



State of Rhode Island
Office of the General Treasurer

SROA Capital Fund IX- Staff Recommendation
September-2024

RECOMMENDATION:

- [Rhode Island Employees Retirement Systems Pooled Trust](#): Approve a commitment of up to \$15 million to SROA Capital Fund IX (“SROA IX”).
- [Rhode Island OPEB System Trust](#): Approve a commitment of up to \$450,000 to SROA Capital Fund IX (“SROA IX”).

ASSET CLASS: Non-Core Real Estate (ERSRI), Private Growth – Non-Core Real Estate (OPEB)

SUB-STRATEGY: Value-Add Self Storage

ALLOCATION:

- [Rhode Island Employees Retirement Systems Pooled Trust](#): The target allocation for Non-Core Real Estate is 2.5% and the allocation as of 8/31/2024 is 2.2%. Pacing plan for 2024 vintage is \$95 million committed to 3-5 funds at \$15-25 million per fund. Pending approval of this recommendation, ERSRI’s 2024 vintage commitments will be \$70 million.
- [Rhode Island OPEB System Trust](#): The target allocation for Private Growth is 5.0% and the Non-Core Real Estate sub-strategy is targeted to represent ~20% of the asset class (i.e. 1.0% at the OPEB Trust level). The actual allocation to Private Growth – Non-Core Real Estate as of 8/31/2024 is 0.2%. Pacing plan for 2024 vintage is \$2 million committed to 3-4 funds at \$0.45-0.60 million per fund. Pending approval of this recommendation, OPEB’s 2024 commitments will be \$2.1 million.

PORTFOLIO FIT:

- [Rhode Island Employees Retirement Systems Pooled Trust](#): The ERSRI Non-Core Real Estate portfolio contains a mix of sector focused and diversified funds that bring operational expertise to value-add and opportunistic asset types (see Appendix 3). ERSRI allocates to sector focused funds that demonstrate specialized expertise and differentiated execution. SROA Capital is founded in 2013 and focuses exclusively on owning and managing self-storage properties in the U.S. While SROA is of the largest owners of self-storage in the U.S., its market share, measured by the number of properties, accounts only about 1% of the total U.S market. The U.S. self-storage market is fragmented with non-institution ‘mom-and-pop’ owners dominating the market. Most of ERSRI’s existing exposure to self-storage is from its position in core real estate funds (Heitman America Real Estate Trust & Morgan Stanley Prime). SROA targets to use moderate leverage (55-60% Loan-to-Value ‘LTV’) whereas core funds target to use lower leverage (20-25% LTV). Compared to core real estate funds, SROA targets single assets or portfolios with a higher risk-return profile. In addition to portfolio acquisitions, SROA is good at sourcing deals from non-institution ‘mom-and-pop’ owners. Part of SROA’s value creation comes from aggregating and institutionalizing undermanaged properties by re-branding, and bringing in a state-of-the-art technology platform, revenue management and customer service. SROA is differentiated from ERSRI’s existing core self-storage exposure.

Pending approval of the recommendation, SROA IX would represent ~3% of the Non-Core Real Estate Portfolio (see Appendix 4).

- [Rhode Island OPEB System Trust](#): The Private Growth portfolio allocates to Private Equity and Non-Core Real Estate (as described above) strategies and is ramping up to its target allocation through commitments made in

tandem with ERSRI. Pending approval of the recommendation, SROA IX would represent ~7% of Private Growth's Non-Core Real Estate allocation within OPEB (see Appendix 5).

MERITS:

- **Resilient Demand, Diversified Rent Roll & Unique Market Fundamentals related to Self-Storage:** A typical self-storage facility can usually be characterized as having 1) high profit margin, 2) low Capex, 3) 400-500 units and thus 400-500 tenants (diversified rent roll), 4) month-to-month lease with the ability to increase rent with a 30-day notice and 5) low delinquency rates and friendly legal framework/eviction process. Self-storage typically represents a small percentage of people's/small business's expenditure (e.g. average 10x10 unit is about \$100/month but can vary substantially depending on the market) and compared to larger expenditure items such as housing, the increase in rent in self-storage can be small to users (e.g. \$5 increase per month Y-o-Y assuming 5% increase on a \$100/month 10x10 unit) but big to self-storage owners at the same time (e.g. 5% annual same-store revenue growth). Demand drivers for self-storage is unlikely to go away and they are death, divorce, dislocation, density, downsizing and disasters. Self-storage tends to have consistent demand from those demand drivers in good and bad economy. Switching cost is somewhat high and renters are less likely to relocate if the rent increase is small to moderate.
- **Sector Specialist & Vertical Integration:** SROA is an owner and operator in self-storage. SROA's sourcing allows it to acquire large portfolios from other institutional owners who need to sell for various reasons (liquidity constraints, debt maturity, end of fund life) but more importantly, SROA's sourcing team is able to filter and source from non-institution 'mom-and-pop' owners and aggregate single assets. Those non-institutionalized single assets usually don't have a revenue management system or a marketing team or sometimes even an onshore customer service representative. By rebranding, centralizing customer service and marketing, and implementing revenue management tools, SROA is able to provide better and timely customer service to users while growing revenue and achieving cost savings through combined management synergies.

CONCERNS:

- **Limited Realizations:** SROA has limited realizations. In addition, current realized investments are mostly recapitalizations. 2014-2015 funds (Elite Fund I to III) are recapped in 2018 SROA SP Fund I which was recapped again in CMA fund I (2022). It's too early to judge the performance on the most recent fund - SROA VIII, a 2020 vintage fund as 1) deals are underwritten with an **intended** long hold period and 2) SROA targets portfolio liquidation and tries to capture portfolio premium over single property sales.
 - **Mitigant – Operating Business with Higher Cash-on-Cash Return in Later Stage:** The goal of achieving both target net multiple of 2.0x and net IRR of 10-13% is dependent on the successful exit of portfolios during fund life. With new institutional investors and potential increase of appetite in stabilized self-storage from core/core+ funds or public companies that target portfolio acquisitions rather than gathering assets on an individual basis, SROA may encounter exit opportunities throughout the life of the fund. If SROA fails to exit on time, the fund may fail to deliver the target net IRR but may still meet or even exceed the target multiples through a longer hold period – investors will be holding core/core+ stabilized assets in its original value add allocation.
- **Third Party Ownership and No Ownership from Senior Management:** No single person has majority (>50%) voting power and majority of the firm is owned by non-employees of the firm. No senior management team has any firm ownership.
 - **Mitigant – Key Man Provision & Succession Plan:** Ben Macfarland, Co-Founder & CEO, is designated as a Key Person and he has an established path to gain majority (>50%) control. He spends all his business time in sourcing, underwriting and monitoring investments, and managing the firm. Senior management team is compensated with a base salary, an annual incentive bonus and a share of carried interest.

ESG: SROA is categorized as an ESG Integrator.

- **ESG:** SROA has an ESG policy and ESG considerations are integrated throughout the investment lifecycle. Acquisition and Investment team is responsible for conducting and compiling ESG due diligence and findings as part of the property condition assessment which will then be used by the investment committee as part of the

decision making. The construction team and operations team will work with district managers and site managers to implement ESG initiatives. SROA tracks energy consumption in SROA VIII and intend to start reporting on SROA IX in 2025. SROA tries to quantify additional return (i.e. yield on cost) on some of its ESG initiatives and it seeks to install solar panel wherever it's economically feasible. SROA started reporting to GRESB ("Global Real Estate Sustainability Benchmark") in 2023 and became a PRI ("Principles for Responsible Investment") signatory in 2024.

- **DEI:** SROA's HR department oversees firm's diversity and inclusion initiatives. The firm has about 800+ employees and it uses human resources information systems (HRIS) from ADP to establish and measure DE&I goals, track progress, identify challenges, and discover opportunities for growth. SROA posts job to multiple channels including Handshake and it's committed to broadening the candidate pool to increase workplace diversity.

FEES: Fees for SROA IX are in-line with industry standards. Through Meketa's client aggregation fee discount, ERSRI and RI OPEB Trust will pay a discounted management fee.

- **Management Fees:** For a commitment less than \$25 million, SROA IX charges a 1.5% management fee for capital commitment during the 3-year investment period and 1.5% of net invested capital thereafter. Through Meketa's relationship, the discounted management fee is 0.8% on capital commitment during investment period and 0.8% on invested capital thereafter.
- **Carried Interest:** For primary fund commitment, carried interest is 20% over an 7% hurdle, slightly below market standard of 8% hurdle, with no catchup to the GP, which is favorable compared to the standard of 50% catch up. Carry is distributed on a total fund basis (European Waterfall).

Appendix 1: ERSRI Prior Fund Exposure

This section is left blank intentionally. ERSRI has no exposure to prior SROA funds.

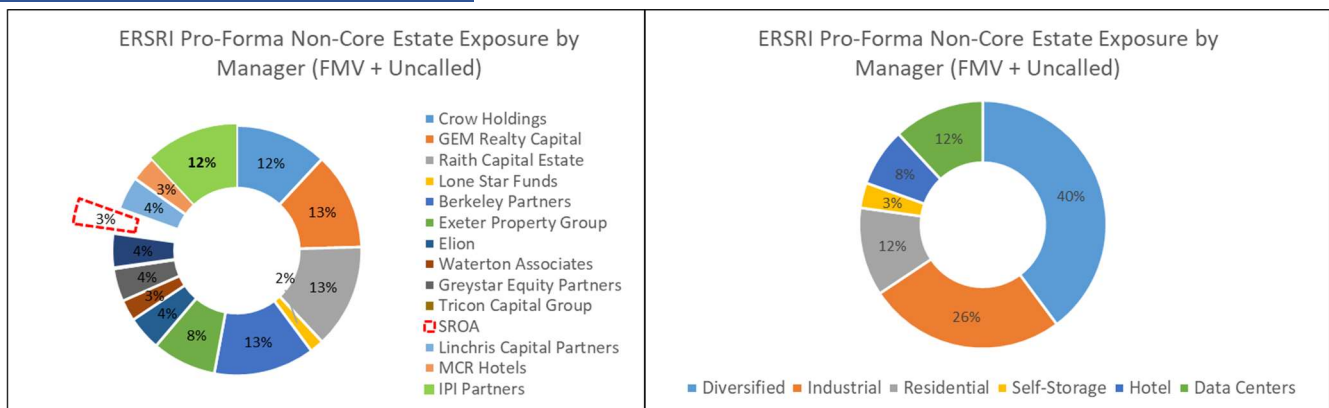
Appendix 2: ERSRI Prior Fund Performance

This section is left blank intentionally. ERSRI has no exposure to prior SROA funds.

Appendix 3: ERSRI Non-Core Real Estate Managers

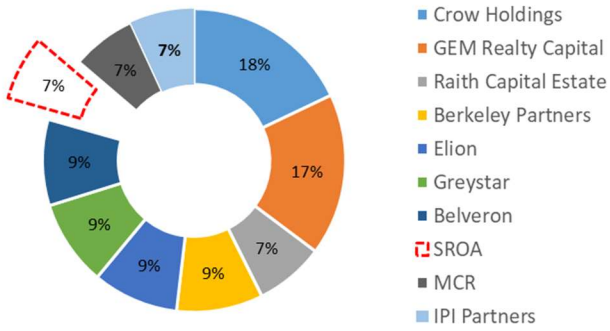
ERSRI Non-Core Real Estate Managers		
Manager	Sub-Strategy	Sector
Crow (Diversified)	Value-Add	Diversified
GEM	Value-Add/Opportunistic	Diversified
Raith	Opportunistic	Diversified
Lone Star	Distressed	Diversified
IC Berkeley	Value-Add	Industrial
Exeter	Value-Add	Industrial
Elion	Value-Add	Industrial
Crow (Retail)	Value-Add	Retail - Food & Service
Waterton	Value-Add	Residential
Greystar	Value-Add	Residential
Belveron	Value-Add	Residential
SROA	Core+ / Value-Add	Self-Storage
Linchris	Value-Add	Hotel
MCR	Value-Add	Hotel
IPI	Value-Add/Opportunistic	Data Centers

Appendix 4: ERSRI Portfolio Fit



Appendix 5: OPEB Portfolio Fit

OPEB Pro-Forma Non-Core Estate Exposure by Sector (FMV + Uncalled)



OPEB Pro-Forma Non-Core Estate Exposure by Sector (FMV + Uncalled)

