



Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 6

MEETING DATE: October 17, 2018

SUBJECT: Core Real Estate Separate Account Transition Summary Report

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

RECOMMENDATION

Staff recommends the Board receive and file this memo summarizing the transition of SCERS' core real estate separate account to open-end core real estate funds.

PURPOSE

This agenda item does not specifically support the 2018-2019 Strategic Management Plan, but complies with the SCERS investment policy statement on reporting requirements and contributes to the effective management and oversight of investment activities.

DISCUSSION

Staff and SCERS' real estate consultant, Townsend, have been executing a transition of SCERS' separate account real estate assets for shares in Clarion Lion Properties Fund, LP (Clarion) and cash, which will be committed to Brookfield Premier Real Estate Partners, LP (Brookfield). This memo summarizes the process of selling SCERS' real estate portfolio of six assets, excluding Leland James Center (Portland office redevelopment project), for \$252.15 million to Clarion, with \$152.15 million in sale proceeds exchanged/invested in Clarion and \$100 million invested in Brookfield. Because the Leland James redevelopment property is in its lease up period, the property will be sold to Clarion at a later date.

At the November 2017 Board meeting, the Board guided Staff and Townsend to proceed with the real estate transition under the implementation protocol as defined within the Real Estate investment policy statement. The Real Estate implementation protocol states, "the selection of investment managers will be delegated to Staff, subject to the Board's ability to review, discuss and object to the recommendations of Staff and Consultant during the investment protocol process."

From an original list of 17 potential OECF managers, Staff and Townsend selected four manager candidates for an in-person interview and submission of a best-and-final purchase price for SCERS' real estate portfolio. Of the four managers, Clarion submitted the highest bid, and while this was a determinant in the final selection, an equally key consideration for Staff and Townsend was to identify the best manager or managers to execute SCERS' core real estate program objectives. While any of the final investment manager candidates were viable choices, among the candidates, Clarion and Brookfield not only distinguished themselves individually, but in combination they offered an ideal balance between risk and return, with the potential for outperformance across market cycles. Clarion's focus on high-quality assets, primarily in core markets based on themes informed by its research, coupled with Brookfield's focus on acquiring high quality assets at a favorable basis and then driving investment performance through active operational improvements, created a pairing that offered the potential to meaningfully outperform over various points in a market cycle.

After much discussion on the merits of each manager candidate based on all of the relevant financial and portfolio considerations, Staff and Townsend ultimately recommended selling SCERS' real estate portfolio of six assets, excluding Leland James Center, to Clarion for \$252.4 million (\$302.4 million less two existing property-level loans). Proceeds received from the sale to Clarion would be tendered in the form of \$152.4 million in shares of Clarion and \$100 million in cash, which SCERS would use to make a \$100 million commitment to Brookfield.

With the Board's approval, Staff and SCERS' legal team began the negotiation of a purchase and sale agreement with Clarion. In parallel, Staff and SCERS legal counsel initiated the review and negotiation of side letters for its investment in Clarion and commitment to BPREP. During this time, Clarion conducted full due diligence on the properties and during the course of its investigation, it was found that one of the property's anchor tenant had multiple lease extension rights that were exercisable at less than a market rental rate, resulting in an impact on the property's future value. As a concession, the purchase price was reduced by \$250,000 to \$252.15 million from \$252.4 million. The concession amounted to 0.1% of the original purchase price.

A purchase contract with Clarion was finalized and executed on August 31, 2018, with a closing initially scheduled for September 10, 2018, but subject to receipt of certain due diligence documents and loan assumption agreements. On September 12, 2018, Clarion received the required documentation for five of the six properties and completed the purchase for those, while the sixth property received the last outstanding documentation on September 25, 2018, with Clarion closing the purchase on October 1, 2018. Concurrent with the closing of the purchase, SCERS completed its exchange into shares of Clarion. In conjunction, SCERS finalized the necessary documents for a \$100 million commitment to Brookfield on September 15, 2018, which was subsequently funded on October 2, 2018 from the cash proceeds received from Clarion.

In summary, SCERS' six separate account real estate assets were sold to Clarion for \$252.15 million (\$302.15 million less two existing loans). In turn, SCERS received shares in Clarion totaling \$152.15 million and made a \$100 million cash investment in Brookfield. A purchase

agreement is currently being negotiated for the remaining asset, Leland James Center. SCERS' separate account manager, BlackRock, with the assistance of Staff and Townsend, is negotiating the terms by which Clarion will purchase Leland James from SCERS and SCERS' Leland James venture partner. Terms under which Clarion will purchase Leland James are expected to be finalized by October 31, 2018, with a closing to occur once agreed upon conditions have been delivered, or by a date certain.

ATTACHMENTS

None.

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