

NORTH CAROLINA  
DEPARTMENT OF STATE TREASURER



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INVESTMENT MANAGEMENT DIVISION

# Real Estate Update

May 26, 2021



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## Real Estate Team

Troy March, CCIM, MBA  
Director of Real Estate

8 Years with IMD  
19 Years Industry Experience

Portfolio Manager

Vacant

Chris Ward  
Analyst

7 years with IMD



## Real Estate Sector Analysis

Risk: ● Higher ● Medium ● Lower

● Data/Cell Tower	<ul style="list-style-type: none"> <li>• WFH technology, e-commerce, home entertainment, low-staffing requirements</li> <li>• 5G adoption driving record demand that shows no sign of slowing</li> </ul>
● Industrial	<ul style="list-style-type: none"> <li>• Home delivery/e-commerce/e-grocery - higher demand for cold storage</li> <li>• More inventory buffer, less JIT, thus increasing warehouse space demand</li> </ul>
● Multifamily	<ul style="list-style-type: none"> <li>• Necessity-based with pricing power correlated to local employment</li> <li>• Limited stock of single-family-for-sale provides buffer for multifamily sector</li> </ul>
● Self-Storage	<ul style="list-style-type: none"> <li>• Demand is historically high; Need for temporary storage: retailers, students</li> <li>• Resilient in crisis, will strength continue after pandemic?</li> </ul>
● Senior Housing	<ul style="list-style-type: none"> <li>• Occupancy impacted due to move-in challenges from COVID, demand still exists</li> <li>• Oversupply of recent years has moderated, demographics drivers are strong</li> </ul>
● Student Housing	<ul style="list-style-type: none"> <li>• Campuses operating on a mix of remote and in-person basis</li> <li>• Leasing for fall 2021 is accelerating, just slightly behind a typical year</li> </ul>
● Office	<ul style="list-style-type: none"> <li>• The effects of work-from-home and de-densification on demand will be impactful</li> <li>• Impact is market specific; some markets benefiting at the expense of others</li> </ul>
● Retail	<ul style="list-style-type: none"> <li>• Neighborhood, necessity-based retail still proving resilient</li> <li>• Pent up demand will provide some recovery in near term but supply overhang will hold down any rent growth for years</li> </ul>
● Hotel	<ul style="list-style-type: none"> <li>• Business travel remains anemic and will be slow to return</li> <li>• Leisure travel has picked up but staffing is very challenging</li> </ul>



## 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

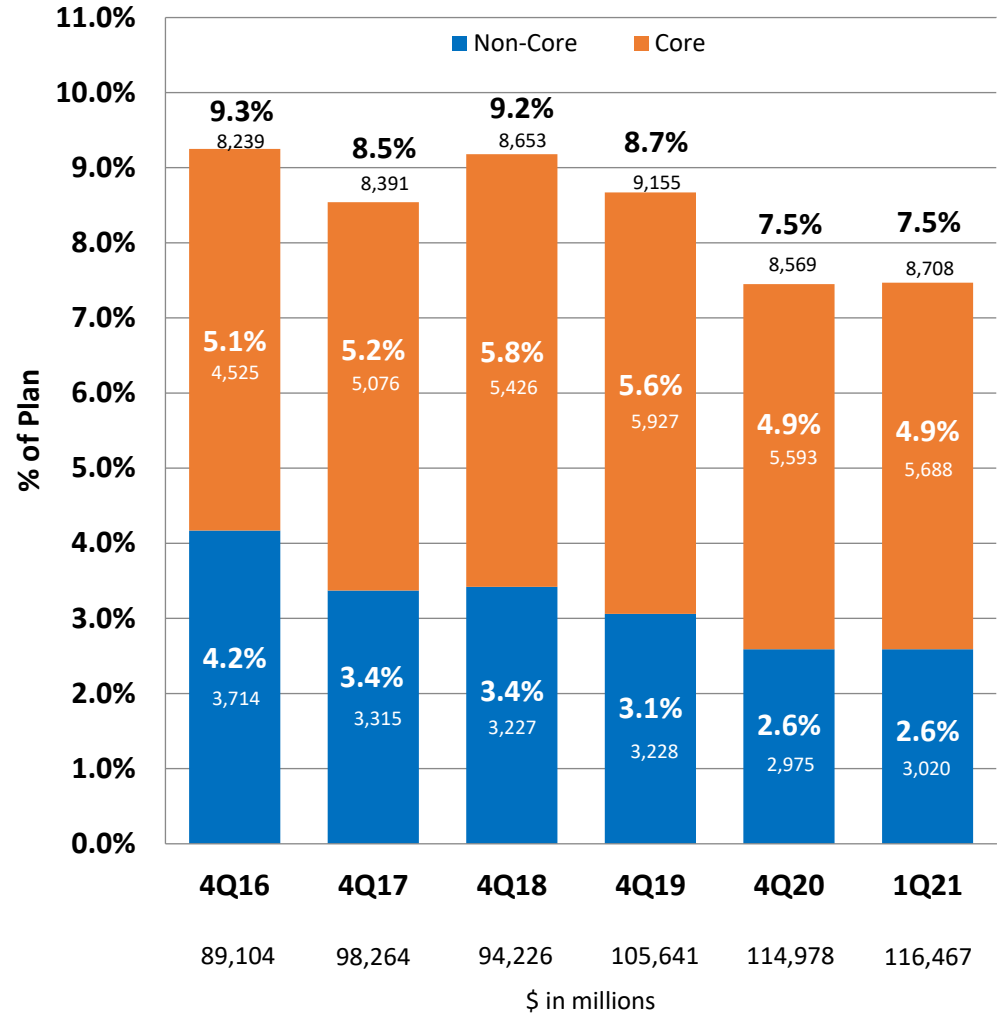
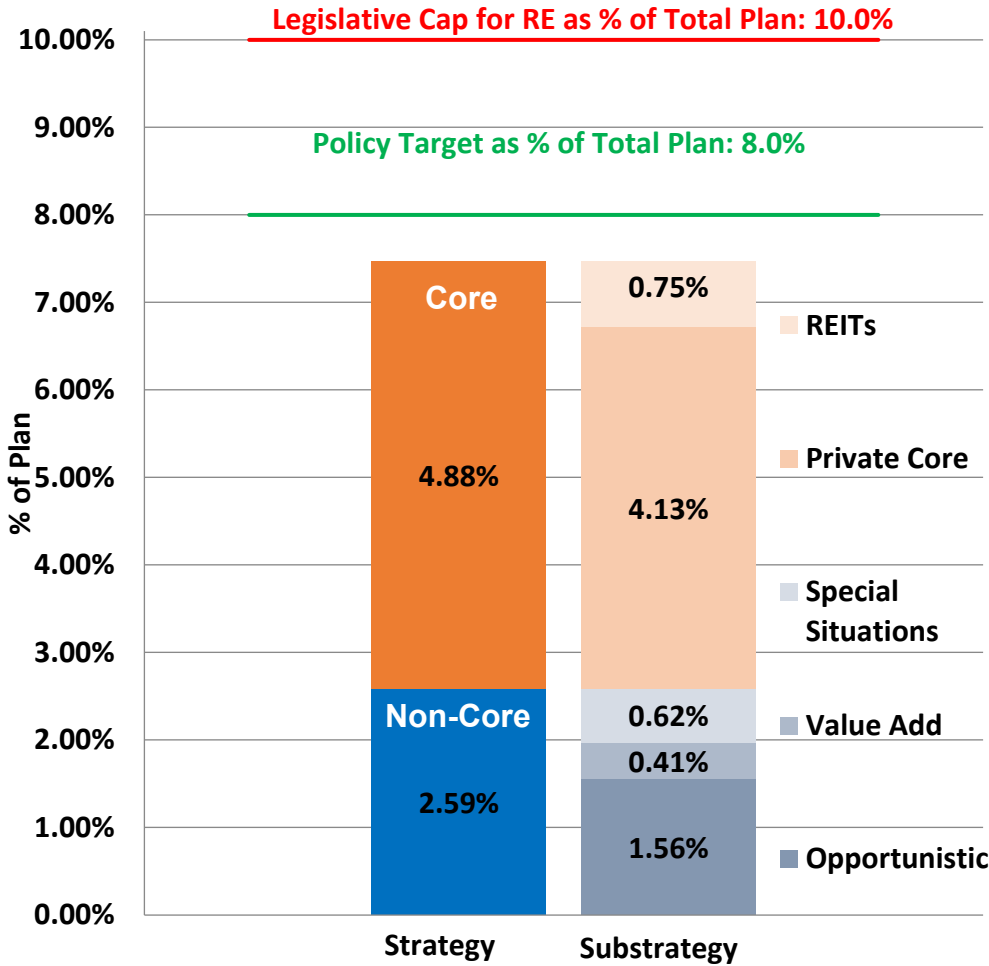
Renovation, development, leasing

Stabilized upon completion

Long-term appreciation and returns

Low correlation to fixed income

# Real Estate Allocation

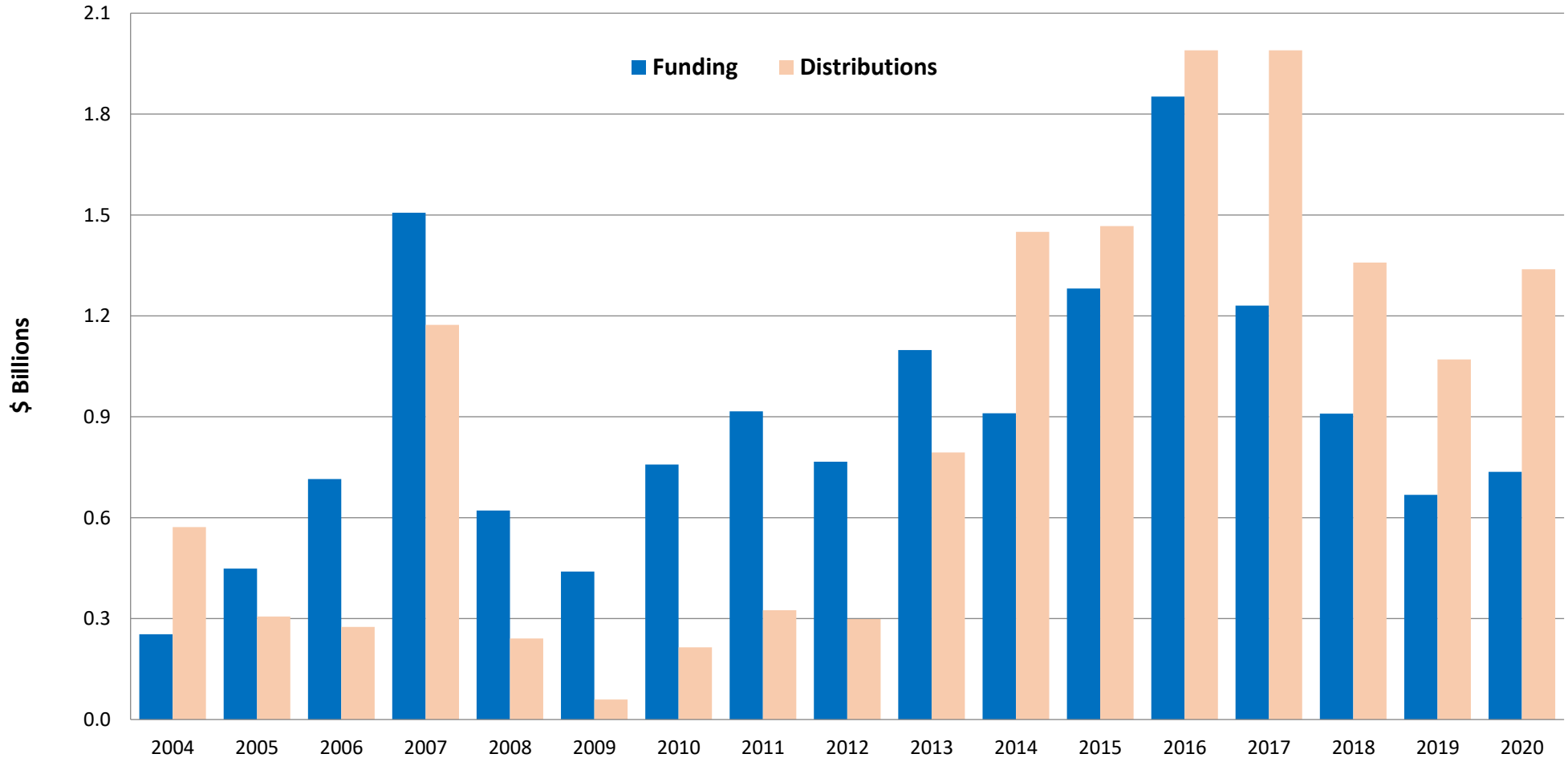


NCRS data as of 3/31/2021  
Special Situations – Build-to-Core Strategy

Real Estate is underweighted by 70 bp as of 5/17, due to rapid growth of total Pension Plan assets and fewer new commitments



# 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	0
(Vintage)*																	

NCRS data through 12/31/2020

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

Net distributions for 2020 were \$602 million. 2021 YTD (as of 5/17) contributions were \$61 million and distributions totaled \$240 million

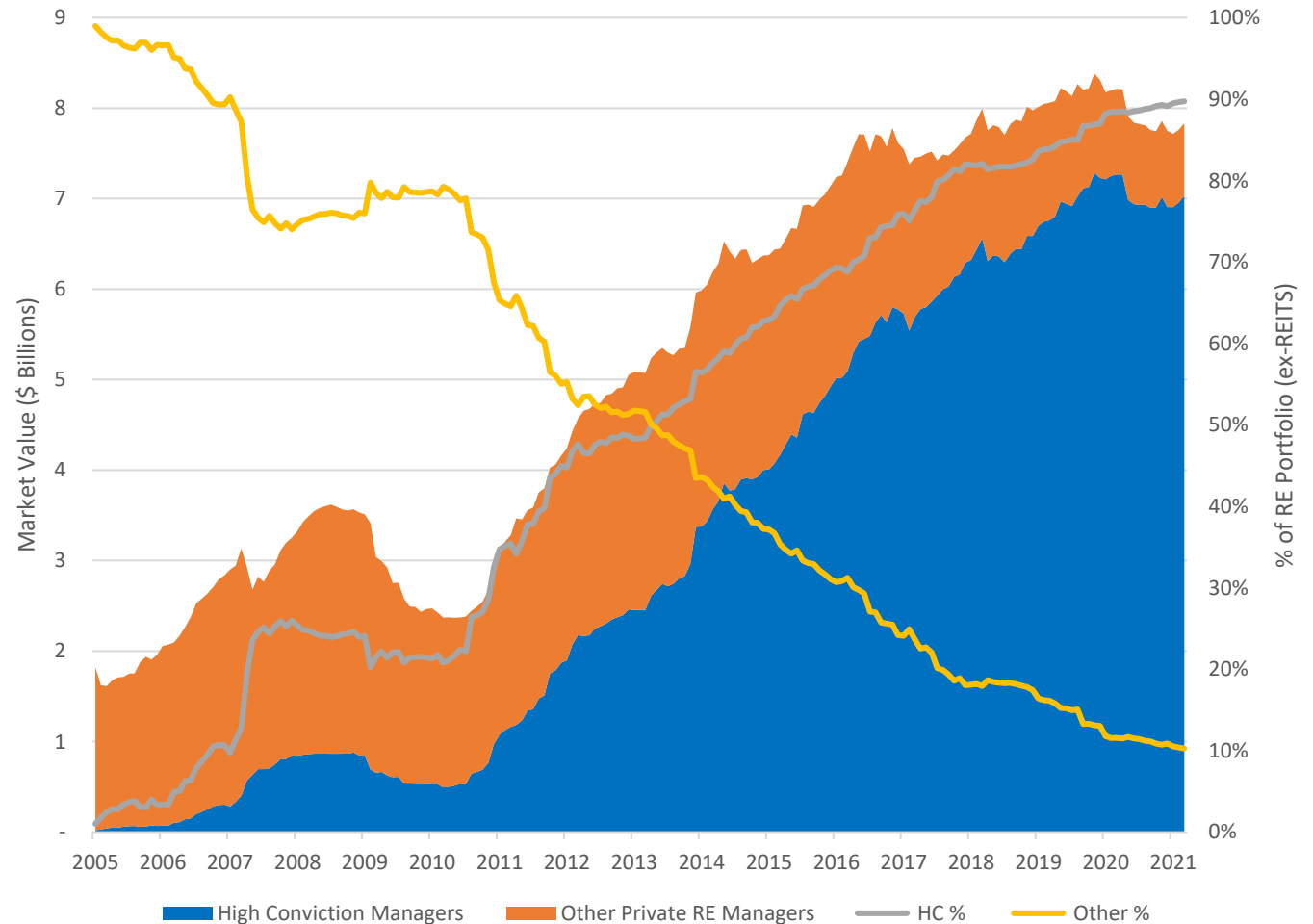


## Manager Concentration (excludes REITs)

Contribution to Return			
	3 Year	5 Year	7 Year
<b>Private Core</b>	<b>5.3</b>	<b>6.7</b>	<b>7.3</b>
High Conviction	5.1	5.9	5.4
Others	0.2	0.8	1.9
<b>Non-Core</b>	<b>6.8</b>	<b>9.3</b>	<b>11.4</b>
High Conviction	6.3	7.9	8.9
Others	0.5	1.4	2.5

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

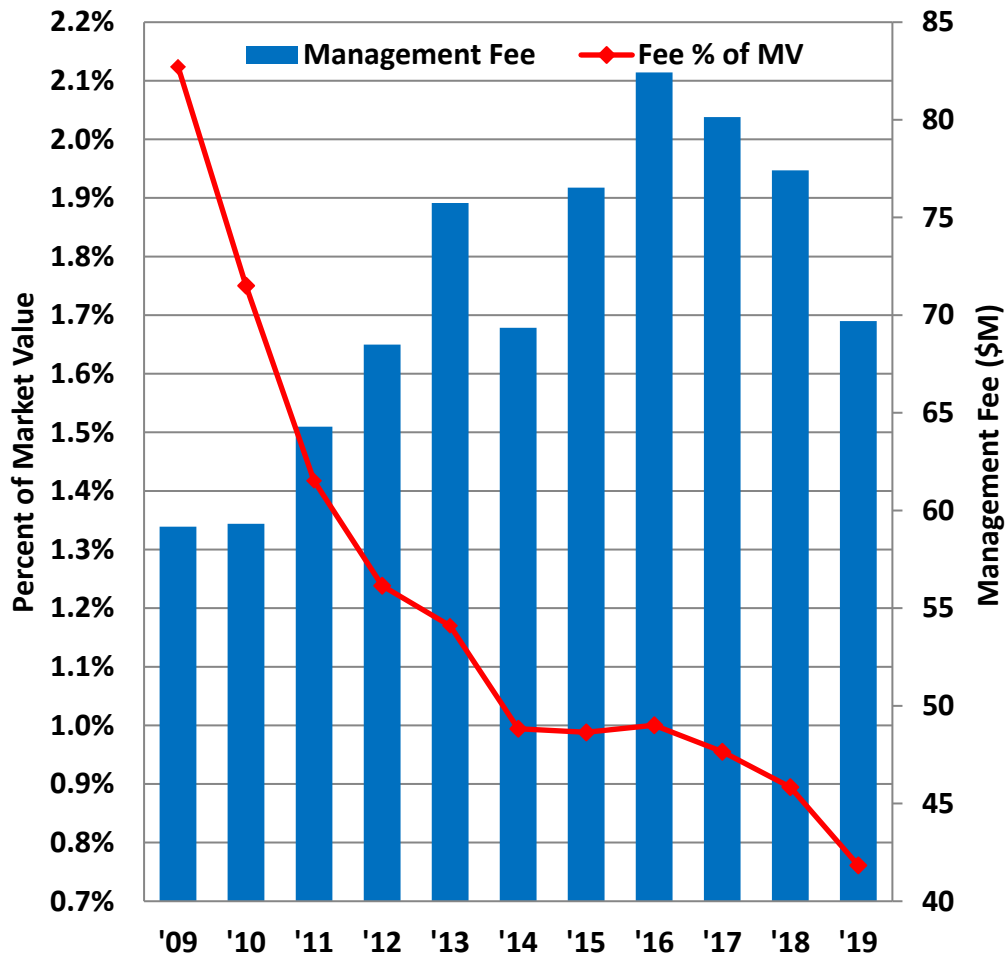
NCRS data through 3/31/2021



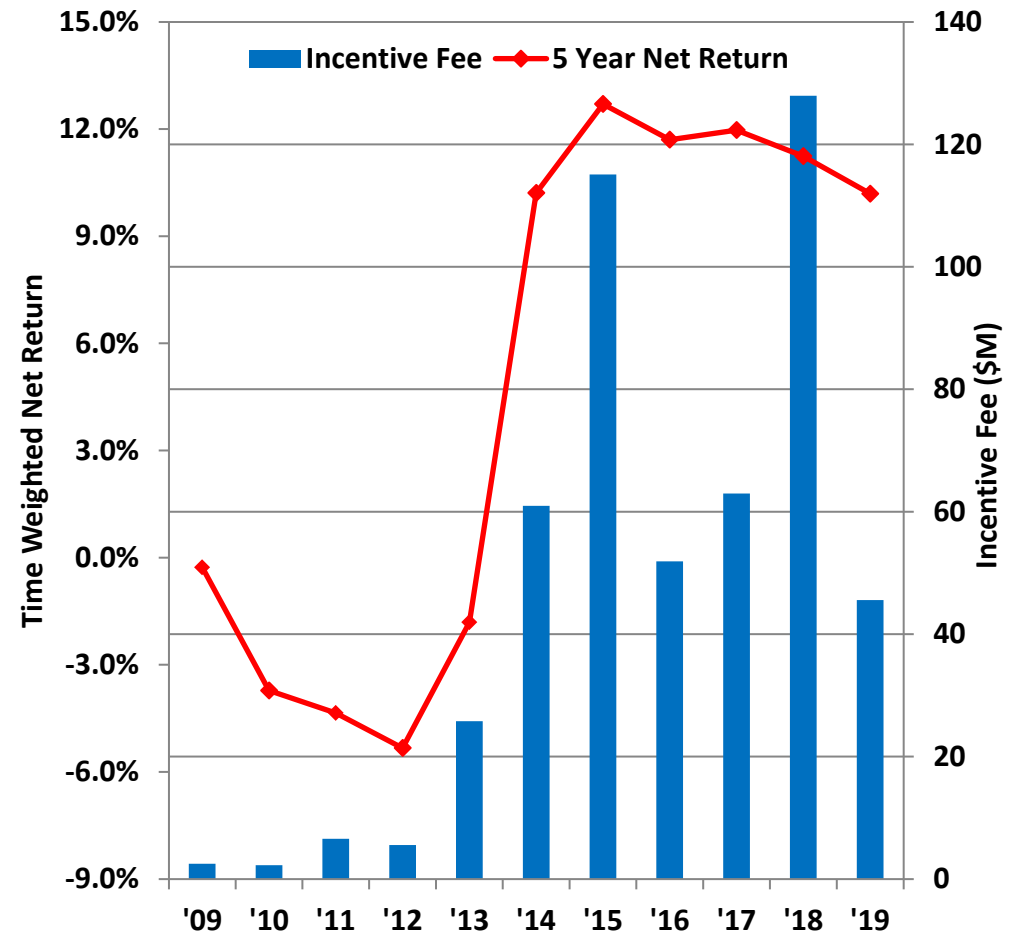
90% of private market value is with high conviction managers – Concentration helps reduce complexity and fees, increases transparency and maximizes returns



# Cost Efficiency



NCRS data through 12/31/2019



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

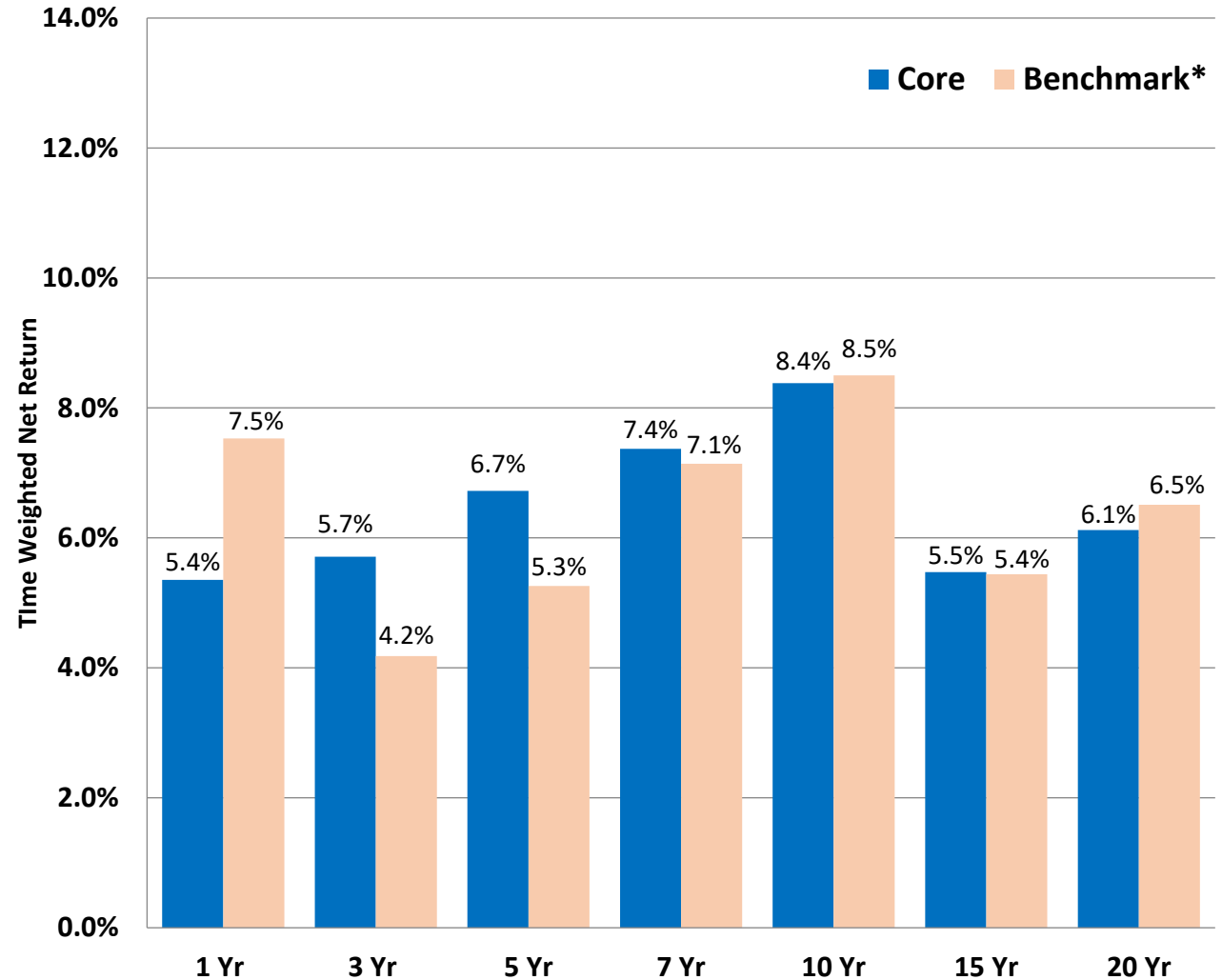
Fees continue to trend lower as we leverage relationships and scale to minimize costs and enhance alignment



## Performance: Core Real Estate

Core Contribution to Return			
3 Year		Contribution	
Private Core RE		4.6	
REITs		1.1	
Total Core		5.7	
Major Drivers		Vintage	
LBA NC Core			
PC Industrial	2016	1.1	
PC NorthRock Core	2008	0.8	
REIT BR World REIT	2016	0.7	
5 Year		Contribution	
Private Core RE		5.7	
REITs		1.0	
Total Core		6.7	
Major Drivers		Vintage	
LBA NC Core			
PC NorthRock Core	2008	1.2	
PC Industrial	2013	0.7	
PC NorthRock II Core	2016	0.6	

NCRS data through 3/31/2021



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

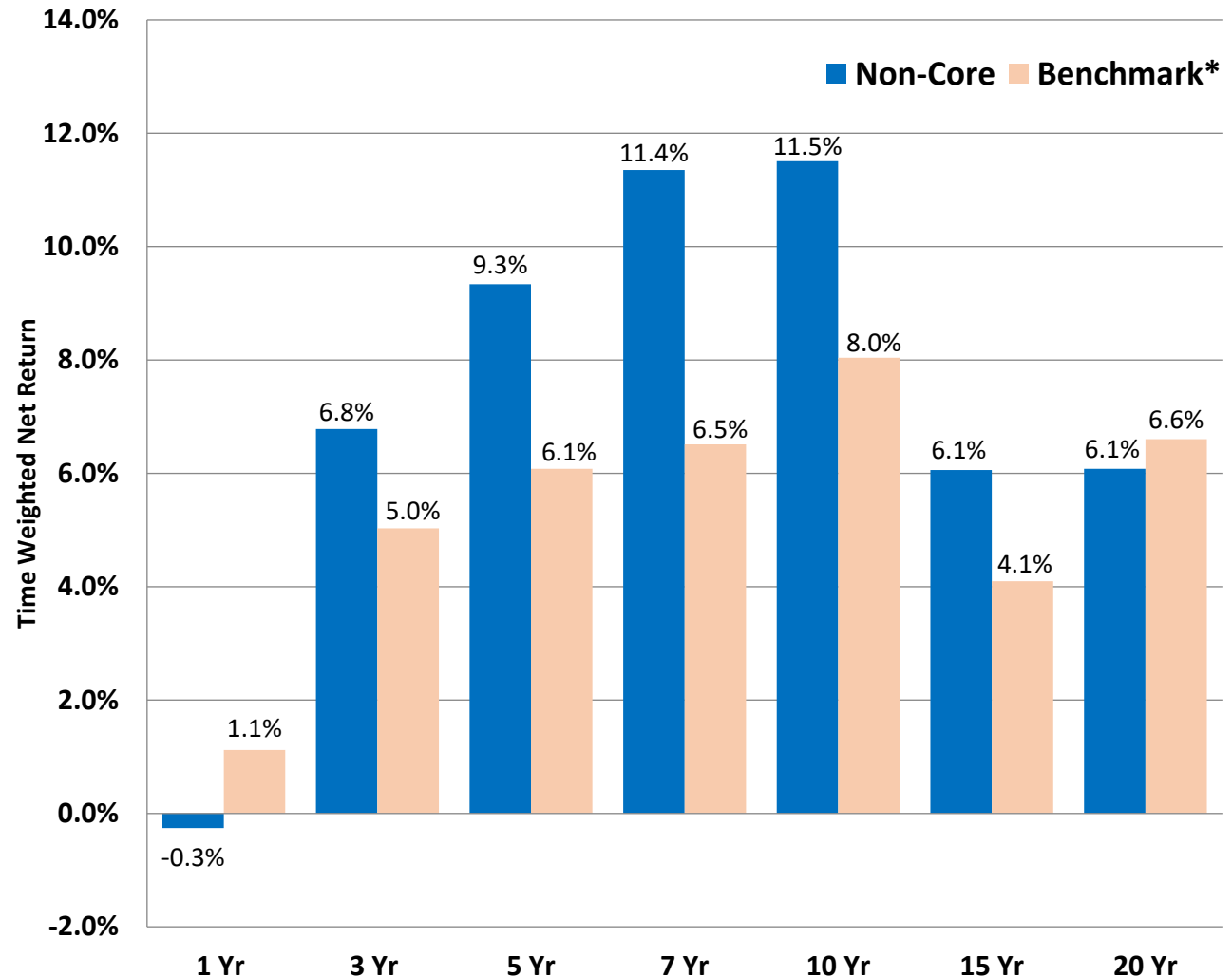
Underweighting to REITs of 470 bp hurt in the one-year period ending 3/31/21 as REITs were up 36.0% YOY



## Performance: Non-Core Real Estate

Non-Core Contribution to Return			
3 Year		Contribution	
Opportunistic		4.1	
Value Add		2.7	
Total Non-Core		6.8	
<u>Major Drivers</u>	<u>Vintage</u>		
Rockwood Dev			
V Partners	2016	1.0	
O NorthCreek	2011	0.8	
V DRA G&I VII	2011	0.7	
5 Year		Contribution	
Opportunistic		6.0	
Value Add		3.3	
Total Non-Core		9.3	
<u>Major Drivers</u>	<u>Vintage</u>		
O NorthCreek	2011	1.3	
V DRA G&I VII	2011	0.8	
Blackstone			
O Europe IV	2013	0.7	

NCRS data through 3/31/2021

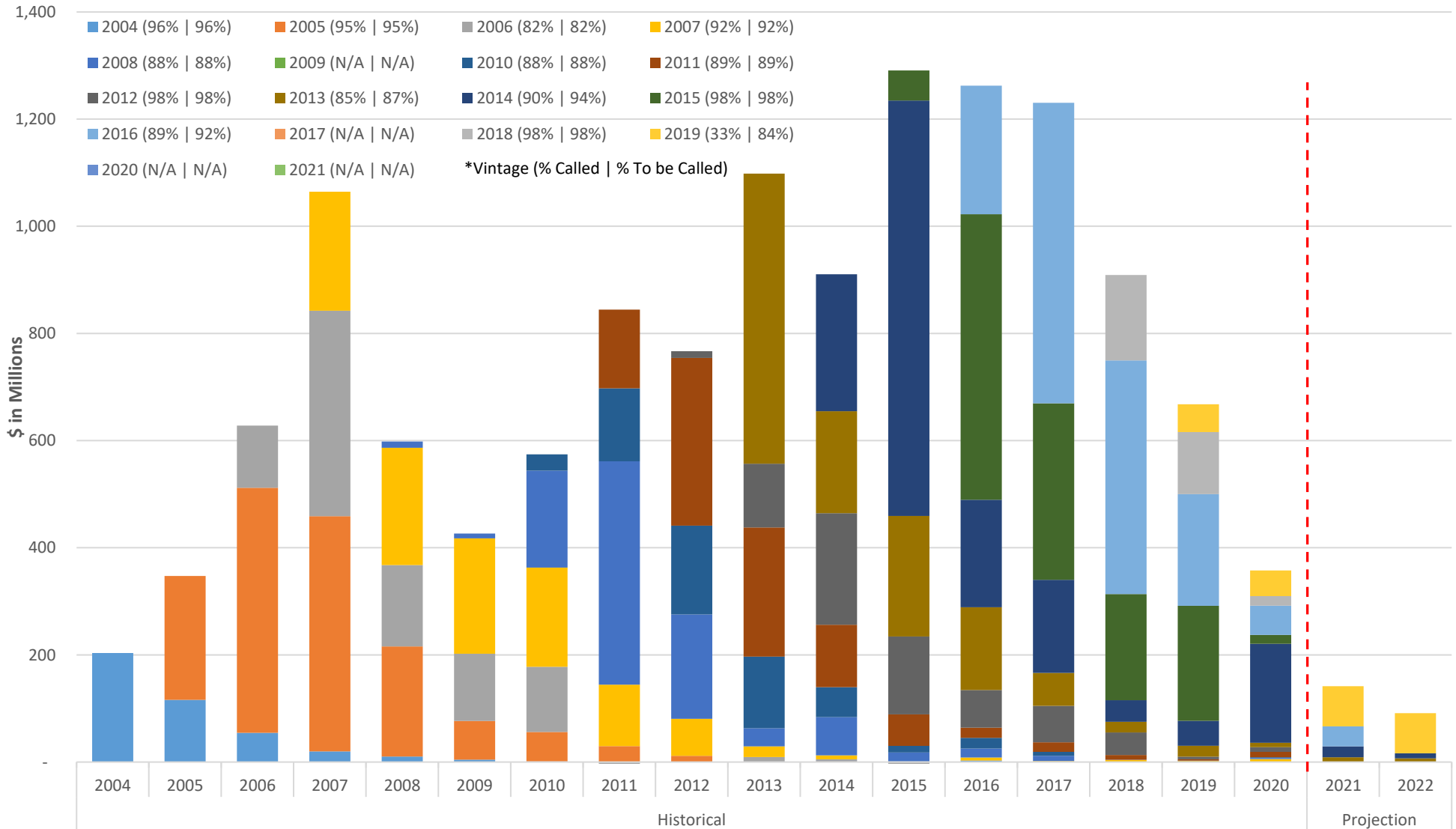


\* Non-Core Real Estate Benchmark is comprised of the following Burgiss Group Private iQ indices: 80% U.S. Non-Core Real Estate (Opportunistic and Value-Added) and 20% Non-U.S. Non-Core Real Estate (Opportunistic and Value-Added).

Write downs taken in 2020 are starting to bounce back, transaction volume is increasing, 2021 will be better



# Unfunded Commitment Pacing by Vintage Year (excludes REITs)



Of the \$1.2 billion in unfunded commitments at 3/31/21, we project ~\$450 million will be called and ~\$750 million will be held as reserves and is unlikely to be called



## Investment Strategy Objectives

- 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



## Appendix

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20	Geographic Diversification



## 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

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

Invest meaningful amounts with fewer best-in-class managers

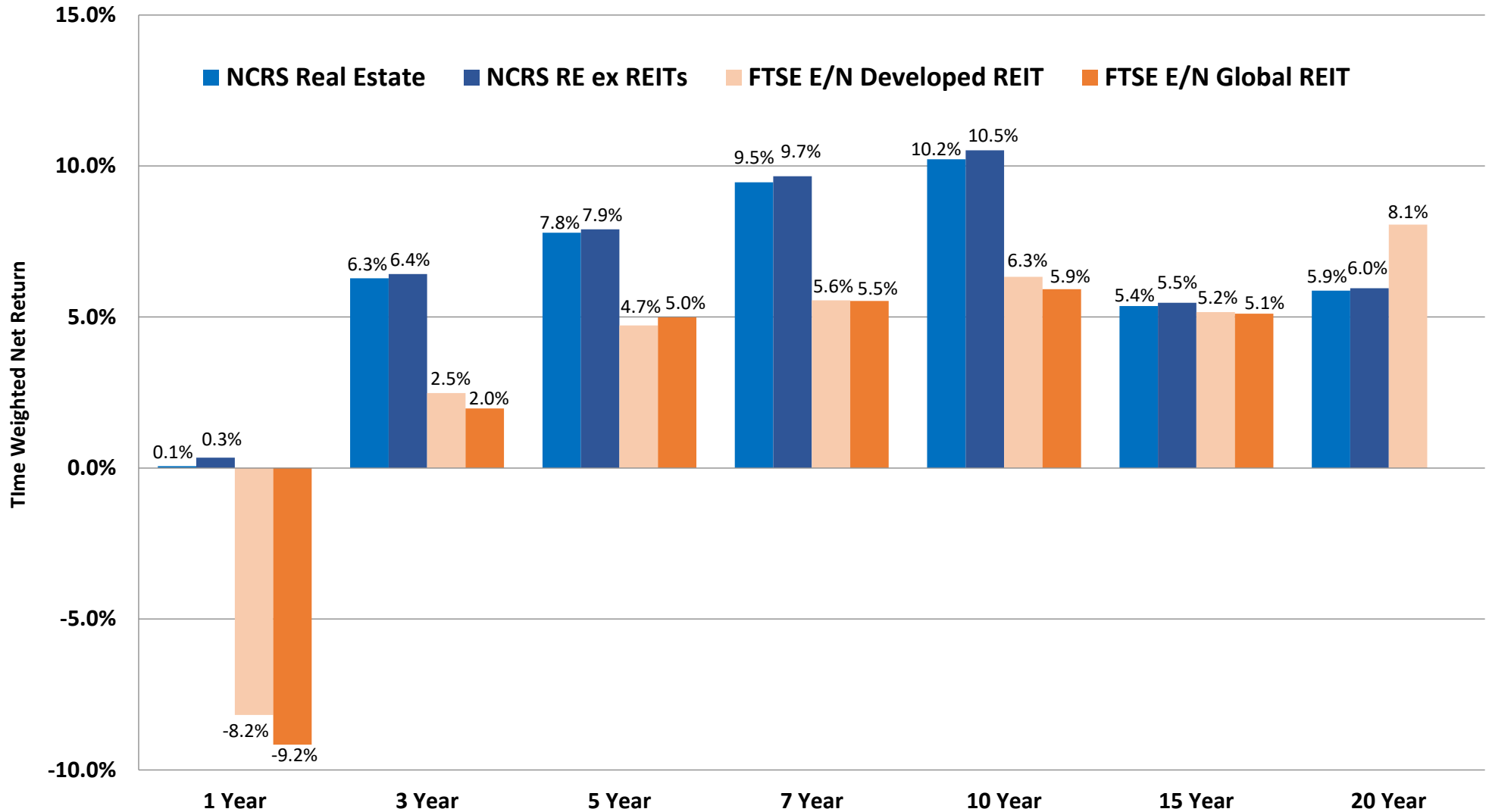
- Separate accounts, Platform investments
- Multiple strategies with single manager
- Fee benefits, founders' discounts

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 12/31/2020



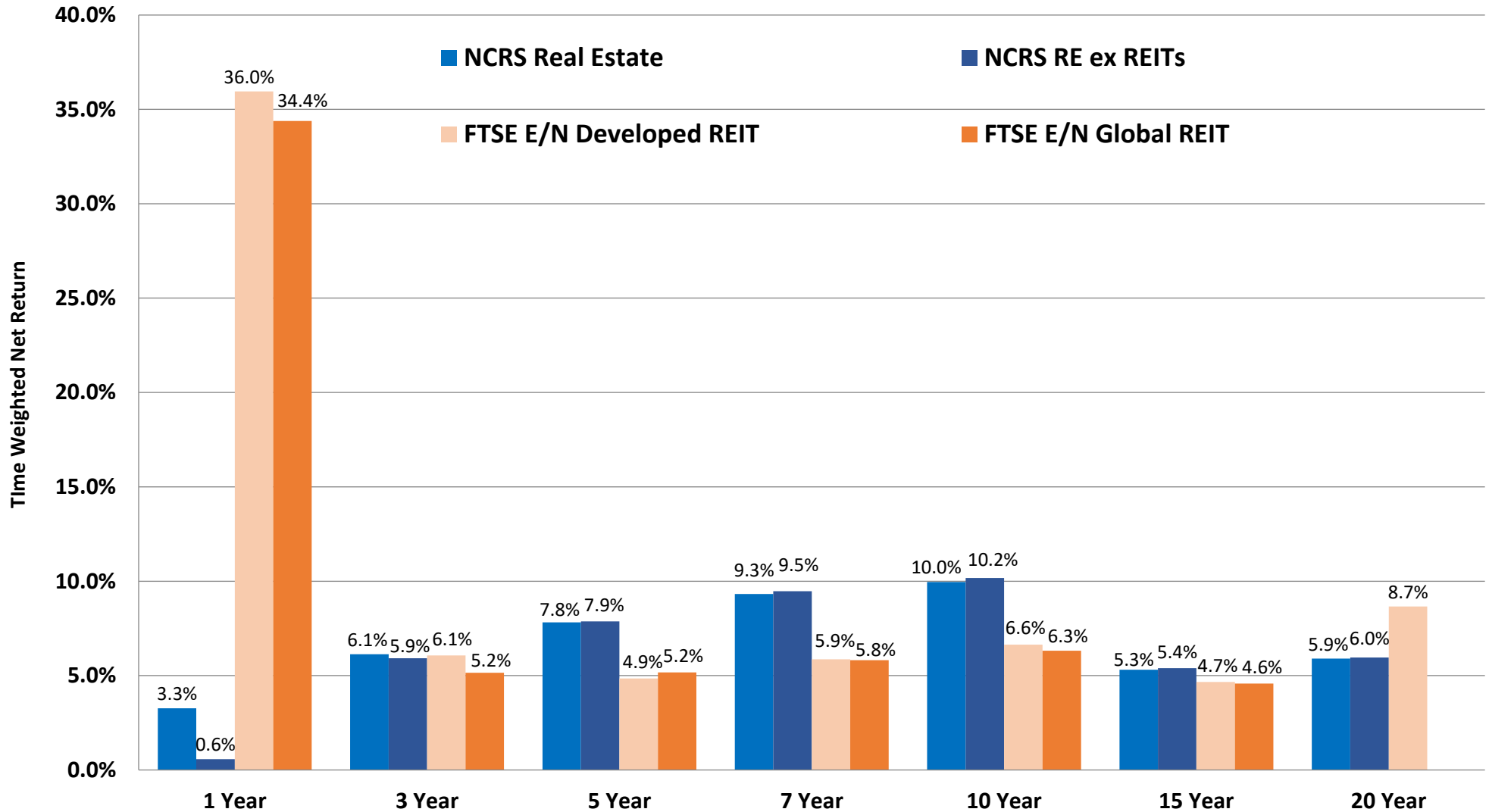
NCRS data through 12/31/2020

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 3/31/2021



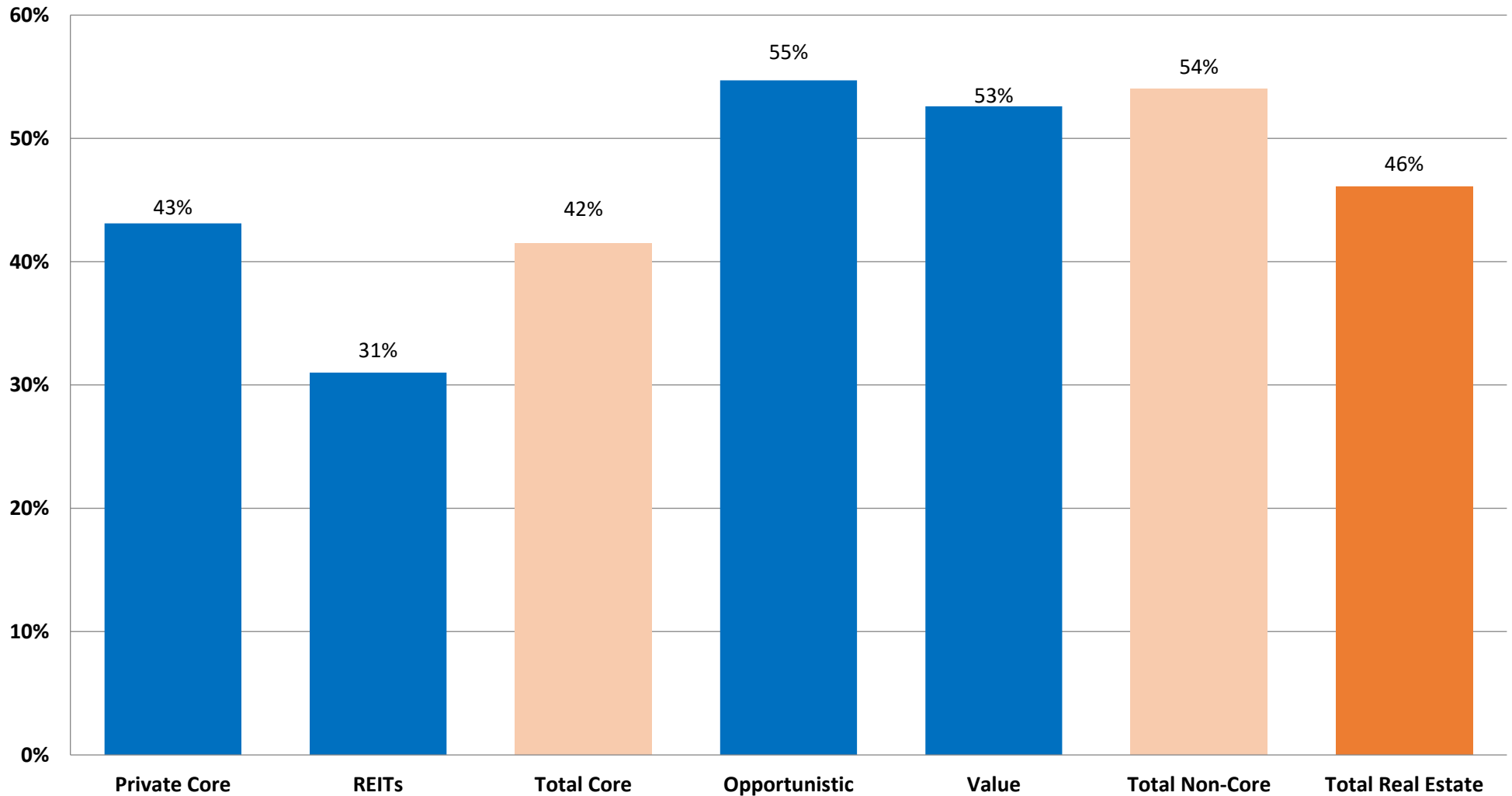
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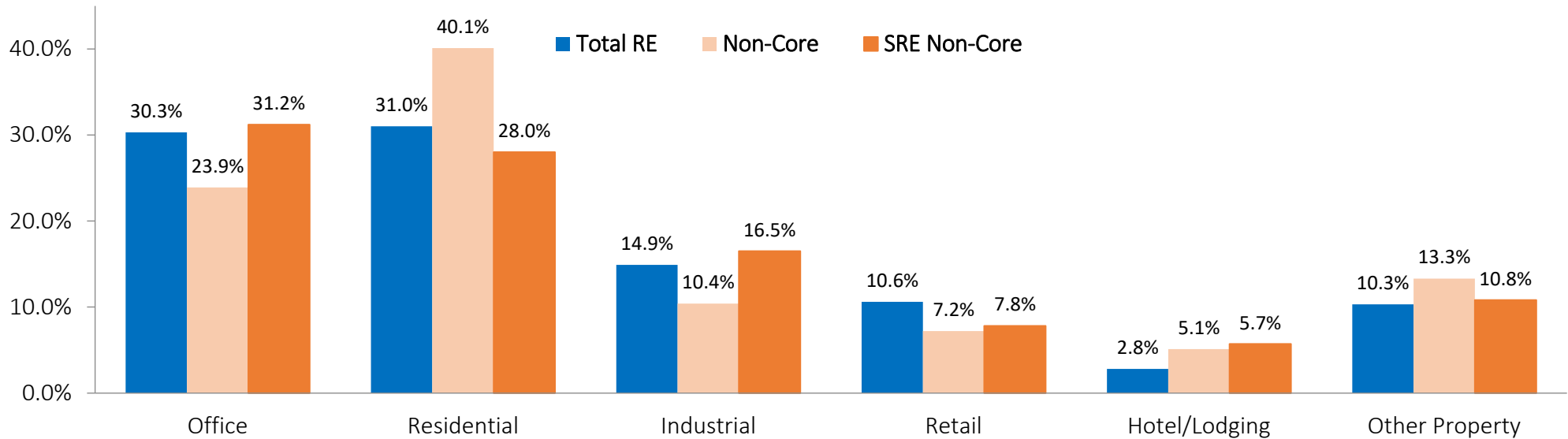
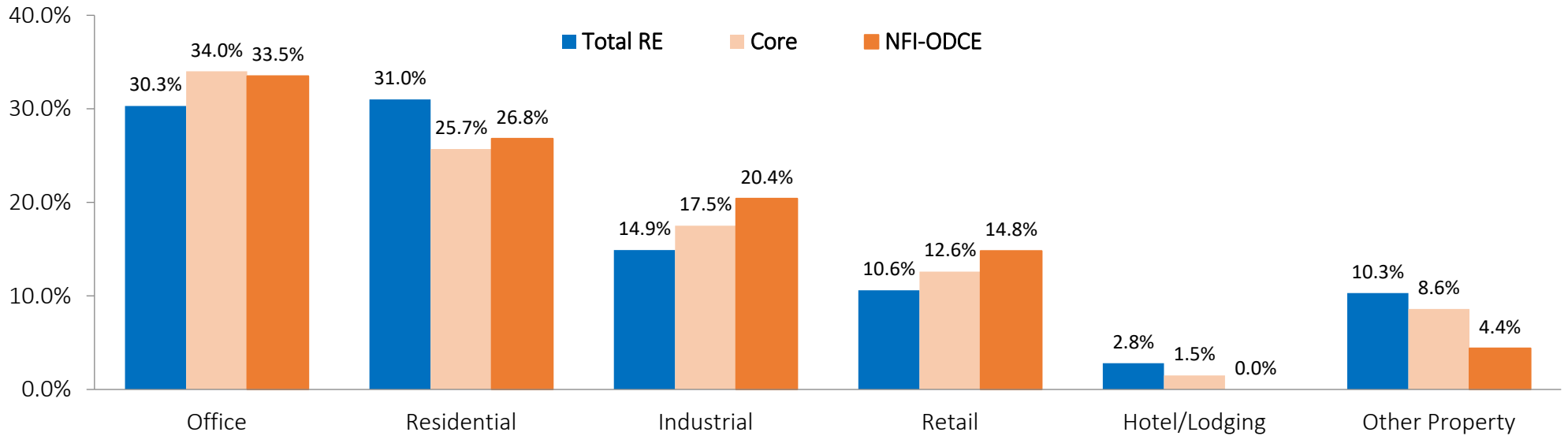
## Leverage



Source: StepStone NCRS 3Q20 Portfolio Monitoring Report

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

## Property Type Diversification



## Geographic Diversification

