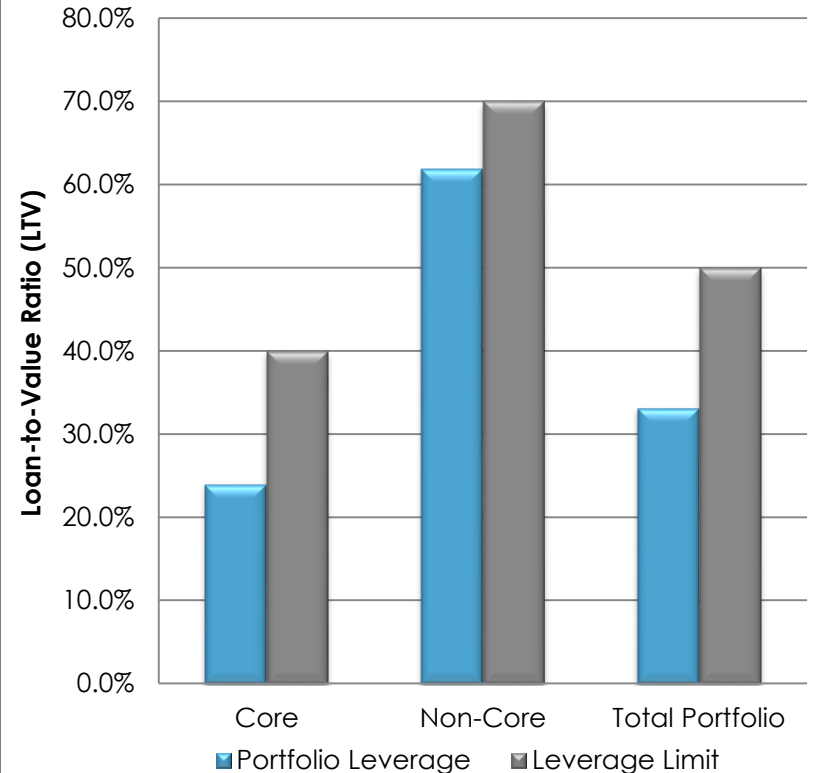
Sources: NCREIF; As of Sept. 30, 2015

# Portfolio Characteristics

### ERSRI Real Estate Portfolio Manager Diversification



### ERSRI Real Estate Portfolio Leverage



# Portfolio Snapshots

## Q3 FY 2007

<b>Market Value</b>	\$294,531,647	
<b>Unfunded Commitments</b>	\$73,925,005	
<b>Fund Type</b>	<b># of Funds</b>	<b>% of Market Value + Unfunded Commitments</b>
<b>Core Funds</b>	4	52.1%
<b>Non-Core Funds</b>	12	47.9%

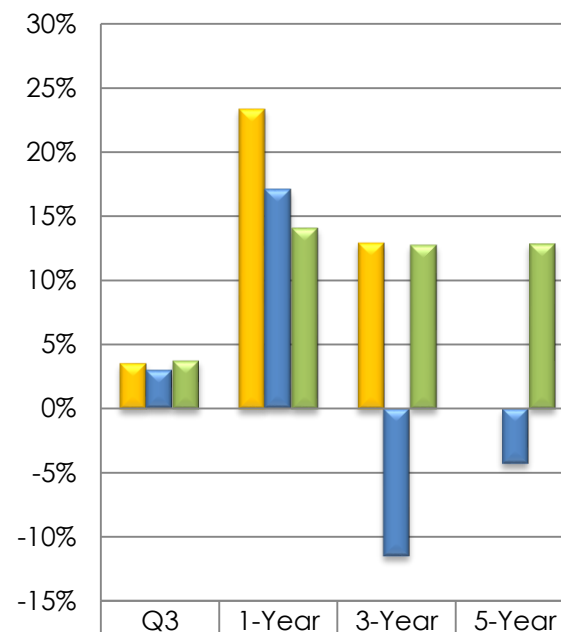
## Q3 FY 2011

<b>Market Value</b>	\$266,013,868	
<b>Unfunded Commitments</b>	\$8,407,433	
<b>Fund Type</b>	<b># of Funds</b>	<b>% of Market Value + Unfunded Commitments</b>
<b>Core Funds</b>	4	65.3%
<b>Non-Core Funds</b>	13	34.7%

## Q3 FY 2015

<b>Market Value</b>	\$439,526,813	
<b>Unfunded Commitments</b>	\$127,670,233	
<b>Fund Type</b>	<b># of Funds</b>	<b>% of Market Value + Unfunded Commitments</b>
<b>Core Funds</b>	5	66.0%
<b>Non-Core Funds</b>	11	34.0%

## ERSRI Real Estate Return Data



	Q3	1-Year	3-Year	5-Year
ERSRI Total Net Returns (FY 2007)	3.6%	23.4%	13.0%*	n/a
ERSRI Total Net Returns (FY 2011)	3.0%	17.1%	-11.5%	-4.3%
ERSRI Total Net Returns (FY 2015)	3.8%	14.1%	12.8%	12.9%

\*ERSRI's 2007 3-Year return represents the historical data available and is generated from 2 years of performance.

# Vintage Year Exposure

Vintage Year	Aggregate Commitments	Investments						
1989	\$ 90,000,000	Heitman IV Prior	L and B Fund III Prior					
2004	\$ 15,000,000	Fremont Strategic II Prior						
2005	\$ 150,000,000	Prudential PRISA	Morgan Stanley Prime Property Fund	RREEF American REIT II Prior	TriCon Capital Fund VII	LaSalle IV Prior		
2006	\$ 140,000,000	JP Morgan Strategic Property Fund	Fillmore East Fund I	JP Morgan Alternative Property Fund	Hunt Commercial II Prior	Starwood Hospitality I Prior	Walton Real Estate V Prior	Westbrook VI Prior
2007	\$ 45,000,000	PRISA II Prior	TA Realty VIII Prior	Westbrook VII Prior				
2008	\$ 4,000,000	Magna Hotel Fund III						
2009	\$ 25,000,000	AEW Core Property Trust						
2013	\$ 205,000,000	AEW Core Property Trust	Heitman America Real Estate Trust	JP Morgan Strategic Property Fund	GEM Realty Fund V	Waterton Fund XII		
2014	\$ 48,000,000	Exeter Industrial Value Fund III	IC Berkeley Partners III					
2015	\$ 48,260,817	Lone Star Real Estate IV	Crow Holdings Retail Fund					

**Core - CURRENT**

**Core - PRIOR**

**Non-Core - CURRENT**

**Non-Core - PRIOR**



# Appetite for Real Estate

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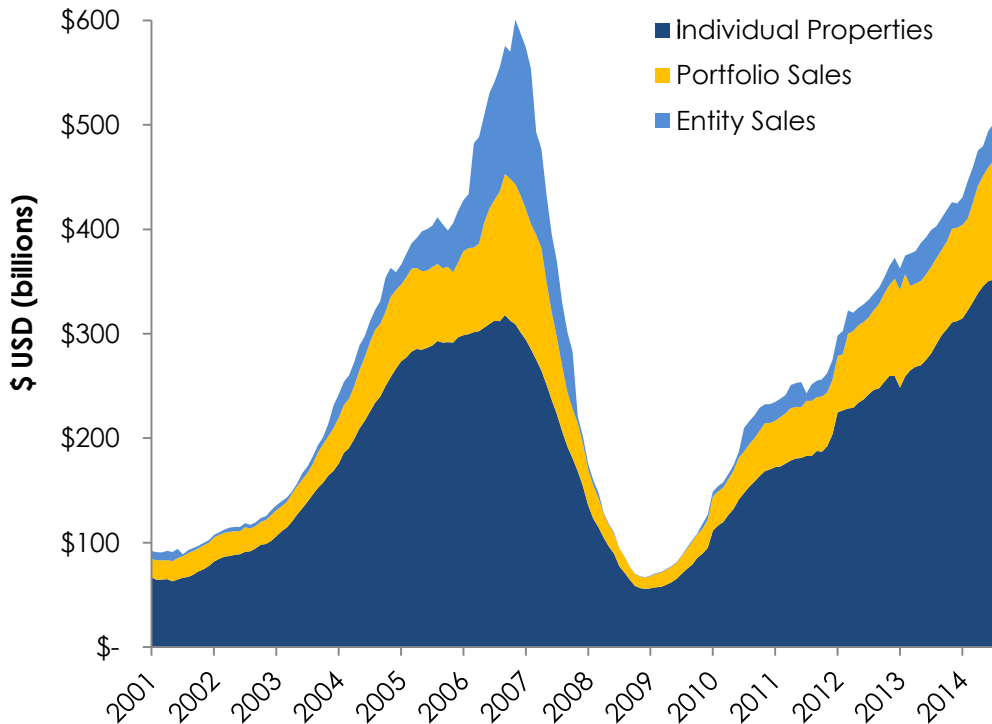
## Opportunities & Challenges

- As always, focus on role of the asset class and judgment are required for private, illiquid assets. Identification of aligned investment managers is crucial.
- There is an unprecedented interest and capital available to invest in real estate, arising from:
  - Increased allocations (lower fixed income allocations)
  - New investors—sovereign, public companies and HNW
  - Inexpensive and plentiful debt
- Relatively little new supply has been delivered, making existing stock “more scarce” in view of increase in demand, with prices following.
- Falling yields have pushed more capital towards riskier strategies.
- Emerging managers tend to be more motivated and have better alignment of interests; however, investors assume certain business risks in addition to portfolio risks.

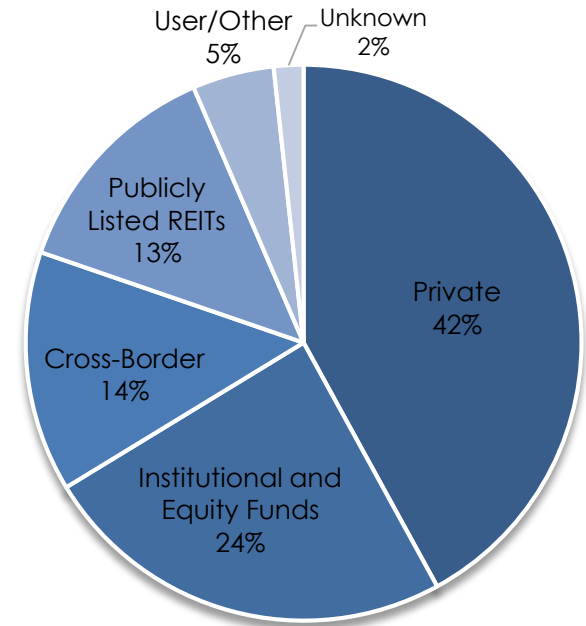
# Capital Flows

## U.S. Volume by Transaction Type

Rolling 12 Month Total



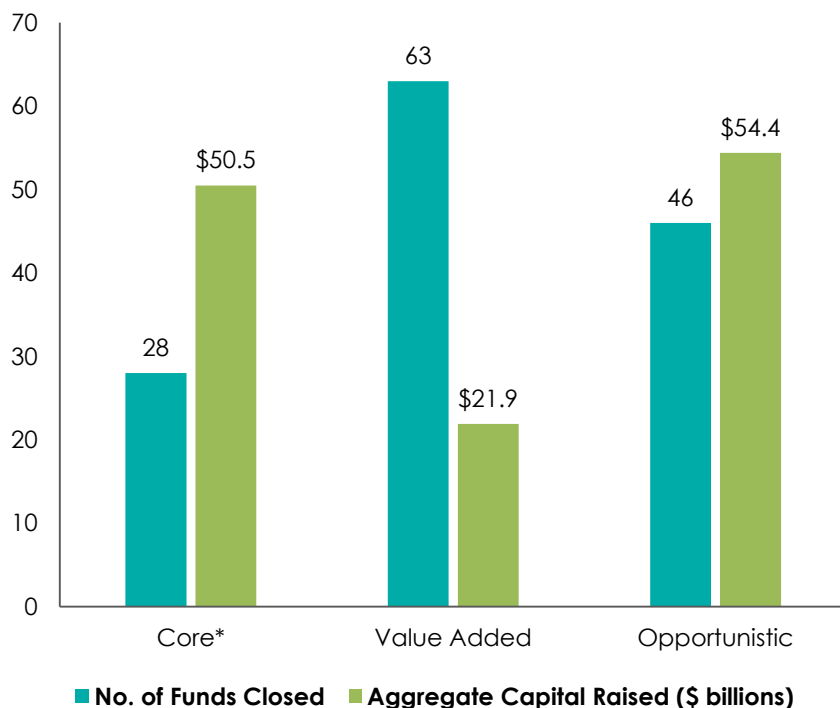
## U.S. CRE Buyer Profile



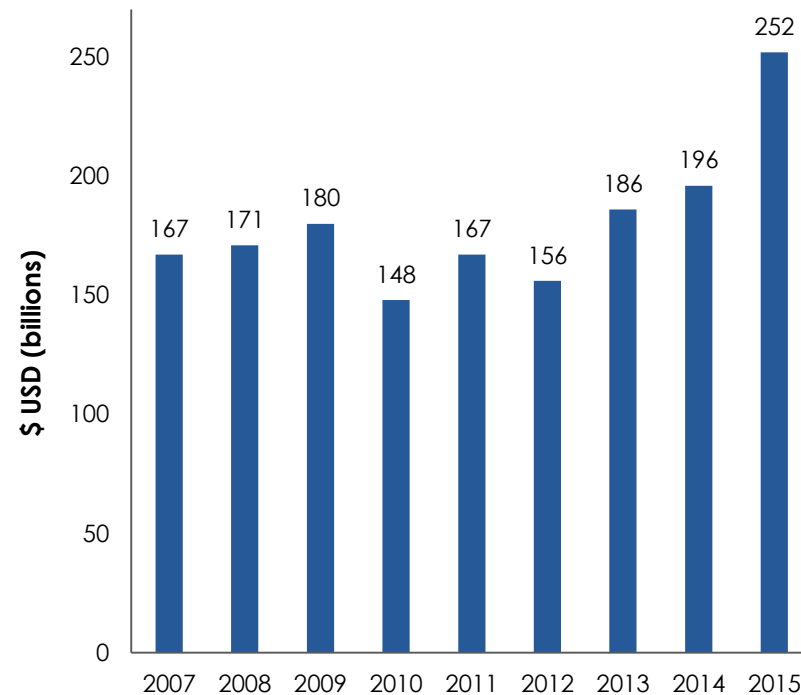
**U.S. commercial transaction volumes have picked up but are still below peak levels**

# Fundraising Environment

## Closed-End Private Real Estate Fundraising in 2015 by Strategy

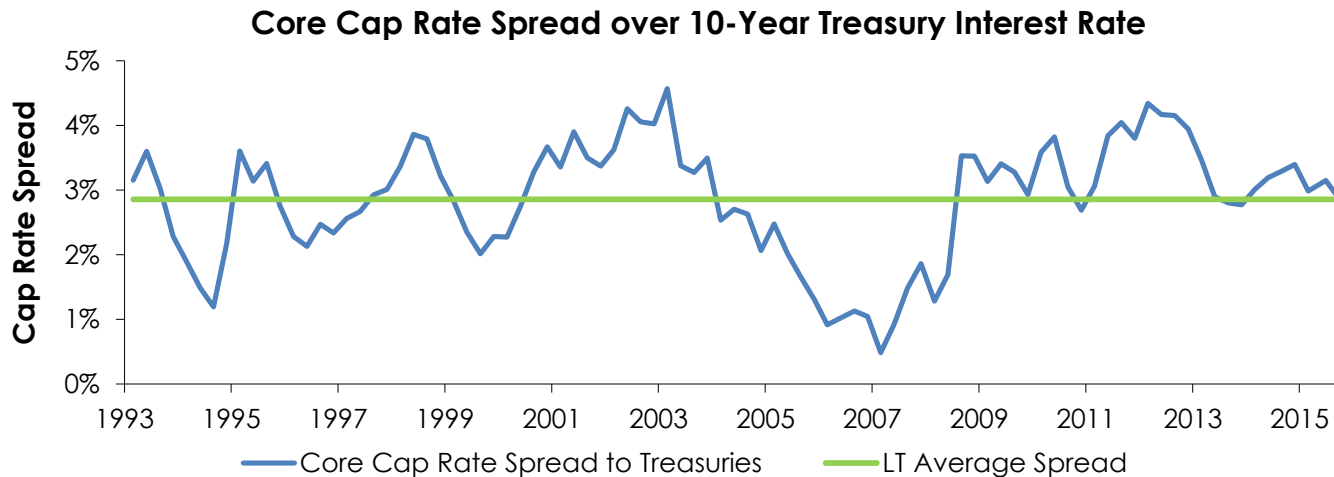
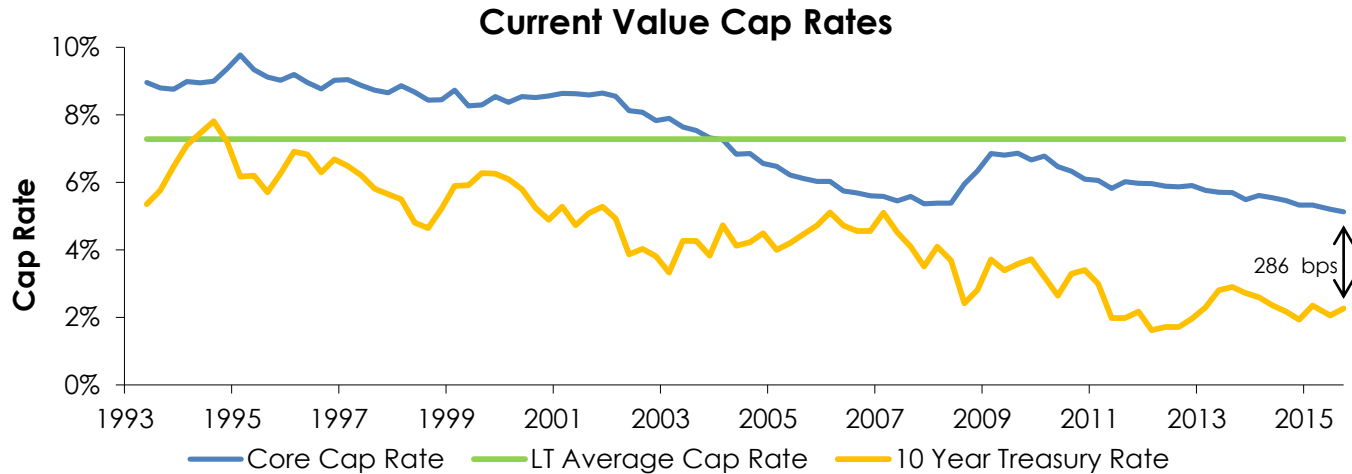


## Dry Powder of Closed-End Private Real Estate



\*Accounts for all funds that Prequin considers core and core-plus  
Source: Prequin Real Estate Online; As of Dec. 31, 2015

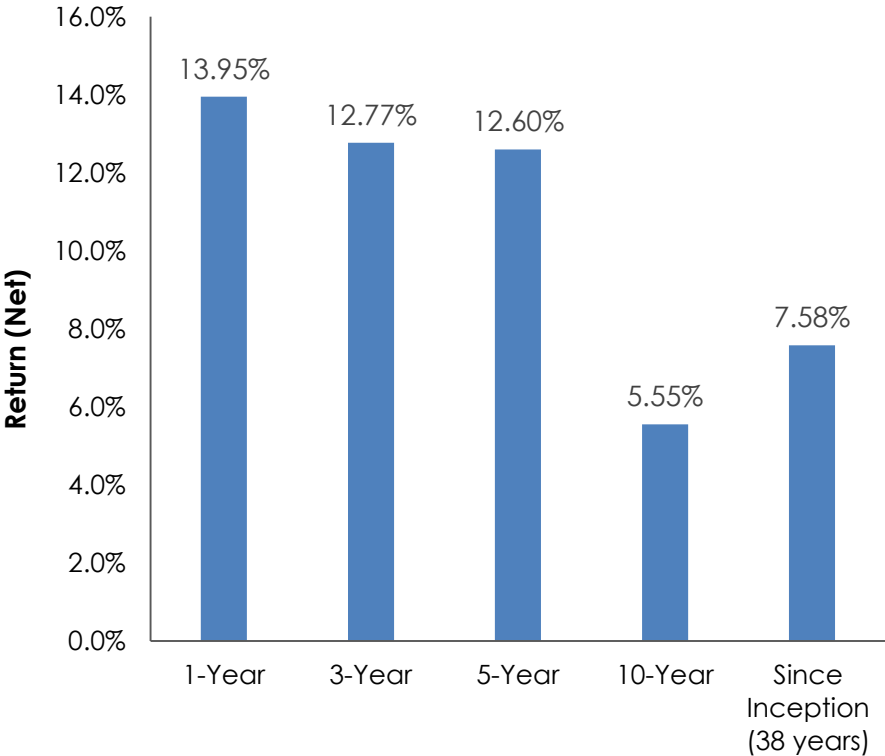
# Pricing Dynamics



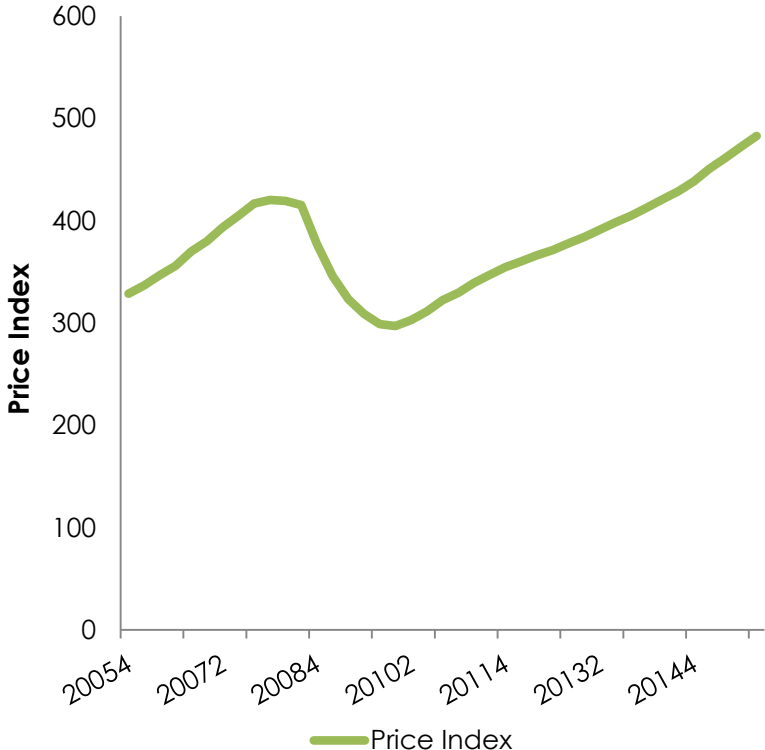
Source: NCREIF, [www.ustreas.gov](http://www.ustreas.gov). Cap rates used in the above two tables are the trailing four quarter average of the NCREIF current value cap rate as of Dec. 31, 2015.

# NFI-ODCE & NPI Performance

### NFI-ODCE Net of Fee Returns

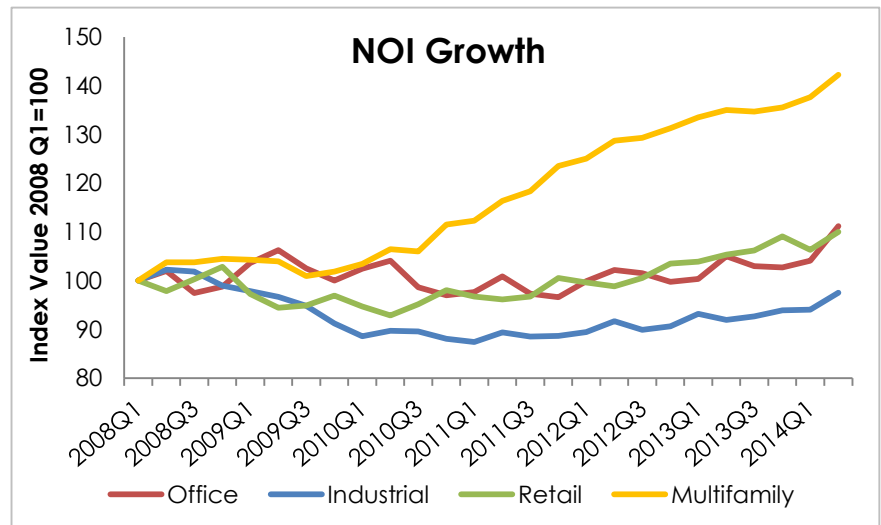
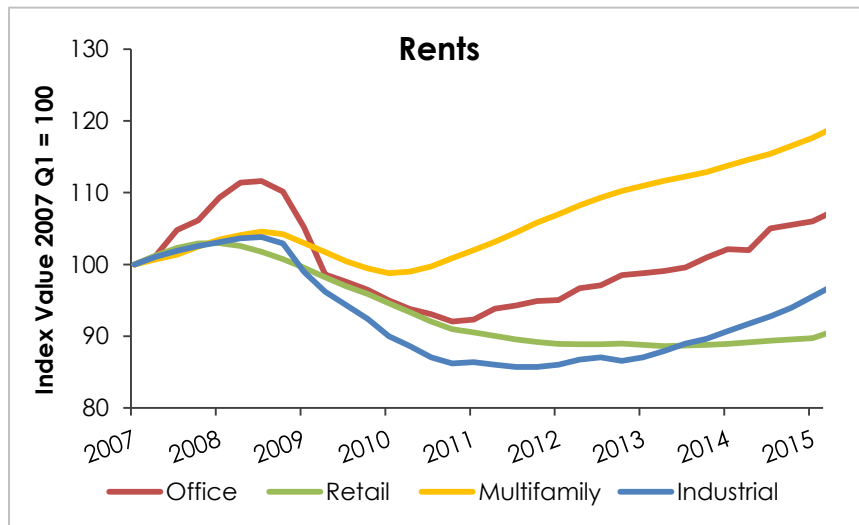
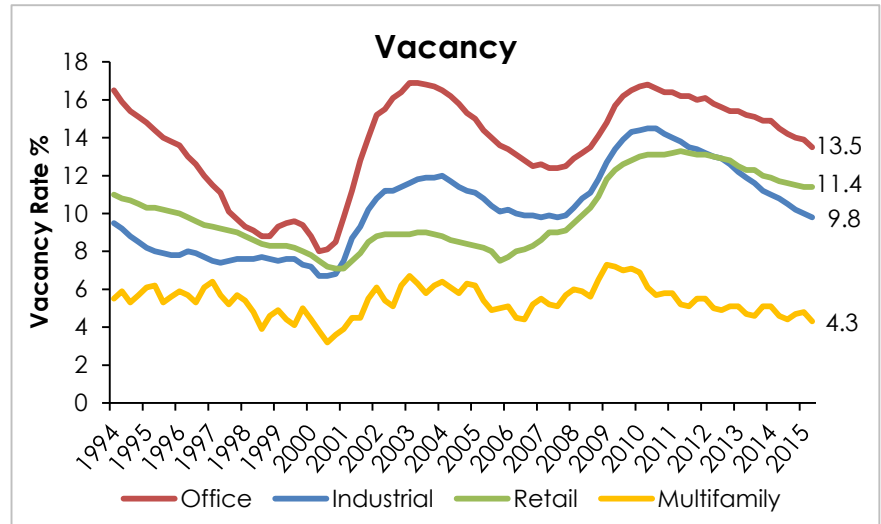
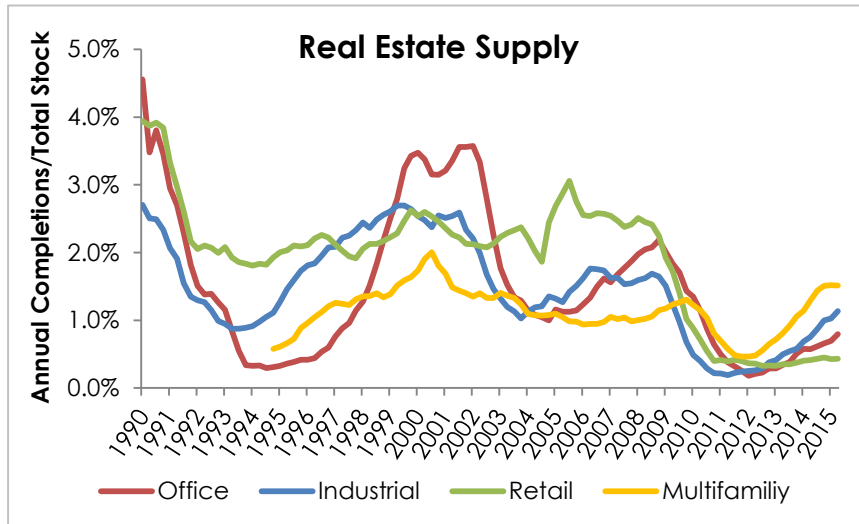


### NCREIF Price Index



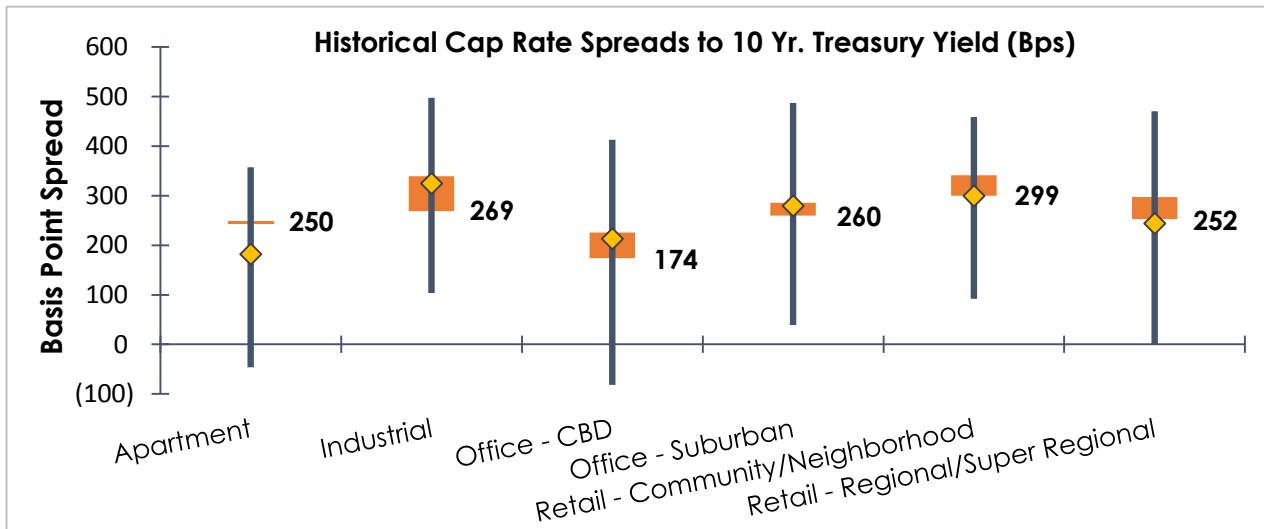
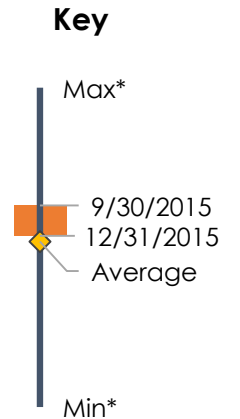
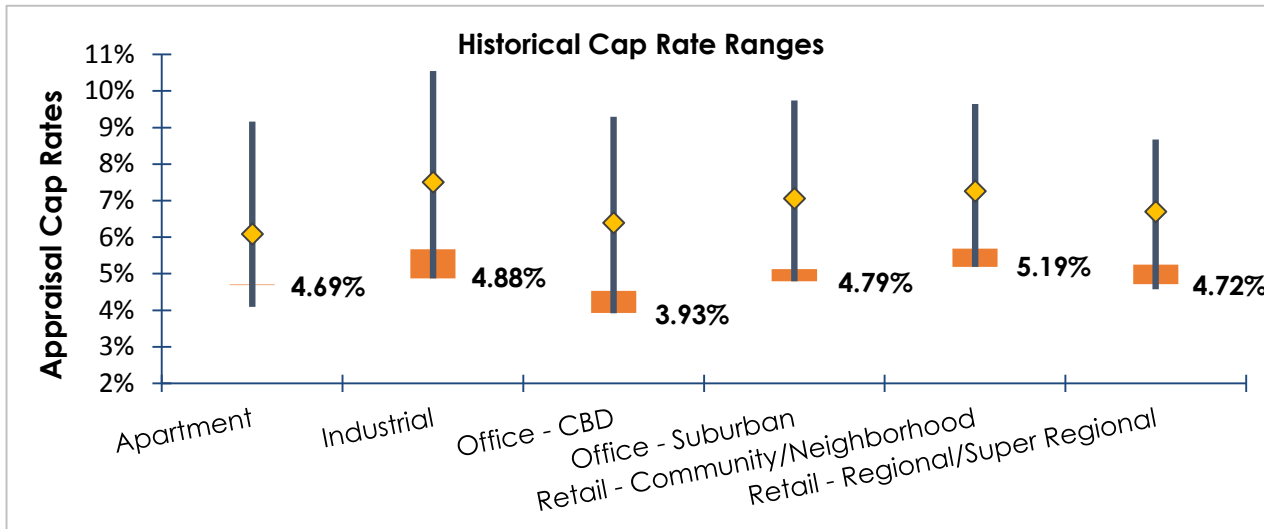
Source: NCREIF; As of Dec. 31, 2015

# Real Estate Recovery and Fundamentals



Source: CBRE-EA, Census, AEW, NCREIF, and PREA; As of Sept. 30, 2015

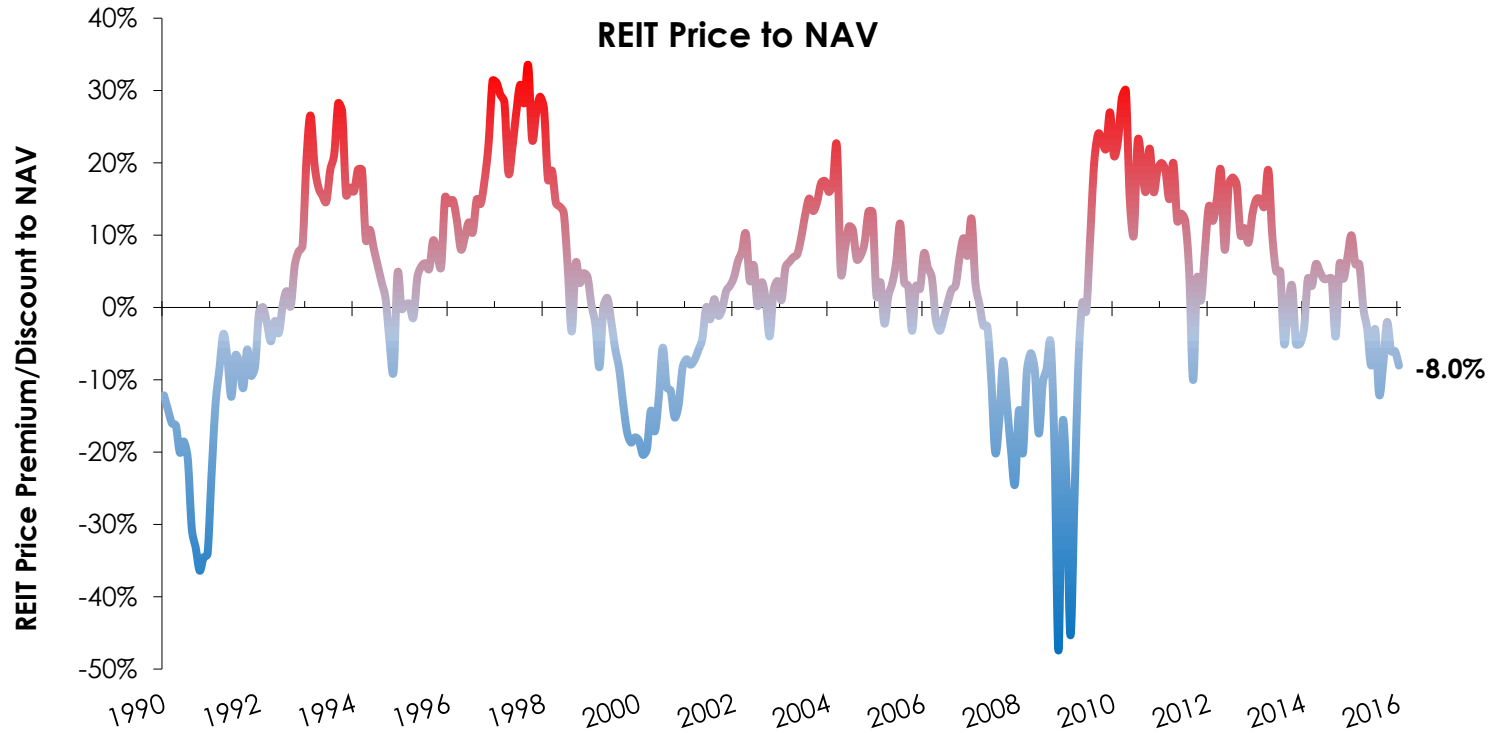
# Pricing Dynamics



Source: NCREIF, AEW; As of Dec. 31, 2015

\*Min-Max ranges refer to 1Q 1995 through 4Q 2015.

# Public Real Estate: U.S.



	4Q 2015 Income	4Q 2015 Appreciation	4Q 2015 Total Return	1-Year	3-Year	5-Year
<b>FTSE EPRA/NAREIT Global Developed</b>	0.94%	6.33%	7.27%	12.98%	12.45%	10.55%
<b>FTSE NAREIT U.S. All REITs</b>	1.20%	5.92%	7.12%	3.04%	9.68%	9.89%

Source: AEW, Green Street Advisors; As of January 31, 2016



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