



Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 20

MEETING DATE: January 19, 2022

SUBJECT: Asset Class Restructuring: Real Estate

SUBMITTED FOR: ___ Consent X Deliberation and Action ___ Receive and File

RECOMMENDATION

Staff recommends the Board approve the proposed implementation plan and revisions to the structure of the Real Estate asset class as presented by Townsend and SCERS' Investment Staff. The specific recommendations include:

- Adopt revised sub-strategy and geographic target allocations, including:
 - Revise target Core/Non-Core real estate weighting from 65%/35% to 60%/40%.
 - Increase Ex-US policy limit maximum from 30% to 35%.
 - Revise U.S. geographic diversification weightings from +/- 10% of the NFI-ODCE index to a similar geographic weighting as NFI-ODCE.
- Adopt a revised policy benchmark for the total real estate portfolio from a blend of 65% NFI-ODCE plus 35% NFI-ODCE + 1% to 60% NFI-ODCE plus 40% NFI-ODCE + 1%.
- Direct staff to make conforming changes to the Real Return Asset Category and Master Investment Policy Statements for approval by the Board at a future meeting.

PURPOSE

This item supports the implementation of the revised strategic asset allocation, which calls for Staff and consultants to identify structuring considerations and implementation plans for each major asset class.

REAL ASSETS STRATEGIC CHANGES

In August 2021, SCERS' Board approved a revised strategic asset allocation, which resulted in the Real Estate target allocation increasing from 7% to 9%, with a range of +/-2%. The actual allocation to Real Estate is 7.2% as of September 30, 2021. Private market valuations are lagged a quarter. The 'Implementation Plan' section for Real Estate discussed below will cover the plan to build the Real Estate allocation and sub-sectors toward the target allocation of 9%.

The Real Estate asset class resides within the Real Return asset category, with the sub-asset class targets shown below:

SCERS Real Return Portfolio	Minimum	Target	Maximum
Real Estate	7%	9%	11%
Real Assets	5%	7%	9%
Liquid Real Return	0%	2%	3%
Real Return Asset Category		18%	

RECOMMENDED REAL ESTATE STRUCTURE REVISIONS

Below are recommendations to SCERS’ Real Estate asset class allocations. The recommended changes will go into effect upon Board approval, with an updated Real Return and Master Investment Policy Statement (IPS) provided later.

Real Estate resides within the broader Real Return asset category IPS, along with Real Assets and Liquid Real Return.

Real Estate Target and Range:

Previously, the Real Estate target allocation was 7%, with a range of +/- 2%; subsequently, a revision of the strategic allocation plan was approved in August 2021 increasing the target to 9%. Staff and Verus recommend maintaining the same +/- 2% range as reflected in the above chart.

Real Estate Sub-Strategy Diversification Guidelines:

Staff and Townsend recommend revising the Real Estate sub-strategy and geographic allocation targets and ranges, specifically, the sub-strategy mix between Core and Non-Core real estate would change slightly, from a 65%/35% weighting to a 60%/40% weighting, with flexible ranges around the targets. Staff and Townsend have been finding a larger opportunity set in Non-Core real estate with compelling risk-adjusted returns, and an increased allocation allows additional flexibility to pursue global thematic opportunities with the potential to enhance the overall portfolio returns.

Real estate investment strategies fall within two broad categories – core/core plus and non-core. Specifically, core and core plus strategies will typically possess a lower but stable risk-return profile due to attributes such as the majority of the return coming from cash yield; location in a primary metropolitan area; greater occupancy levels; long term leases; newer construction; and lower leverage (generally below 40%). Core plus strategies will look to enhance core returns by correcting a minor physical or fiscal deficiency or take advantage of a temporary market dislocation, and may use slightly more leverage than core real estate investments as well as include some non-traditional property types. A core/core plus portfolio serves as the foundation of an overall real estate portfolio and is meant to provide meaningful cash yield, low volatility, and is inflation linked.

Non-core real estate investments can provide a higher return but entail more risk by executing on a value-add or opportunistic strategy. Value add assets will generally have greater physical deficiencies requiring significant capital renovations or have high vacancy. Opportunistic strategies will assume more risks such as vacant or nearly vacant properties, redevelopment or repositioning of assets, or ground up development. Value add and opportunistic strategies will use higher levels of leverage (up to 65% or more) and generate a higher proportion of its return, if not all, from capital appreciation due to the significant capital expenditures needed. Non-core real estate serves as a compliment and return enhancer to the core portfolio, where the core portfolio is the foundation or Hub and the non-core portfolio is the building or Spoke investment.

In addition to the revision in the sub-strategy allocation mix, Staff and Townsend recommend increasing the non-U.S. allocation from a maximum policy limit of 30% to 35%, with a range from 0-35%. SCERS' current allocation to non-U.S. real estate is approximately 27%. This adjustment better reflects the greater number of interesting and better relative value opportunities outside of the U.S., and a more global portfolio offers greater diversification benefits than one concentrated only in the U.S. The increased maximum allocation to non-U.S. real estate will provide greater flexibility for existing non-U.S. fund commitments that are still drawing capital, while allowing SCERS to take advantage of new thematic opportunities that may offer compelling risk-adjusted returns globally, whether tactically or strategically.

In the equity and bond markets, institutional investors have long accepted the diversification benefits of a global portfolio. However, global diversification in real estate portfolios is less common despite the benefits observed from the public markets. The lack of a global real estate perspective can be attributed to the lack of expertise, skills, and knowledge in managing a global portfolio by pension fund staff. Consequently, most U.S. pension plans predominantly invest domestically, thus concentrating their investment risks to one market.

Local economic conditions are known to influence real estate performance; therefore, investing solely in a single market presents concentrated exposure to that one market's economic shocks and cycles, affecting overall portfolio returns. By limiting the real estate exposure to only the U.S, investors are missing out, not only the benefits of risk diversification, but access to a larger opportunity set of assets that may offer more attractive risk-return profiles, as each region in the world is experiencing different demographic trends, economic drivers, and macro sensitivities.

Because real estate performance is a function of location, market dynamics, and competitive set, a global investment approach provides diversification across multiple regions and locations. As one would expect, each region of the world experiences differing levels of economic growth and will be in different stages of the real estate cycle, not only the region but also each property type within a region will have differing cycles and sensitivities.

Having a wider opportunity set of investments offers a global real estate investor an advantage in potentially enhancing overall portfolio returns, while at the same time mitigating overall return volatility. Additionally, as noted, each property type within a market experiences different growth rates and demand drivers, creating further opportunities to drive returns from thematic strategies emanating from structural changes occurring in a country, an example being the growth in e-commerce generating outsized demand for industrial properties.

As with any investment, there are risks and real estate is no exception. Many of the real estate risks are inherent whether in the U.S or globally, and generally include tenant demand, supply, local and macro conditions, and investor demand, among others. When investing globally, there are other considerations to take into account beyond the fundamental real estate risk and foremost is currency. Hedging real estate cash flows is difficult due to the unknown timing of the cash flows and the costs to purchase hedges can be expensive at certain times. Typically, currency differences are naturally hedged by borrowing in the local currency. Of course, another natural currency hedge in a global real estate portfolio is diversifying investments across regions to mitigate any single currency exposure. In past due diligence on the currency impact on returns, Staff found that over a 10-year to 15-year fund life, the currency effect was +/-50 basis points for Euros and Australian dollars. Obviously, there will be year-to-year fluctuations but over the long term, the fluctuations tend to smooth out.

Outside of currency risk, additional nuances faced by global investors are legal system, regulatory regimes, and tax treatment. Tax-efficient vehicles have become more prevalent, with U.S. Feeder funds organized to eliminate local country taxation. Most European legal structures and property laws are similar to the U.S. and the regulatory regimes are quite similar to the U.S., with some jurisdictions more stringent than in the U.S. In short, while there are certainly differences across regions, it is for this reason that a global portfolio can enhance a U.S. investor's portfolio returns and increase diversification.

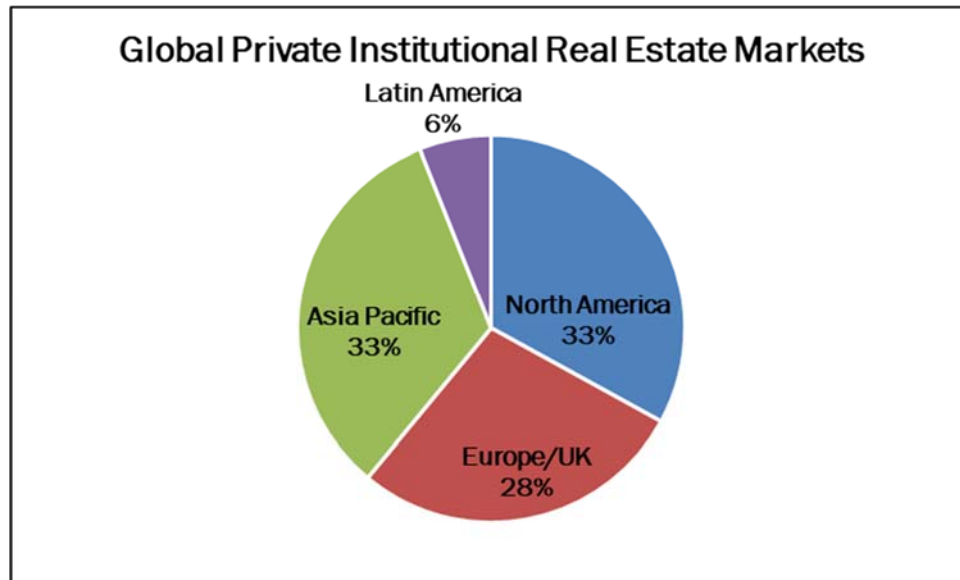
Return volatility or investment risk is mitigated through diversification, the larger the base of uncorrelated investments, the less chance of a single investment affecting the overall portfolio. Because each country has different demand drivers and economic conditions, it follows that real estate returns would also be different at any point in time. This difference in global economies results in differences in asset performance. By assembling a portfolio of investments across countries where the return outcomes are less correlated to each other, the most efficient and highest risk-adjusted portfolio is achieved. Adding exposures to a combination of higher growing countries like China and safe haven countries such as Japan and the Nordics, a global real estate portfolio can potentially generate long-term sustainable returns with lower volatility. Below is an example of country real estate return correlations to the U.S., as provided by LaSalle Investment Management.

Correlations to US	Private Market Indices as of 2016		
	5 Year	10 Year	15 Year
Australia	0.19	0.88	0.87
Japan	0.23	0.81	N/A
France	0.64	0.74	0.75
Germany	0.08	0.49	0.15
Netherlands	-0.28	0.51	0.48
UK	0.56	0.52	0.57
Canada	0.02	0.66	0.64

Source: LaSalle Investment Management

A 2019 opinion article by Nuveen titled, Global Real Estate Opportunity and Diversification, estimated the global private real estate investable universe at \$7.1 trillion. Compiling data provided by MSCI as of December 31, 2017, Nuveen found that the institutional real estate

investable universe was roughly split between North America, Europe, and Asia Pacific, as shown in the chart below. This would indicate that a U.S. only investor would be eliminating 67% of the world’s real estate market totaling \$4.2 trillion.



Source: Nuveen using MSCI data as of December 31, 2017

Recognizing that real estate is universal, a JP Morgan January 2021 research article, Going Global in Core Real Estate, determined a global real estate allocation would deliver enhanced risk-adjusted returns, lower volatility, reduce drawdowns, and better inflation performance for pension plans. Based on their 20-year historical analysis, with a real estate allocation of 50% U.S., 30% Europe, and 20% to Asia Pacific, the portfolio return increased by 0.9%, volatility decreased by 4%, and max drawdown reduced by 15%.

In terms of an optimal portfolio, JP Morgan makes a case for a global diversified portfolio constructed starting with a strong core real estate foundation and adding value add and opportunistic real estate as complementary exposures to enhance returns. As such, JP Morgan’s optimal global diversified real estate portfolio weighting would be a 40%-60% allocation to U.S., a 20%-40% weighting to Europe, and a 10%-30% share to Asia Pacific.

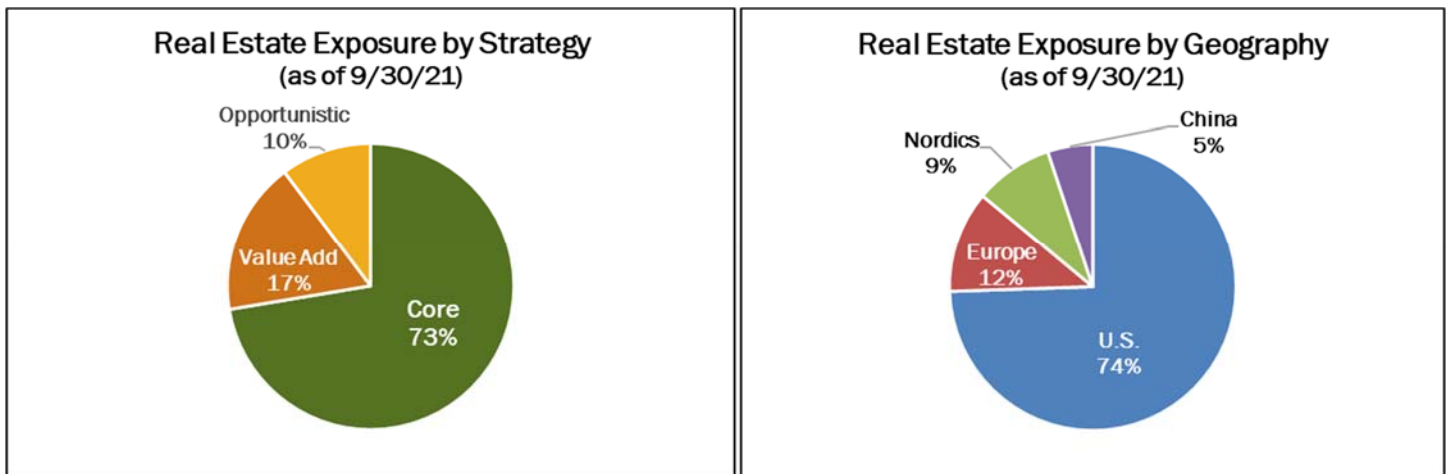
Current Real Estate Sub-Strategy Allocations:

SCERS Real Estate Portfolio Construction (Current)				
	Minimum	Target	Maximum	Policy Index Benchmark
Total Real Estate Portfolio	5%	7%	9%	Custom blend of benchmarks below:
Core Real estate	50%	65%	80%	65% NFI-Open End Diversified Core Equity (ODCE)
Non-Core Real Estate	20%	35%	50%	35% NFI-ODCE + 1%
Non-U.S. Real Estate	0%	N/A	30%	

Recommended Real Estate Sub-Strategy Allocations:

SCERS Real Estate Portfolio Construction (Proposed)				
	Minimum	Target	Maximum	Policy Index Benchmark
Total Real Estate Portfolio	7%	9%	11%	Custom blend of benchmarks below:
Core Real estate	50%	60%	70%	60% NFI-Open End Diversified Core Equity (ODCE)
Non-Core Real Estate	30%	40%	50%	40% NFI-ODCE + 1%
Non-U.S. Real Estate	0%	N/A	35%	

SCERS' current Real Estate exposures by sub-strategy and geography:



RECOMMENDED POLICY BENCHMARK CHANGE FOR REAL ESTATE

Performance of core and core plus real estate investments are expected to exceed the NCREIF Fund Index – Open-End Diversified Core Equity (NFI-ODCE) index, net of fees, while the performance of non-core real estate investments are expected to exceed the NFI-ODCE index + 1.0%, net of fees. In turn, the total SCERS Real Estate Portfolio performance is expected to exceed a blend of the core/core plus index and non-core index based on the target sub-strategy allocation, currently 65% NFI-ODCE plus 35% NFI-ODCE + 1%.

With the recommendation to change the sub-strategy allocation between core and non-core real estate from 65%/35% to a 60%/40% weighting, the total SCERS Real Estate Portfolio policy index would change to a blend of the core/core plus index and non-core index based on the new target sub-strategy allocation, 60% NFI-ODCE plus 40% NFI-ODCE + 1%.

REAL ASSETS INVESTMENT PLAN

Staff and Townsend will present the 2022 Real Estate capital-pacing plan in February 2022, which highlights annual commitments toward reaching and maintaining the 9% target allocation over the long-term.

The capital budget incorporates several variables and assumptions, such as plan assets, the growth rate of the plan (SCERS' actuarial rate adjusting for plan cash outflows), capital market assumptions for real estate, and capital drawdown and distribution assumptions for underlying funds. Per Townsend's preliminary pacing model, SCERS' Real Estate portfolio is expected to reach the new 9% target allocation towards the end of 2023.

Staff and Townsend expect to make 4-5 commitments totaling \$210 million, with \$120 million to core real estate, where Staff and Townsend have targeted a U.S. specialty sector open-end core fund and a European diversified open-end core fund for the first half of 2022. Within non-core, Staff and Townsend have targeted 2-3 funds totaling \$90 million, with 1-2 in Asia, 1 in the Nordics, and 1-2 in the U.S.

In addition to targeting new commitments, Staff and Townsend will also evaluate rebalancing SCERS' U.S. open-end core portfolio to reduce the overweight to U.S. core and enhance the overall diversification of the portfolio by reaching the target geographic and sub-strategy weights.

NEXT STEPS

- Present the 2022 Real Estate Annual Investment Plan in February 2022.
- Incorporate the approved Real Estate structure changes into the Real Return asset category IPS and the Master IPS.

ATTACHMENTS

- Board Order
- Townsend Real Estate Portfolio Structuring Considerations Presentation

Prepared by:

/S/

JR Pearce
Senior Investment Officer

/S/

Steve Davis
Chief Investment Officer

/S/

Eric Stern
Chief Executive Officer



Retirement Board Order

Sacramento County Employees' Retirement System

Before the Board of Retirement
January 19, 2022

AGENDA ITEM:

Asset Class Restructuring: Real Estate

THE BOARD OF RETIREMENT hereby accepts the recommendation of staff to approve the following revisions to the structure of the Real Estate asset class.

- Adopt revised sub-strategy and geographic target allocations, including:
 - Revise target Core/Non-Core real estate weighting from 65%/35% to 60%/40%.
 - Increase Ex-US policy limit maximum from 30% to 35%.
 - Revise U.S. geographic diversification weightings from +/- 10% of the NFI-ODCE index to a similar geographic weighting as NFI-ODCE.
- Adopt a revised policy benchmark for the total real estate portfolio from a blend of 65% NFI-ODCE plus 35% NFI-ODCE + 1% to 60% NFI-ODCE plus 40% NFI-ODCE + 1%.
- Direct staff to make conforming changes to the Real Return Asset Category and Master Investment Policy Statements for approval by the Board at a future meeting.

I HEREBY CERTIFY that the above order was passed and adopted on January 19, 2022 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:



Retirement Board Order

Sacramento County Employees' Retirement System

ABSENT:

ABSTAIN:

ALTERNATES (Present but not voting):

Richard B. Fowler II
Board President

Eric Stern
Chief Executive Officer and
Board Secretary



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Real Estate Portfolio

Asset Class Restructuring

JANUARY 2022

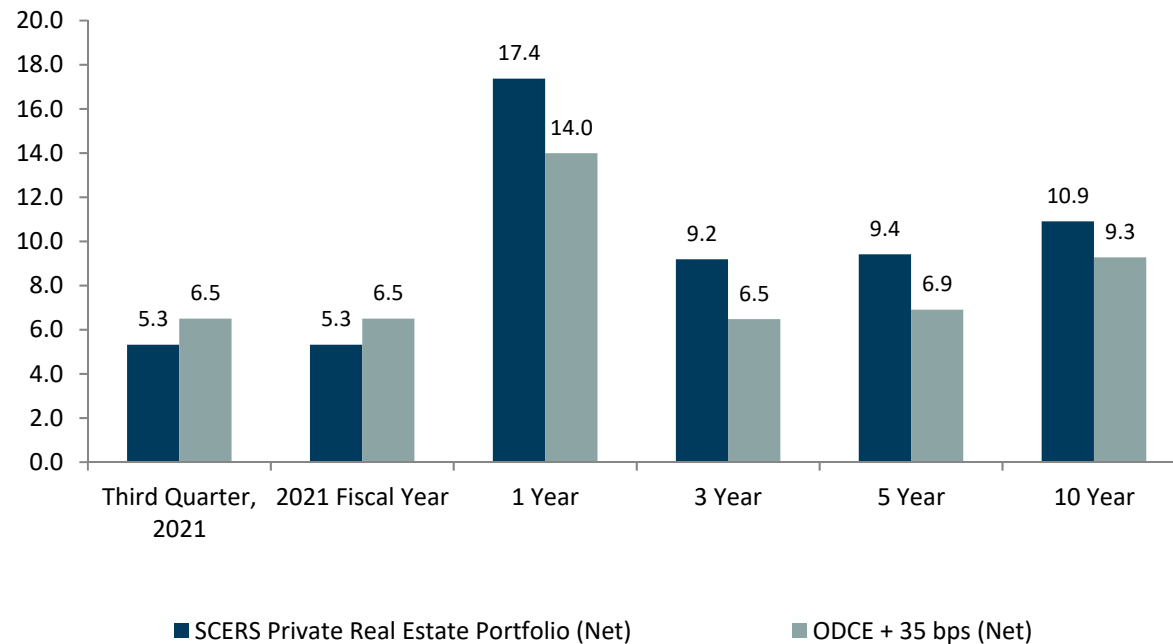


SCERS

SACRAMENTO COUNTY
EMPLOYEES'
RETIREMENT SYSTEM

Portfolio Objectives

- SCERS' Private Real Estate Portfolio, as a component of the Real Return Portfolio, seeks to achieve:
 - Attractive returns on a real (net of inflation) basis and a hedge against inflation risk;
 - Moderate income and cash flow generation;
 - Diversification for SCERS' portfolio, including low or negative correlation to equities and nominal bonds; and
 - Greater consistency in the return distribution and muted downside risk
- The target allocation to Real Estate increased from 7% to 9% in the revised strategic asset allocation
- The Private Real Estate Portfolio continues to meet its objectives; there are no recommended changes to stated portfolio objectives
- However, there are minor recommended changes to the target risk which will be reflected in the Investment Policy Statement going forward, subject to board approval
- The SCERS Total Real Estate Portfolio has outperformed its benchmark over all time period shown except the most recent quarter



Recommended Portfolio Guideline Changes

- Several guideline changes are being recommended and for simplicity, these are outlined below:

	Strategic Constraint / Guideline	Recommended Constraint	Recommended Permissible Range
Private Real Estate Portfolio	7% Target (5-9% Range)	9% Target	7-11%
Core Real Estate	65% Target	60% Target	60-100%
Non-Core Real Estate	35% Maximum	40% Maximum	0-40%
Property Type Diversification	SCERS Private Portfolio will target weightings by property type and geography to be within $\pm 10\%$ of the NFI-ODCE	Limit a single primary property type (Apartment, Retail, Office, Industrial) to 0-40% or NFI-ODCE weight, whichever is greater Limit 0-25% to all "Other" property types, collectively	See Constraint Description
Geographic Diversification	SCERS Private Portfolio will target geographic weightings within $\pm 10\%$ of the NFI-ODCE	SCERS Private Portfolio be diversified by geographic region. U.S. exposures will target similar geographic weightings as the NFI-ODCE	See Constraint Description
Ex- US Allocation	30% Maximum	35% Maximum	0-35%

* 9% target allocation to Real Estate was approved as part of the strategic asset allocation in August 2021

Sub-Strategy and Geographic Allocation

- Revise the Sub-Strategy mix between Core and Non-Core from 65%/35% to 60%/40%
 - Core serves as the foundation/Hub with its lower but stable risk-return due to the majority of the return from cash yield
 - Non-Core, or Spoke investment, offers a higher return but with more risk since the majority of the return comes from capital appreciation
 - Non-Core, which represents a larger opportunity set, serves as a compliment and return enhancer to the Core portfolio
 - An increase to Non-Core allows additional flexibility to pursue global thematic opportunities offering compelling returns

- Revise the Geographic policy maximum for non-U.S. from 30% to 35%; current allocation is 27%
 - Access to a larger opportunity set offers an advantage in identifying the most attractive risk-return strategies globally
 - Global investable institutional real estate market is 33% North America, 28% Europe/UK, and 33% Asia Pacific
 - Exposure to higher growth countries like China will offer higher returns while exposure to safe haven countries like Japan and Nordics offer stability of returns

 - A Global approach provides better diversification across multiple regions and cities as each region of the world experiences different levels of economic growth, demographic trends, and macro sensitivities
 - Investing solely in a single market presents concentrated exposure to that market's economic shocks and cycles
 - Investment risk or return volatility is mitigated through diversification; the larger the base of uncorrelated investments, the less chance of a single investment affecting the overall portfolio performance
 - Property types within regions also experience different growth rates and demand drivers, creating further opportunity to enhance returns from thematic strategies emanating from structural changes occurring within a region

Portfolio Benchmark

- SCERS' Real Estate Portfolio is benchmarked to the NFI-ODCE index, with a 1% premium added to reflect the additional risk of non-core investments. While the NFI-ODCE benchmark is imperfect, it is a representation of the U.S. Core real estate market and an indicator of both the magnitude and direction of the implied opportunity cost of SCERS' real estate investments

- The NFI-ODCE index is 100% U.S. based and does not account for SCERS' non-U.S. investments. A more appropriate benchmark is SCERS' customized Global Ancillary Benchmark comprising a blend of NFI-ODCE (Core), NFI-ODCE + 1% (Non-Core), Global Real Estate Fund Index (GREFI) Europe Core, GREFI Europe Non-Core, and GREFI Non-Core Asia Pacific
 - This composite benchmark reflects SCERS' weighted average invested capital by sub-strategy and geographic region
 - Because the GREFI indices report on a 12-week lag, the SCERS Global Ancillary Benchmark is reported one additional quarter lag from SCERS U.S. benchmark

Funding Status

- Key information of the SCERS Real Estate Portfolio through September 30, 2021
- Figures exclude commitments / redemptions / dispositions approved subsequent to quarter-end and future distributions
- Unfunded commitments may never be fully drawn
- SCERS Real Estate Portfolio weightings are in line with targets and within the permissible ranges

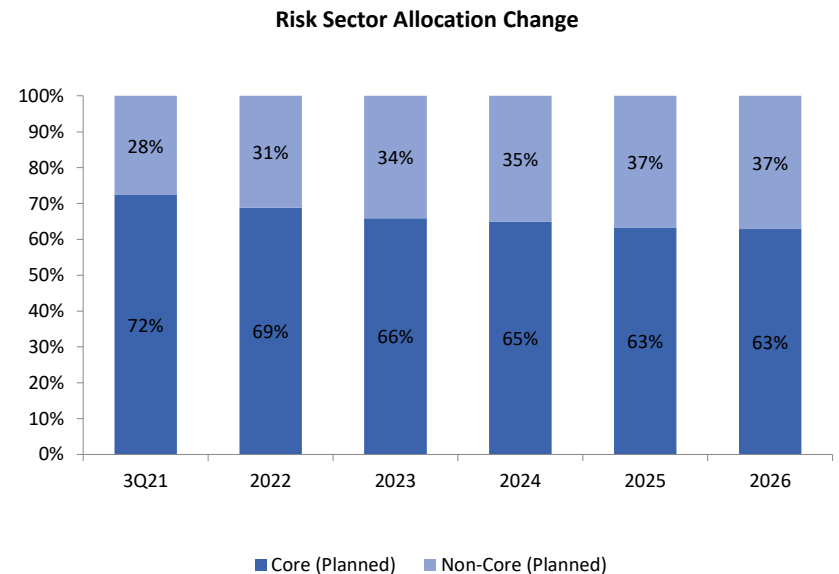
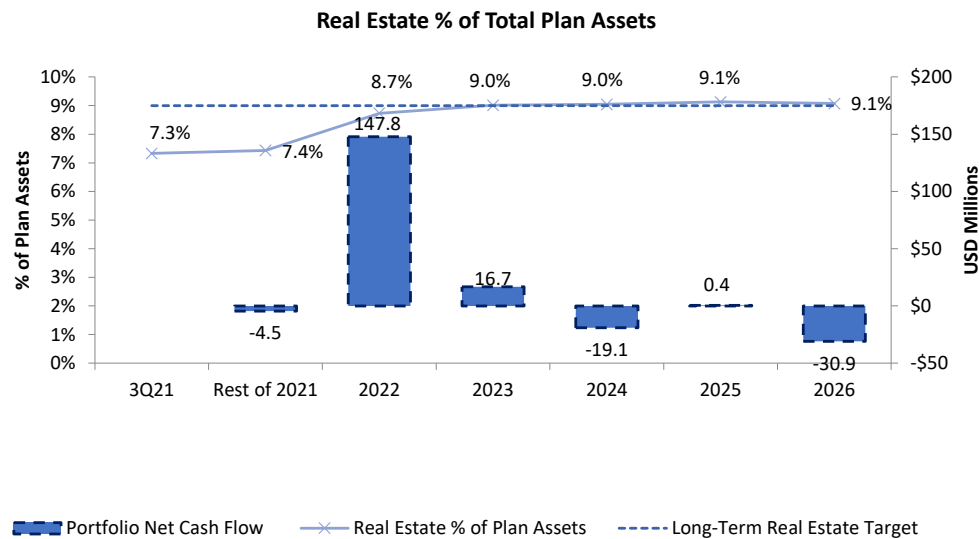
SCERS Portfolio Snapshot <i>As of September 30, 2021</i>	Market Value (in millions of dollars)*	% of SCERS Plan	% of Real Estate
SCERS Total Plan Assets	12,854	100.0%	
Private Portfolio Target	1,157	9.0%**	
Private Portfolio Permissible Range		7.0-11.0%**	
Private Real Estate			
Core Portfolio	682	5.3%	72.4%
Non-Core Portfolio	260	2.0%	27.6%
Total SCERS Private Real Estate Market Value	942	7.3%	
Total SCERS Private Real Estate Unfunded Commitments	164	1.3%	

• Figures may not add due to rounding

** The 9% Private Portfolio (RE) target and permissible range were approved during the third quarter of 2021

Portfolio Capital Projections

- Assuming a 5% total plan growth rate, the SCERS Portfolio is expected to remain well below the 11% maximum level. This includes a substantial (\$120M) commitment to Core/Core+ investments in 2022 and an average ~\$70M per year in new Non-Core investments through 2023 to allow for further vintage year diversification.
- Relatively modest rebalancing (less than \$30M of net outflows) should be required to meet SCERS' 9% target allocation between 2023 and 2026

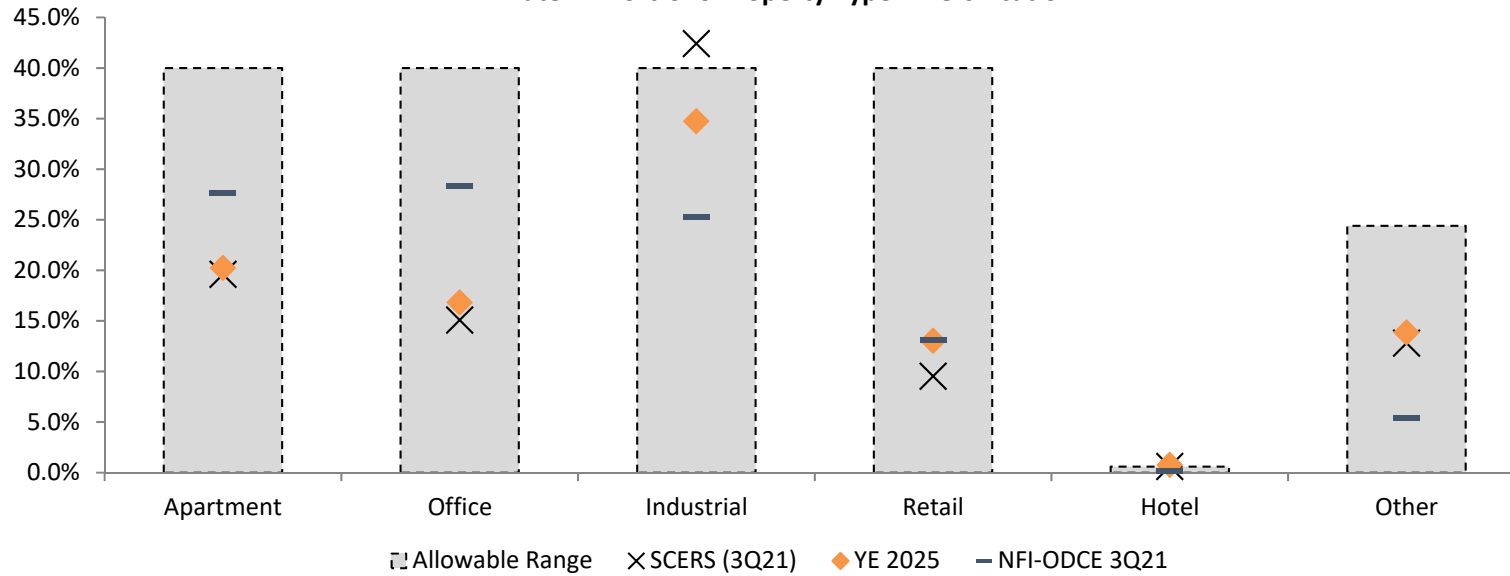


SCERS Non-Core Real Estate Portfolio (5 Year Projections)						
\$ Millions	2021	2022	2023	2024	2025	2026
Contributions	18.5	202.5	99.5	87.6	72.7	22.9
Distributions	23.1	54.7	82.7	106.7	72.3	53.8
Net Cash Outflows	4.5	-147.8	-16.7	19.1	-0.4	30.9

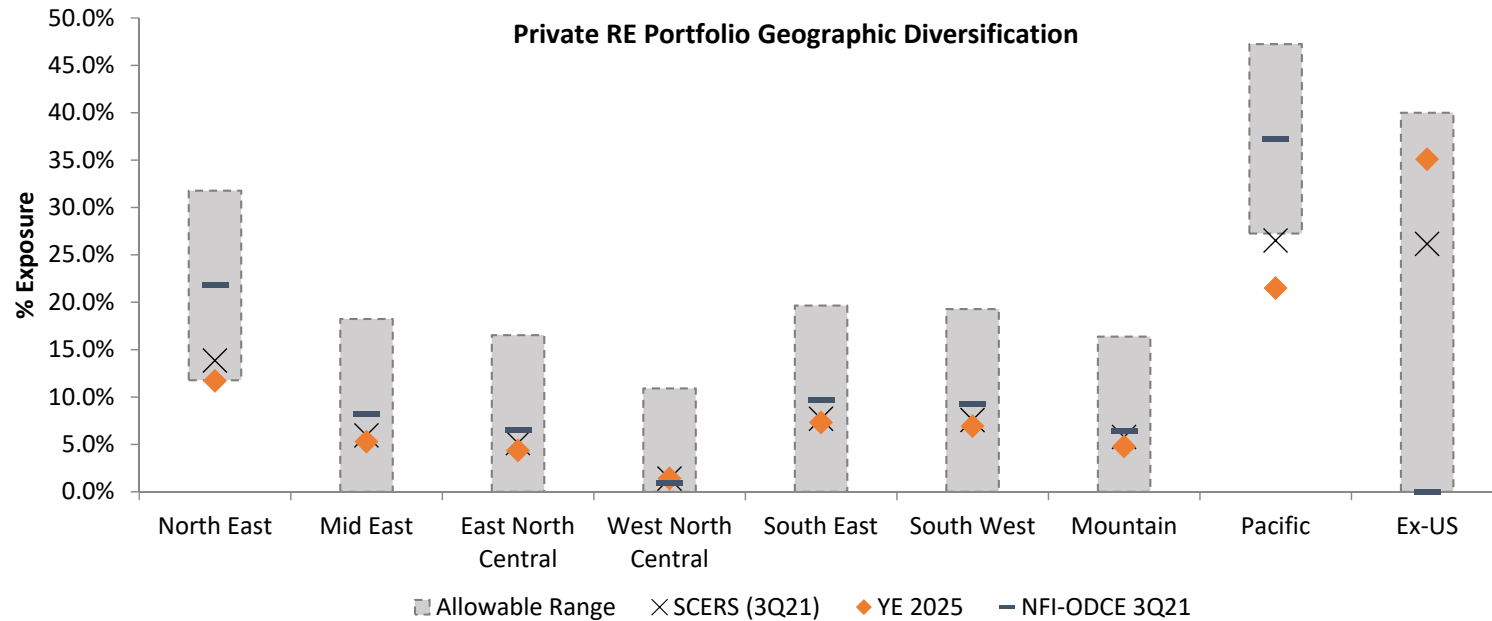
Assumes (1) full liquidation of closed-end vehicles within 10 years, (2) new **incremental** Core/Core+ commitments of \$120M, (3) \$50M to \$90M placeholder commitments to new Non-Core investments each year through 2023, and (4) few denominator fluctuations – annual growth rate of 5%

Real Estate Private Portfolio Diversification

Private RE Portfolio Property Type Diversification



Private RE Portfolio Geographic Diversification



Next Steps

- Present the 2022 Real Estate Investment Plan in February 2022
- Update the Real Return asset category IPS and Master IPS for the approved Real Estate structure revisions
- Increase Total Real Estate exposure toward the 9% target, current modeling achieves target by 2023
 - Target 4-5 new commitments totaling \$210M in 2022:
 - Target 2-3 new Core/Core+ Open End funds totaling \$120 million, with a focus on:
 - Thematic investment strategy by sector specialist (i.e. Multi-family, Life Sciences, etc.)
 - Complimentary diversification, including ex-U.S. exposure (i.e. Europe diversified)
 - Attractive fee schedule
 - Potentially rebalance existing U.S. Core/Core + Open End funds, with a focus on:
 - Enhance overall portfolio diversification by reaching target geographic and sub-strategy weights
 - Strong future risk-adjusted return expectation
 - Consistent top performing managers with differentiated portfolio construction and investment outlook
 - Target 2-3 Non-Core Closed End funds totaling \$90 million at \$30-45M each
 - Remain selective given limited capital
 - Focus on best-in-class specialists/operators by sector, geography, or offer a unique value proposition
 - Complementary to the existing portfolio

Investment Proposal to Amend Policy Guidelines

Client: Sacramento County Employees' Retirement System ("SCERS" or the "Client")

Date: December 17, 2021

Recommended Action to be taken:

We recommend the SCERS Board approve new guidelines permitting SCERS' real estate portfolio to allocate up to 35% to international ("Ex-US") investments and updating targeted Core/Non-Core exposure from 65%/35% to 60%/40%.

Client Profile:

SCERS recently increased the target real estate allocation from 7% to 9%, at the same time increasing the allowable exposure range to between 7.0% and 11.0%. As of September 30, 2021, SCERS was 7.3% funded (\$942 million) and is below the new real estate target but within the allowable range. Including all approved unfunded commitments, the SCERS total exposure to real estate is 8.6% (\$1,106 million).

SCERS's portfolio composition and target allocations as of September 30, 2021 is provided below.

SCERS Portfolio Snapshot <i>As of September 30, 2021</i>	Market Value (in millions of dollars)*	% of SCERS Plan	% of Real Estate
SCERS Total Plan Assets	12,854	100.0%	
Private Portfolio Target	1,157	9.0%	
Private Portfolio Permissible Range		7.0-11.0%	
Private Real Estate			
Core Portfolio	682	5.3%	72.4%
Non-Core Portfolio	260	2.0%	27.6%
Total SCERS Private Real Estate Market Value	942	7.3%	
Total SCERS Private Real Estate Unfunded Commitments	164	1.3%	

*Figures may not add due to rounding

Discussion

SCERS continues to implement a global investment framework within real estate, similar to how the Client manages other asset classes such as fixed income and public equities. International investments offer SCERS broader portfolio diversification and opportunities created by different demographics, investment fundamentals, and market cycles than in the US. This will allow SCERS to take advantage of unique and interesting opportunities that domestically may not be present or not present currently. SCERS' real estate portfolio currently has 26% Ex-US exposure and a 30% policy limit. Based on the approximate size of the global investable universe, SCERS has chosen 35% as a more appropriate Ex-US limit. It is also important for the SCERS board to consider inherent risks of substantial Ex-US exposure for a US-based plan. International investments expose SCERS to benchmark tracking error, currency risk, political risk, and tax drag. In addition, the real estate asset class has historically been used as an inflation hedge and investing in domestic real estate markets is a more appropriate hedge against domestic inflation than investing in other countries. This increase would allow SCERS more geographic variation than most Townsend advisory clients. Townsend believes it is important for a US pension plan to maintain a stable base of Core/Core+ investments, as well as a base that is predominantly USD denominated. However, this geographic change is in-line with how the client is managing other asset classes. Overall, the portfolio will be well-diversified by geographic region and, within the US, by subregion. The portion of the portfolio within the US will be well-diversified and is expected to have similar geographic exposures to the NFI-ODCE.

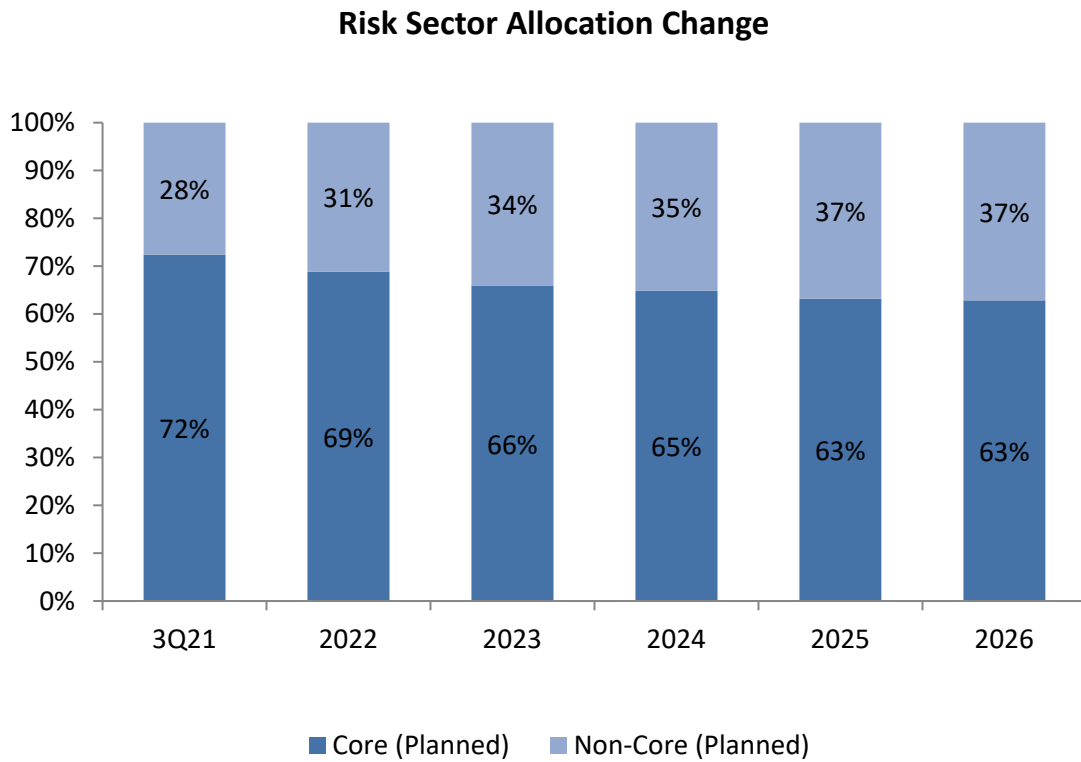
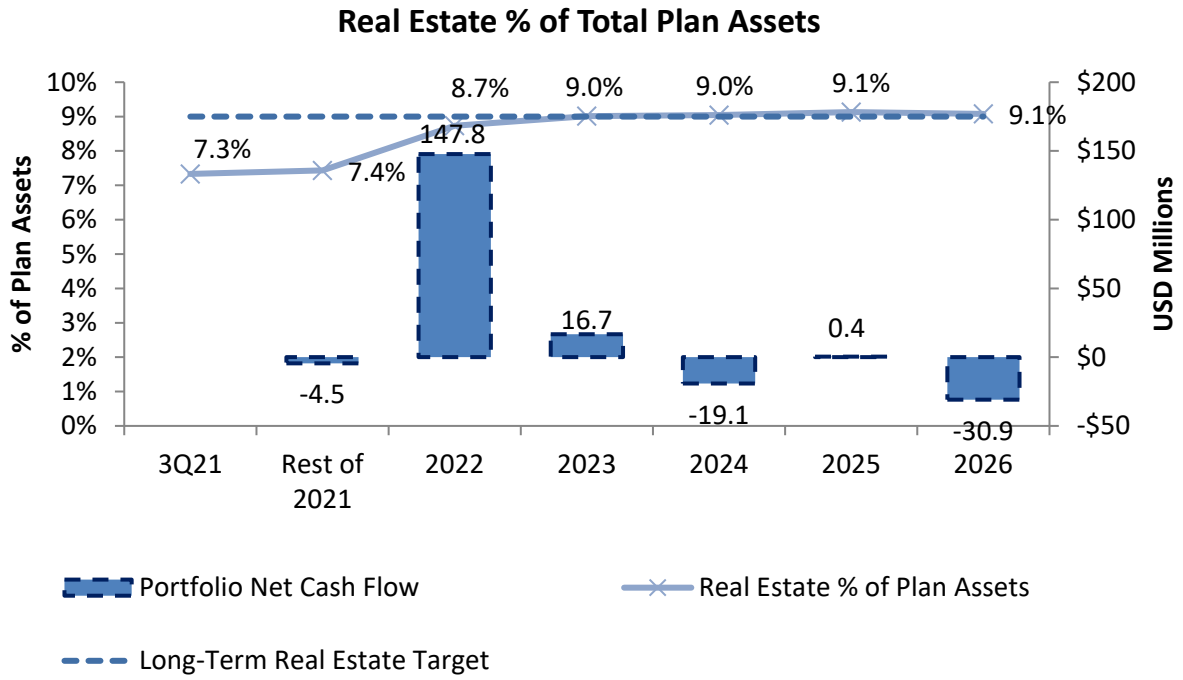
SCERS COMPLIANCE RECOMMENDED GUIDELINE CHANGES

Private Portfolio Risk Policies	
Geographic Diversification	<p>SCERS Private Portfolio be diversified by geographic region. U.S. exposures will target similar geographic weightings as the NFI-ODCE.</p> <p>Ex-US exposure is separately limited to 35% of the Private Portfolio.</p> <p>Exceptions may exist at different points in the market cycle, particularly in the Non-Core sector.</p>

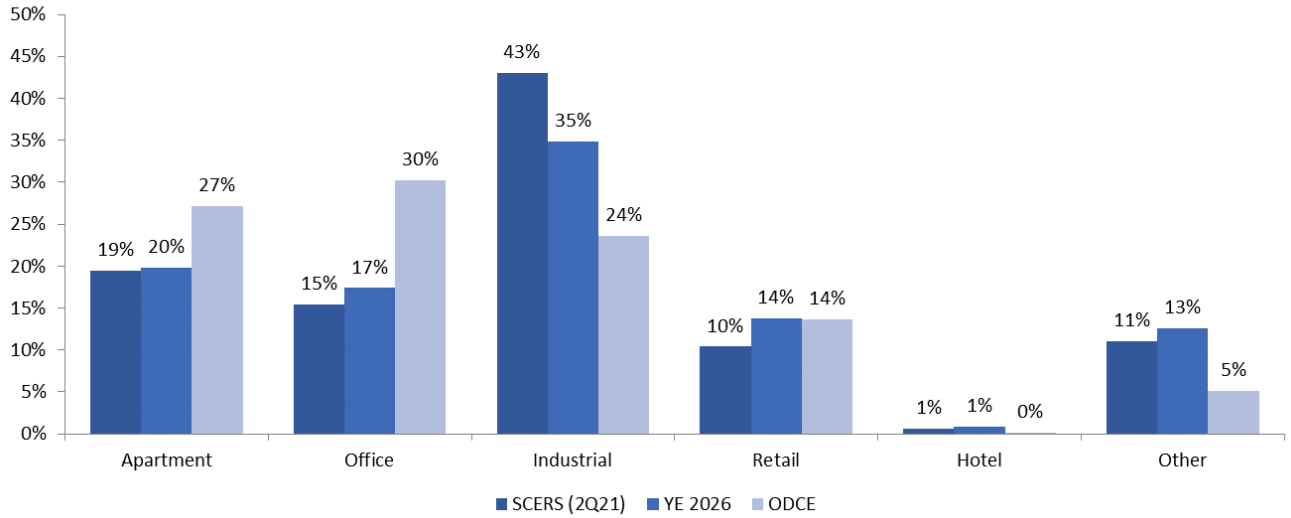
In addition, Townsend recommends new strategic targets of 60% Core and 40% Non-Core. SCERS' current targets are 65% Core and 35% Non-Core, although the client has been targeting a Non-Core overweight more recently. Based on the current opportunity set and targets of other similar public pension plans, we feel comfortable with this revision. A 65%/35% split will provide more flexibility to pursue thematic opportunities and allow the client to increase Ex-US exposure through higher returning strategies that can provide buffer over potential currency depreciation, unlike lower returning Core/Core+ investments.

SCERS intends to continue making non-core commitments this and next year to further diversify vintage year exposures and remain fully invested in real estate. Several of these commitments are expected to focus on non-US funds, for example targeting real estate in Japan and the Nordics.

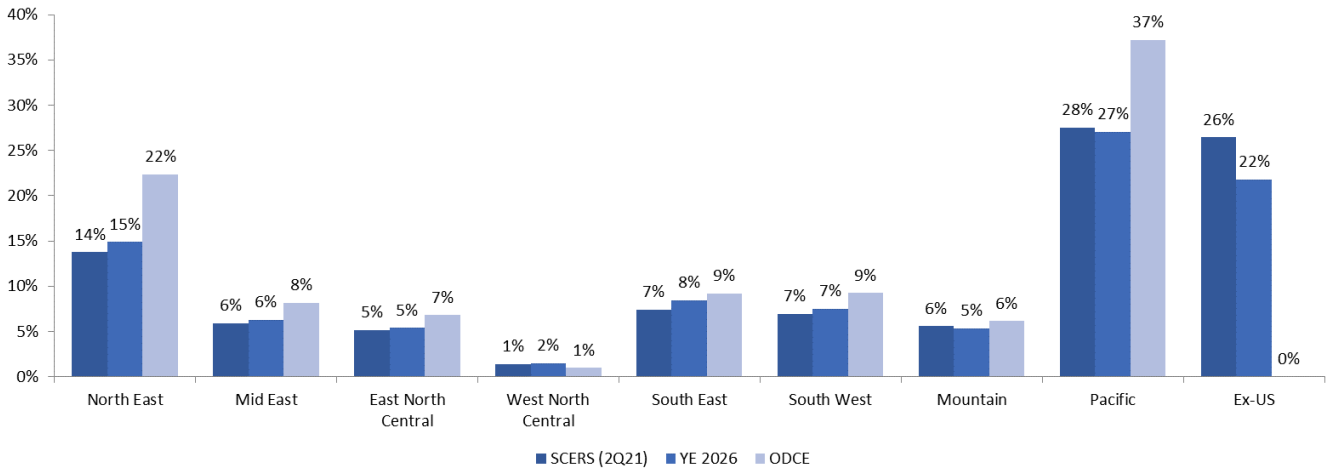
Projected Portfolio Composition:



SCERS Projected Property Type Diversification



SCERS Projected Geographic Diversification



Attachments:

- A. Investment Compliance Matrix