

AGENDA

A REGULAR MEETING OF THE REAL ASSETS COMMITTEE OF THE BOARD OF INVESTMENTS*

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CA 91101

8:00 A.M., WEDNESDAY, APRIL 10, 2019

*The Committee may take action on any item on the agenda,
and agenda items may be taken out of order.*

- I. CALL TO ORDER
- II. APPROVAL OF THE MINUTES
 - A. Approval of the Minutes of the Real Estate Committee Meeting of September 12, 2018.
- III. PUBLIC COMMENT
- IV. NON-CONSENT ITEM
 - A. Recommendation as submitted by John McClelland, Principal Investment Officer: That the Committee advance the Real Estate Structure Review Update, including authorization for up to \$500 million for investment by separate account managers to the Board for approval.
(Memo dated March 29, 2019)
- V. REPORT
 - A. 2019 Real Assets Committee Work Plan Overview
John McClelland, Principal Investment Officer
Jim Rice, Principal Investment Officer
(Memo dated March 29, 2019)

April 10, 2019

Page 2

VI. ITEMS FOR STAFF REVIEW

VII. GOOD OF THE ORDER
(For information purposes only)

VIII. ADJOURNMENT

*The Board of Investments has adopted a policy permitting any member of the Board to attend a standing committee meeting open to the public. Members of the Board of Investments who are not members of the Committee may attend and participate in a meeting of a Committee but may not vote, make a motion, or second on any matter discussed at the meeting. The only action the Committee may take at the meeting is approval of a recommendation to take further action at a subsequent meeting of the Board.

Documents subject to public disclosure that relate to an agenda item for an open session of the Board of Investments that are distributed to members of the Board of Investments less than 72 hours prior to the meeting will be available for public inspection at the time they are distributed to a majority of the Board of Investments Members at LACERA's offices at 300 N. Lake Avenue, Suite 820, Pasadena, CA 91101, during normal business hours of 9:00 a.m. to 5:00 p.m. Monday through Friday.

Persons requiring an alternative format of this agenda pursuant to Section 202 of the Americans with Disabilities Act of 1990 may request one by calling the Board Offices at (626) 564-6000, Ext. 4401/4402, from 8:30 a.m. to 5:00 p.m. Monday through Friday, but no later than 48 hours prior to the time the meeting is to commence. Assistive Listening Devices are available upon request. American Sign Language (ASL) Interpreters are available with at least three (3) business days' notice before the meeting date.

MINUTES OF THE REGULAR MEETING OF THE REAL ASSETS COMMITTEE
OF THE BOARD OF INVESTMENTS

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

300 N. LAKE AVENUE, SUITE 810, PASADENA, CA

9:00 A.M., WEDNESDAY, SEPTEMBER 12, 2018

PRESENT: Michael Schneider, Chair

David Green

Wayne Moore

ABSENT: Gina Sanchez

Ronald Okum

Shawn Kehoe, Alternate

MEMBERS AT LARGE:

Herman Santos

Vivian Gray

STAFF, ADVISORS, PARTICIPANTS

Jonathan Gabel, Chief Investment Officer

John McClelland, Principal Investment Officer

James Rice, Principal Investment Officer

Amit Aggarwal, Investment Officer

STAFF, ADVISORS, PARTICIPANTS (continued)

Kevin Bassi, Senior Investment Analyst

Cindy Rivera, Investment Analyst

Meketa Investment Group

Tim Filla, Senior Vice President

I. CALL TO ORDER

The meeting was called to order at 1:10 p.m., in the Board Room of Gateway Plaza.

II. APPROVAL OF THE MINUTES

- A. Approval of the Minutes of the Regular Meeting the Real Estate Committee Meeting of June 13, 2018.

Mr. Green made a motion, Mr. Moore seconded, to approve the minutes of the regular meeting of June 13, 2018. The motion passed unanimously.

III. PUBLIC COMMENT

There were no requests from the public to speak.

IV. NON-CONSENT AGENDA

- A. Recommendation as submitted by Jonathan Grabel, Chief Investment Officer and John McClelland, Principal Investment Officer: That the Committee approve the RFI Recommendation-Real Estate Administration Services. (Memo dated August 28, 2018)

Messrs. Grabel and McClelland were present and answered questions from the Committee.

Mr. Green made a motion, Mr. Okum seconded, to approve the recommendation. The motion passed unanimously.

(Mr. Green left the meeting at 1:30 p.m.)

V. REPORTS

- A. Real Assets and Inflation Hedge Implementation Plan for Infrastructure and Natural Resources & Commodities Sub-Asset Categories.

James Rice, Principal Investment Officer

Kevin Bassi, Senior Investment Analyst

(Memo dated September 12, 2018)

Messrs. Rice and Bassi were present and answered questions from the

Committee.

- B. Real Estate Investment Strategy-Review

John McClelland, Principal Investment Officer

Amit Aggarwal, Investment Officer

Cindy Rivera, Investment Analyst

(Memo dated August 30, 2018)

Messrs. McClelland, Aggarwal, and Ms. Rivera were present and answered

questions from the Committee.

VI. ITEMS FOR STAFF REVIEW

There were no items to report.

VII. GOOD OF THE ORDER

(For information purposes only)

Mr. Santos suggested that staff review and reevaluate the Board of Investments committees for efficiency, effectiveness, and efficacy.

VIII. ADJOURNMENT

There being no further business to come before the Committee, the meeting was adjourned at approximately at 1:50 p.m.

March 29, 2019

TO: Each Member
Real Assets Committee

FROM: John McClelland 
Principal Investment Officer

FOR: April 10, 2019 Real Assets Committee

SUBJECT: **REAL ESTATE STRUCTURE REVIEW
UPDATE FOR FISCAL YEAR 2019-2020**

RECOMMENDATION

Advance to the Board for approval:

1. Accept the Real Estate Structure Review Update; and
2. Approve allocating up to \$500 million for investment by separate account managers.

BACKGROUND

Staff has prepared an Update (**ATTACHMENT A**) to the Real Estate Structure Review approved by the Board in May 2018, for review by the Real Assets Committee and ultimately for approval by the Board. Consistent with other asset classes, a biennial Structure Review replaces the annual Investment Plan. The Update is intended to cover the second year of the biennial period for real estate. It will be followed by a Structure Review in 2020 that will cover fiscal years 2020-2021 and 2021-2022. The Board's real estate consultant, The Townsend Group, has reviewed Update and concurs with the recommendation (see **ATTACHMENT B**).

The Update provides a review of the role of real estate, which is updated to reflect the asset allocation revisions completed in 2018. The Update also addresses the market environment, investment themes and prior and planned initiatives. Although a main initiative for the 2019-2020 fiscal year will be to reduce the exposure to real assets to get closer to the allocation target (i.e. sell assets), a modest amount of the new investment activity is proposed so that vintage year diversification can be maintained. Accordingly, approval is sought for up to \$500 million to be invested by the Fund's existing separate account managers, subject to the limitation described below.

Since the Update calls for LACERA to be a net seller during the 2019-2020 fiscal year, new investment by separate account managers will be contingent upon **anticipated and realized** sales using a ratio of 1:2. For every \$1 dollar of new investment, \$2 of sales should occur.

Each Member of the Committee

March 29, 2019

Page 2

The Update proposes that up to \$250 million of new investment be permitted in anticipation of sales. However, the balance of the up to \$500 million (the remaining \$250 million) will only be released for investment when the cumulative **realized** sales from the separate accounts exceeds twice the amount of new investments, or \$500 million.

Example 1: If \$250 million of new investments are made and \$500 million of realized sales occur, then no additional new investments may be permitted. (Cumulative sales of \$500 equals, but does not exceed, twice the amount of new investments (2 X \$250).

Example 2: If \$250 million of new investments are made and \$700 million of realized sales occur, then up to \$100 million of additional new investments may be permitted. (Cumulative sales of \$700 exceeds twice the amount of new investments (2 X \$250) by \$200. Maintaining the 1:2 ration would allow up to \$100 million of new investments.

Attachments

Noted and Reviewed:



Jonathan Grabel
Chief Investment Officer

ATTACHMENT A

Real Estate Structure Review Update For Fiscal Year 2019-2020

Real Assets Committee

April 10, 2019

John McClelland – Principal Investment Officer



LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

Table of Contents

Content

- I. Role of Real Estate
- II. Market Environment & Opportunity
- III. Portfolio Structure
- IV. Portfolio Performance
- V. Investment Themes
- VI. Initiatives
 - 2018-2019 Review
 - 2019-2020 Update
- VII. Advance to Board

Appendices

- A. Real Estate Acquisitions and Dispositions
- B. Ten Largest Assets by Gross Asset Value
- C. Real Estate Portfolio Leverage Summary
- D. Real Estate Portfolio Debt Maturity
- E. Real Estate International Exposure
- F. Rebalance Illustration - All Real Estate
- G. Rebalance Illustration - Real Assets



Role of Real Estate

Real estate is part of three Asset Classes

Real Assets (Benchmark = ODCE + 50bps)

Growth (Benchmark = ODCE + 300bps)

Credit (Benchmark = NPI Income)

Real Assets-Diversify, generate income, inflation hedge

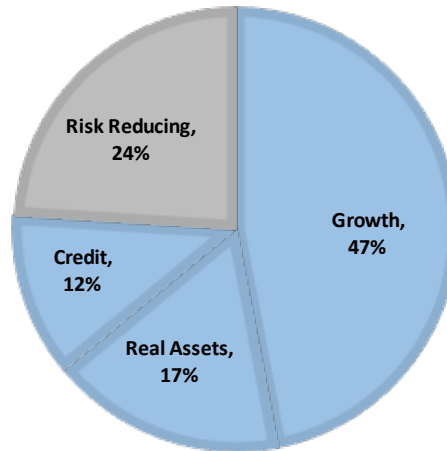
Growth-Drive returns

Credit-Realize attractive risk-adjusted returns, earn illiquidity premium

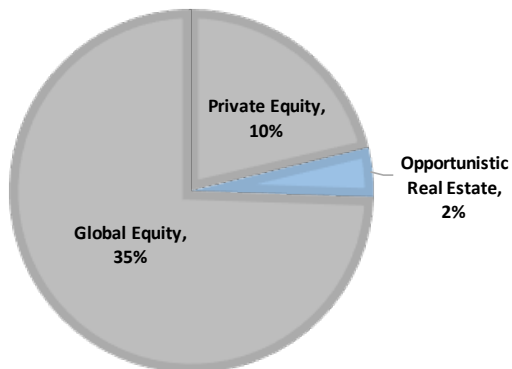


Role of Real Estate

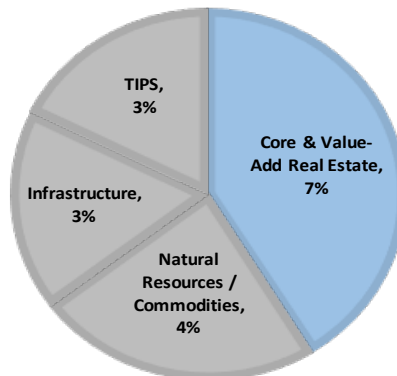
TOTAL FUND \$55.9B
ALLOCATION TARGET



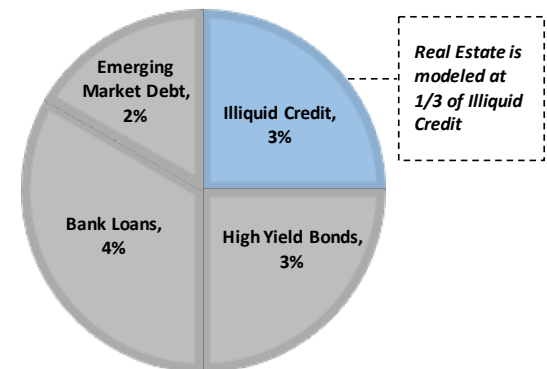
GROWTH \$31.6B
47% TARGET



REAL ASSETS \$7.0B
17% TARGET



CREDIT \$4.5B
12% TARGET



\$ amounts are as of 2/28/2019.



Market Environment and Opportunity

Low cap rates

- Cap rates continue to be at or close to historical lows.

Technological disruptions

- E-commerce continues to perform well while brick and mortar retail sales weaken.

Demographic shifts/trends

- Aging population, increased urbanization and greater attainment of higher education.

Maintain Vintage Year Exposure

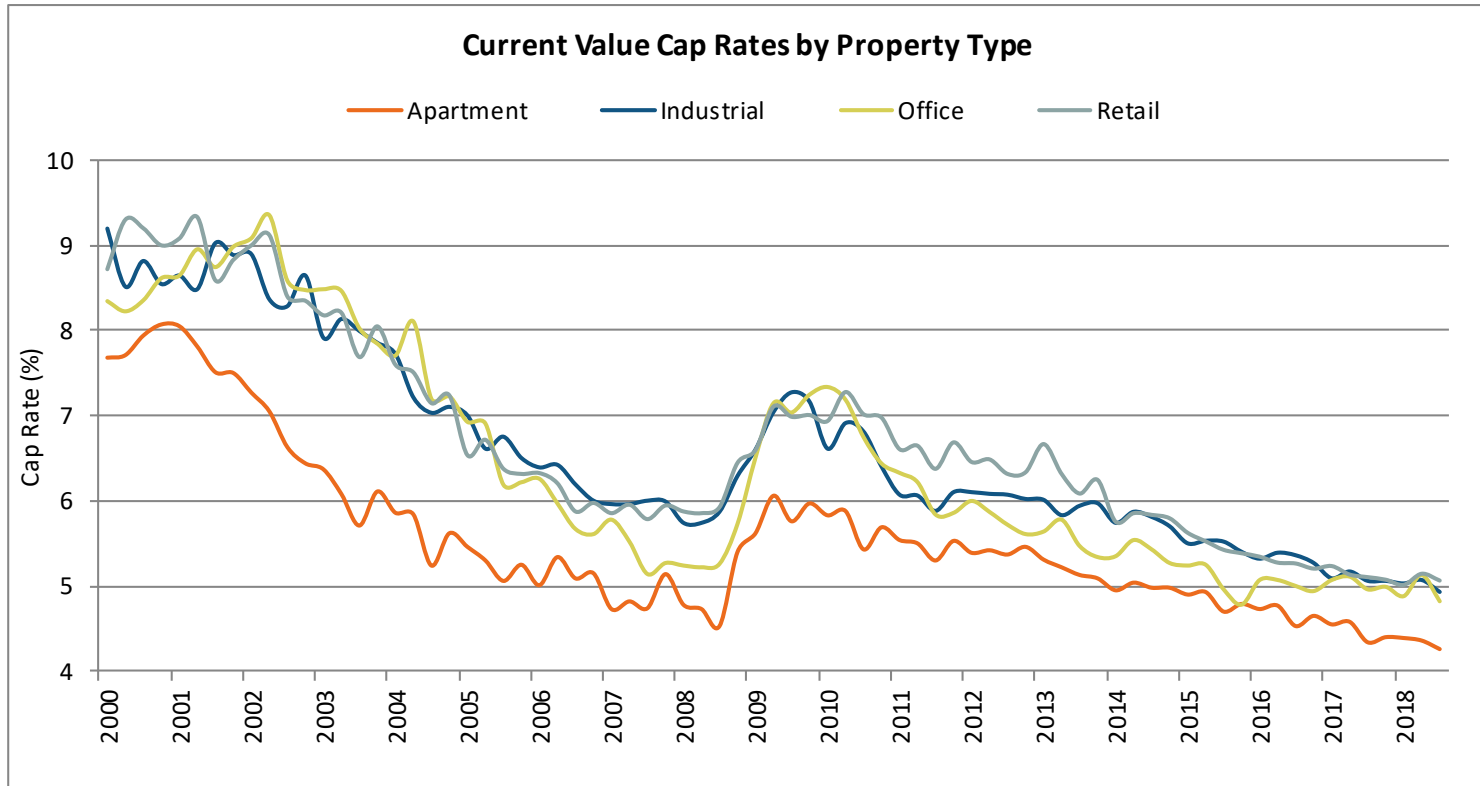
- Investing in every vintage year provides diversification across the portfolio.

With more conservative leverage, relative valuation metrics remaining reasonable, and healthy fundamentals, US commercial real estate markets remain on solid footing. -What is Different in this

Commercial Real Estate Cycle, Townsend Views Occasional Paper No.4 – March 2019, Prashant Tewari and Christian Nye



U.S. Cap Rate Movement Trend

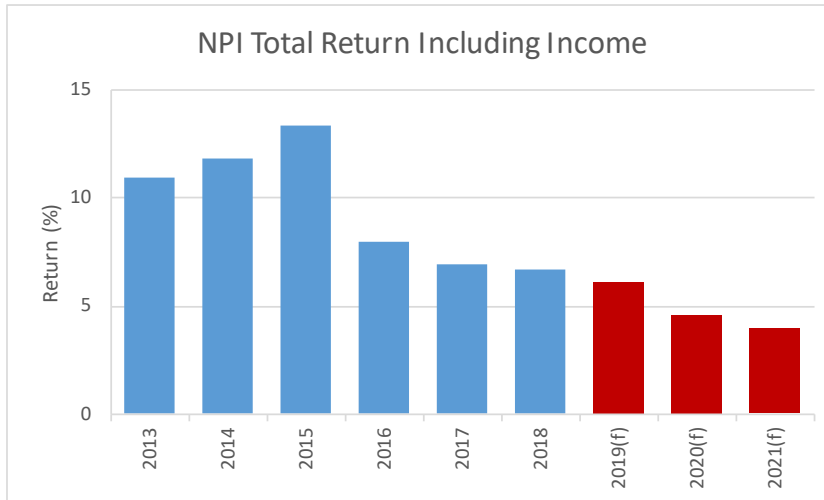


NCREIF, data as of Q3 2018

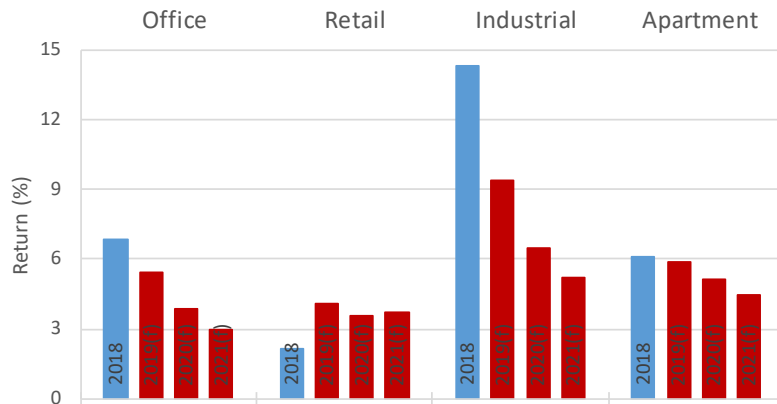


Pension Real Estate Association (PREA)

Consensus Forecast Survey



Average Forecast Total Returns, by Property Type



- NPI Total Return has significantly declined since 2015, due almost entirely to lower appreciation.
- Further declines in return are forecast in 2019-2021.
- Industrial provided highest total returns while Retail provided the lowest return in 2018.
- The consensus amongst investors surveyed by NCREIF is lower returns into the 2019-2021 period across property types, with Retail as the exception.
- Returns from industrial and apartments are expected to exceed returns from office and retail through 2021.

NCREIF Property Index (NPI) and Sub-Indices by Property Type survey results as of Q1 2019



Portfolio Structure



Portfolio Structure

As of September 30, 2018 \$ in millions¹

Functional Asset Class/Strategy	Current Market Value		Target		Difference
	\$	%	\$	%	
Real Assets and Inflation Hedges	\$5,218	9.1%	\$3,999	7.0%	(\$1,218)
Growth	\$794	1.4%	\$1,143	2.0%	\$349
Credit ²	\$130	0.2%	\$571	1.0%	\$441
Total	\$6,141	10.7%	\$5,713	10.0%	(\$428)

Structure Commentary

- Rebalancing to target requires substantial sales from Real Assets and Inflation Hedges.
- Consider reducing below target to free up capital for investment at beginning of next cycle.
- Continue search for Growth opportunities.
- Work with Credit team to determine if additional real estate debt investments should be made.

1. Adjusted to include acquisition and disposition activity through 12/31/2018.

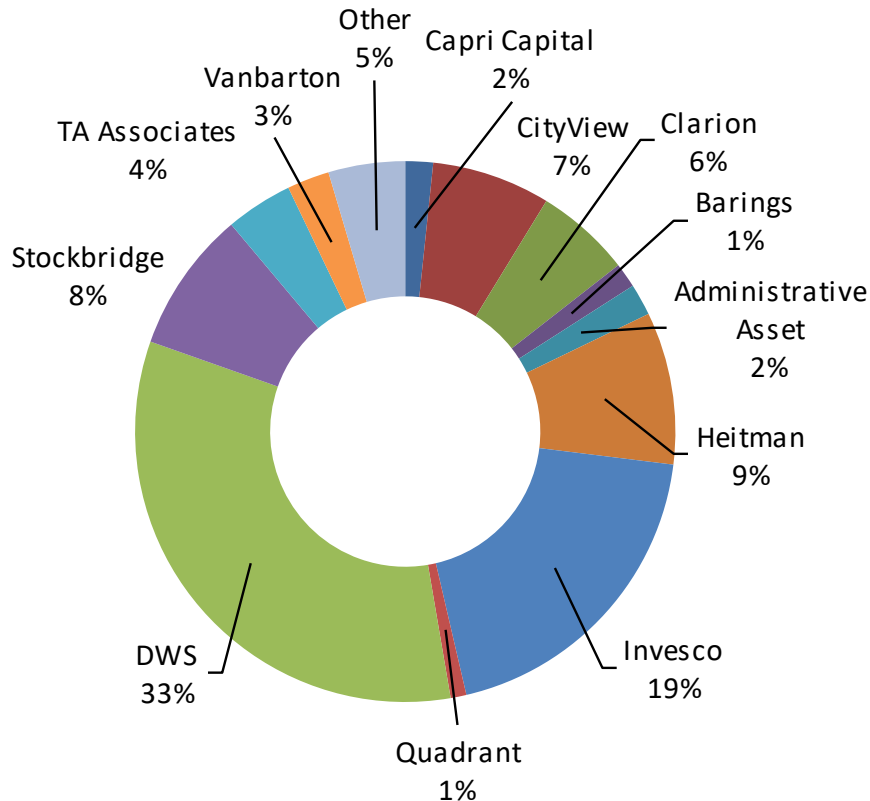
2. Real Estate is modeled at 1/3 of Illiquid Credit.



Diversification by Manager After Transfer to DWS

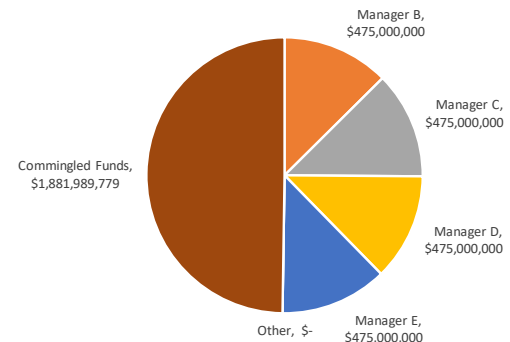
(As of September 30, 2018)¹

Real Estate Portfolio \$6.4B



- Exposure to DWS to decrease significantly as assets are sold over next 24 months.
- Number of managers will decrease as legacy portfolios are liquidated over next 24 months.
- Use of ODCE funds planned to expand.

Possible Future Real Assets Allocation (\$3.8 Billion or 7% of Total Fund)

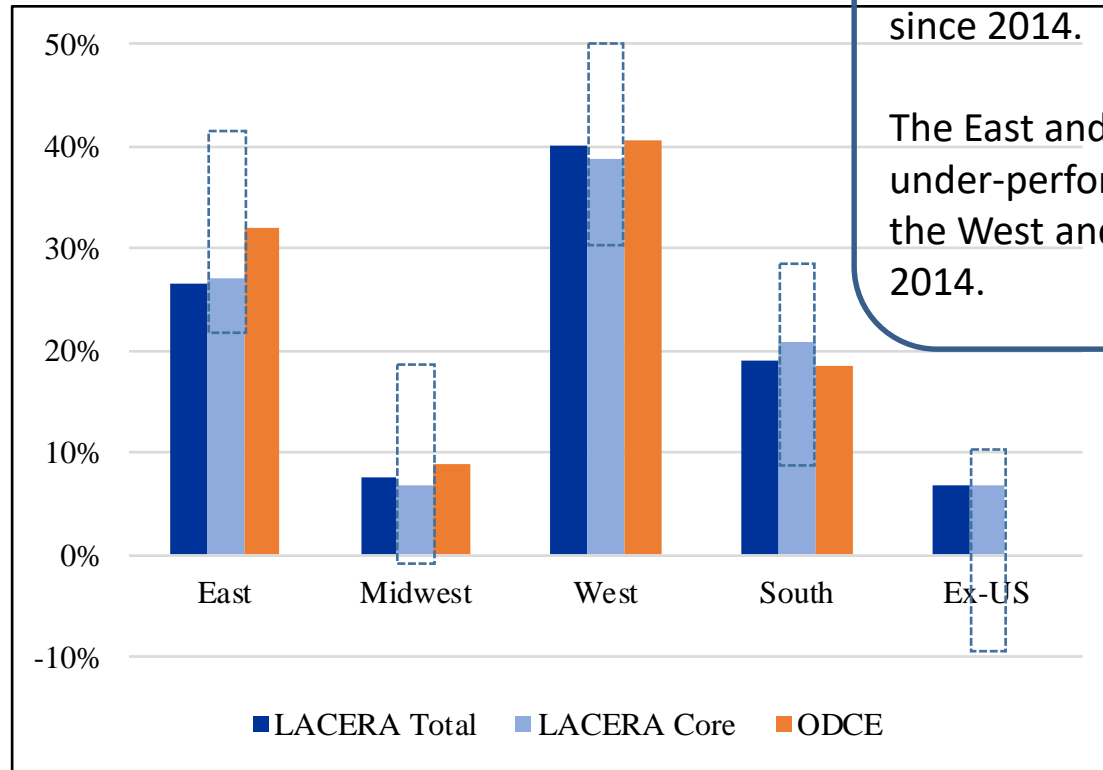


1. Adjusted to include acquisition and disposition activity through 12/31/2018 and asset transfers in Q1 2019.



Diversification by Geography


As of September 30, 2018 \$ in millions¹



The West region has out-performed all other regions since 2014.

The East and Midwest have under-performed relative to the West and South since 2014.

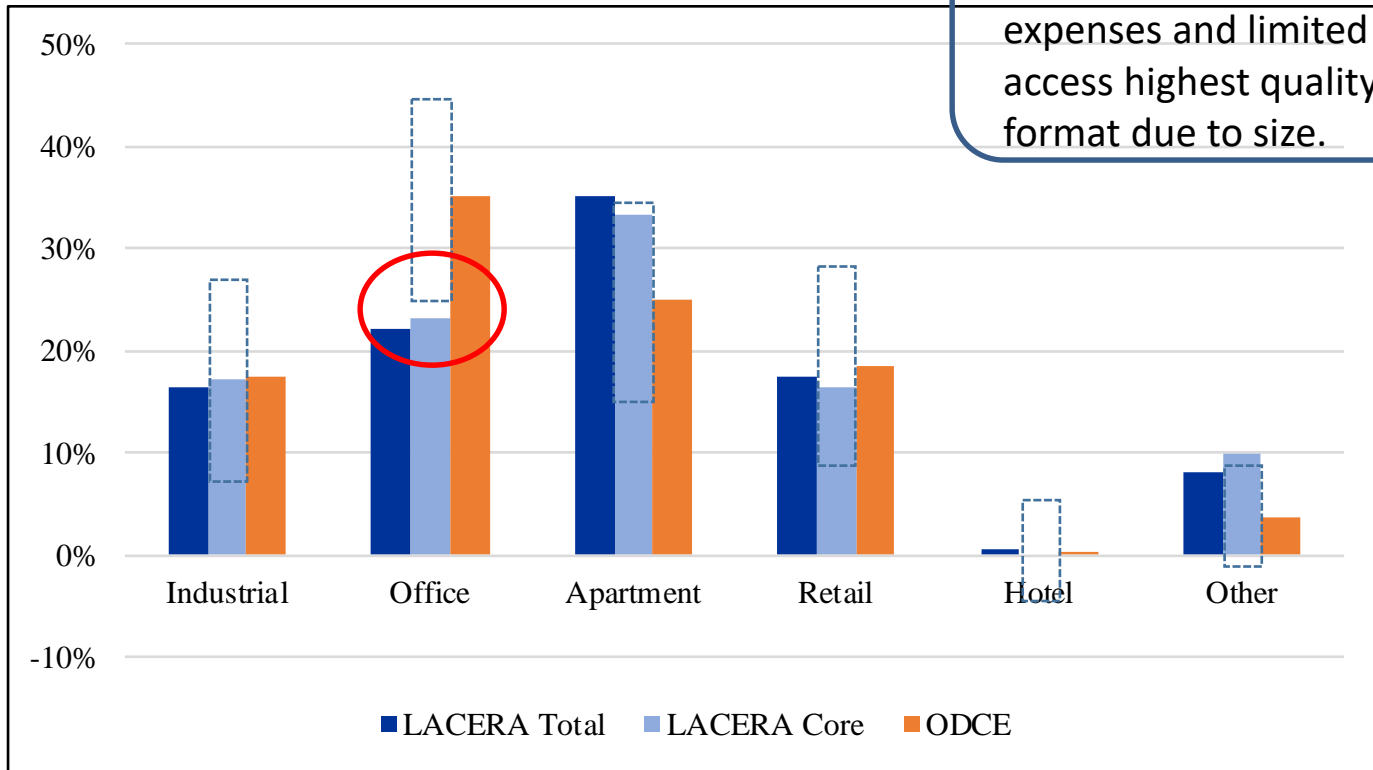
1. Adjusted to include acquisition and disposition activity through 12/31/2018.

 Denotes a +/- 10% variance from the ODCE benchmark.

Diversification by Property Type

As of September 30, 2018 \$ in millions¹

Underweight office due to expected lower returns than other property types, high capital expenses and limited ability to access highest quality assets in IMA format due to size.



1. Adjusted to include acquisition and disposition activity through 12/31/2018.

Denotes a +/- 10% variance from the ODCE benchmark for Industrial, Office, Apartment, and Retail; and a +/- 5% variance for Hotel and Other.



Real Estate Returns by Investment Type

Five-Year Returns (as of September 30, 2018)

Functional Asset Class/Strategy	Net Market Value (\$ in millions)	% of Portfolio	Income	Apprec.	Total Gross Return	Total Net Return	Custom Benchmark	Difference
Real Assets & Inflation Hedges	\$5,408	84%	5.5%	4.2%	9.8%	9.2%	10.0%	-0.8%
Growth	\$794	12%	4.6%	11.9%	16.9%	14.1%	13.0%	1.1%
Credit	\$130	2%	9.4%	0.1%	9.5%	8.4%	4.9%	3.5%
Administrative Asset	\$117	2%	7.3%	4.4%	11.9%	11.8%	n/a	n/a
Total	\$6,448	100%	5.5%	5.0%	10.7%	9.8%	10.6%	-0.8%

Ten-Year Returns (as of September 30, 2018)

Functional Asset Class/Strategy	Net Market Value (\$ in millions)	% of Portfolio	Income	Apprec.	Total Gross Return	Total Net Return	Custom Benchmark	Difference
Real Assets & Inflation Hedges	\$5,408	84%	5.9%	-0.8%	5.0%	4.4%	4.9%	-0.5%
Growth	\$794	12%	2.8%	-10.3%	-7.9%	-11.9%	9.4%	-21.3%
Credit	\$130	2%	n/a	n/a	n/a	n/a		
Administrative Asset	\$117	2%	8.0%	-6.1%	1.6%	1.6%	n/a	n/a
Total	\$6,448	100%	5.7%	-0.9%	4.8%	4.0%	6.7%	-2.7%



Investment Themes

Low cap rates

- Consider “build-to-sell” and “build-to-core” (Growth investments) rather than core investments.
- Sell core assets.

Technological disruptions

- Increase industrial exposure and challenge mall holdings.

Demographic shifts

- Target niche strategies such as medical office, senior housing, student housing, self-storage, etc.

Maintain Vintage Year Exposure

- Continue to allocate capital to IMAs, domestic and international commingled funds in order to get vintage year diversification.

Initiatives Review

2018-2019 Review



Prior Initiatives/Themes

Approved July 2018

- **Immediate Modifications**

- Cease Discretionary Value-Add Investing from IMA Managers – **Completed**
- Develop Manager-Specific Performance Hurdles (Present to Board for approval) – **Completed**
- Track Benchmark Variances and Impact on Performance – **Underway. The Consultant is integrating this into future performance reports.**

Prior Initiatives/Themes

Approved July 2018

- **Six to Twelve Months**

- Evaluate Managers and Mandates (Present to Board for approval of any changes) – **Completed**
- Increase Industrial – **Underway- \$35 million of net new industrial investments have been made.**
- Decrease Apartment – **Underway - \$263 million of sales have been completed and \$501 million of additional sales are expected within the 19-20 fiscal year.**
- Evaluate Office and Retail exposure options – **Pending – This project will be completed within the 19-20 fiscal year.**



Prior Initiatives/Themes

Approved July 2018

• On-Going

- Justify Benchmark Variances – Per policy, any deviation greater or less than 10% of the benchmark for property type or geography will be justified.
- Evaluate domestic commingled fund opportunities for value-add and high-return investments (Present any recommendations to the Board for approval) – Several funds have been considered, one presented to date (Bain), and additional recommendations anticipated in the 19-20 fiscal year.
- Evaluate open-end domestic commingled funds for potential core investments (Present any recommendations to the Board for approval) – Core Property Index Fund presented to Board (approved). Additional ODCE fund evaluations underway for consideration following completion of rebalancing.
- Sell chronically under-performing assets – \$230 million of sales completed. More pending.



2019-2020 Update

Themes Guiding FY 2019-20 Investment Activity

Updated April 2019

- Continue Prior initiatives
 - Reduce size and rebalance Real Assets
 - Sell assets during fiscal year to realize \$1 billion net reduction
 - Remain defensive
 - Maintain $\geq 60\%$ of portfolio in Core
 - Maintain vintage year exposure
 - Allow IMA managers to invest up to \$500 million (see proposed conditions on later slide)
 - International Investment Plan
 - Commit to 1-3 funds annually
 - Decrease apartments
 - Sell \geq \$500 million of apartments
 - Increase industrial
 - Consider additional commitments to industrial funds.



Themes Guiding FY 2019-20 Investment Activity

Updated April 2019

- Continue Portfolio Rebalance Efforts
 - Evaluate office and retail
 - Consider whether to gain access to office and regional malls, and if so, how.
 - Work with Credit team regarding real estate debt investments
 - Increase use of open-end funds
 - Identify ODCE fund candidates for investment following completion of rebalance
- Operational Considerations
 - Review appraisal frequency and process
 - Consider retaining an appraisal management firm
 - Administrative Services RFI results (Performance/Title Holding Corporations/Book of Record)
- Strategy
 - Developing a more intentional portfolio composition



Capital Allocation Authorization

Separate Account Managers

Maintain Vintage Year Exposure

Authorize Up to \$500 million of new investments by existing separate account managers:

- Clarion
- Heitman
- Invesco
- DWS/RREEF
- Stockbridge

\$250 million of new funds may be made available initially. An additional \$250 million may be released on a cumulative 1:2 ratio based on realized sales. (Ex. \$100 may be invested only after \$200 of sales have been realized.)

Advance to Board

Staff proposes advancing the following :

1. Accept the Structure Update
2. Approve allocating up to \$500 million for investment by separate account managers

APPENDIX



Real Estate Acquisitions and Dispositions

CY 2018

CLOSED										
Acquisition/Disposition	Region	Type	Style	Acq./Disp. Date	MV 1/1/2018	MV 12/31/2018	\$ Change	% Change	IRR, net lev.	IRR, net un-lev.
Acquisition	East	Apartment	High Return	1/23/2018	19,935,562	27,450,250	7,514,688	37.7%	13.0%	9.8%
Acquisition	South	Retail	Core	4/27/2018	20,755,500	20,402,000	(353,500)	-1.7%	8.2%	7.7%
Acquisition	Midwest	Office	Core	12/19/2018	N/A	38,624,850	N/A	N/A	8.4%	6.6%
Disposition	South	Retail	Value-Add	2/27/2018	3,500,000	3,600,000	100,000	2.9%	-1.4%	1.1%
Disposition	Midwest	Retail	Value-Add	7/25/2018	2,600,000	2,485,000	(115,000)	-4.4%	-1.4%	1.1%
Disposition	South	Apartment	High Return	9/11/2018	81,882,722	79,235,010	(2,647,712)	-3.2%	11.2%	N/A - JV
Disposition	East	Apartment	Core	10/10/2018	117,220,000	114,000,000	(3,220,000)	-2.7%	10.8%	10.2%
Disposition	Midwest	Office	Core	10/1/2018	19,184,727	18,625,000	(559,727)	-2.9%	N/A	8.4%
Disposition	West	Hotel	Value-Add	11/16/2018	218,200,000	224,100,000	5,900,000	2.7%	N/A	1.6%

PIPELINE										
Acquisition/Disposition	Region	Type	Style	Acquisition Date	MV 1/1/2018	MV 12/31/2018	\$ Change	% Change	IRR, net lev.	IRR, net un-lev.
Acquisition	West	Apartment	High Return	N/A	N/A	48,800,000	N/A	N/A	10.6%	9.4%
Acquisition	West	Industrial	Core	N/A	N/A	46,000,000	N/A	N/A	7.4%	6.2%
Disposition	South	Office	Core	12/30/2015	23,300,000	24,000,000	700,000	3.0%	N/A	6.8%
Disposition	West	Office	High Return	10/7/2016	19,347,998	19,000,000	(347,998)	-1.8%	N/A	N/A
Disposition	West	Office	High Return	10/7/2016	9,848,137	16,659,546	6,811,409	69.2%	N/A	N/A
Disposition	West	Industrial	Core	9/23/2016	1,293,779	1,449,368	155,589	12.0%	64.2%	41.6%
Disposition	West	Industrial	Core	11/21/2014	12,962,931	11,825,000	(1,137,931)	-8.8%	N/A	N/A
Disposition	West	Industrial	Core	11/21/2014	17,207,230	16,225,000	(982,230)	-5.7%	N/A	N/A
Disposition	West	Industrial	Core	11/21/2014	7,106,786	6,700,000	(406,786)	-5.7%	N/A	N/A
Disposition	West	Apartment	Core	7/1/2014	182,000,000	185,300,000	3,300,000	1.8%	7.3%	5.5%
Disposition	Midwest	Retail	Value-Add	2/23/2007	5,300,000	6,600,000	1,300,000	24.5%	-1.4%	1.1%
Disposition	South	Apartment	Core	2/23/2007	39,600,000	42,708,000	3,108,000	7.8%	2.3%	3.1%



Ten Largest Assets by Gross Asset Value

As of September 30, 2018 \$ in millions¹

No.	Type	City	State	GAV	NAV	NAV % of Total Real Estate
1	Apartment	New York	NY	\$444.2	\$294.2	4.6%
2	Hotel	New York	NY	\$407.0	\$132.0	2.0%
3	Apartment	Los Angeles	CA	\$332.7	\$182.7	2.8%
4	Apartment	Marina del Rey	CA	\$294.5	\$179.5	2.8%
5	Industrial	Compton	CA	\$240.6	\$135.6	2.1%
6	Student Housing	College Park	MD	\$233.7	\$124.2	1.9%
7	Retail	New York	NY	\$230.0	\$132.9	2.1%
8	Retail	Collegeville	PA	\$212.3	\$117.3	1.8%
9	Retail	Cranston	RI	\$194.0	\$152.7	2.4%
10	Apartment	Los Angeles	CA	\$184.8	\$94.4	1.5%

1. Adjusted to include acquisition and disposition activity through 12/31/2018.



Real Estate Portfolio Leverage Summary

As of September 30, 2018 \$ in millions

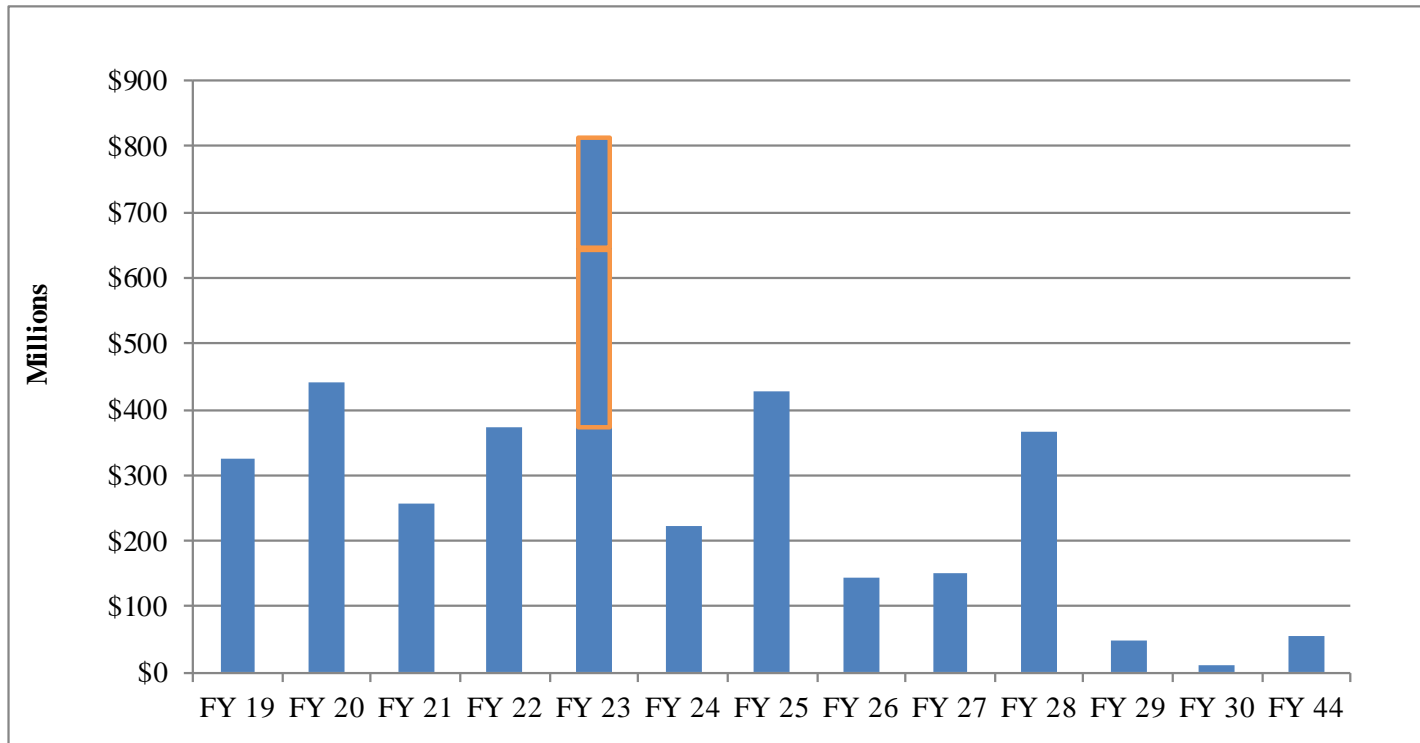
Investment Style	Gross MV	Debt	Net Market Value	LTV *
Real Assets and Inflation Hedges	\$8,448	\$2,923	\$5,525	35%
Growth	\$1,313	\$519	\$794	40%
Credit	\$270	\$140	\$130	52%
Total	\$10,031	\$3,582	\$6,448	35%

* Loan To Value



Real Estate Portfolio Debt Maturity Schedule

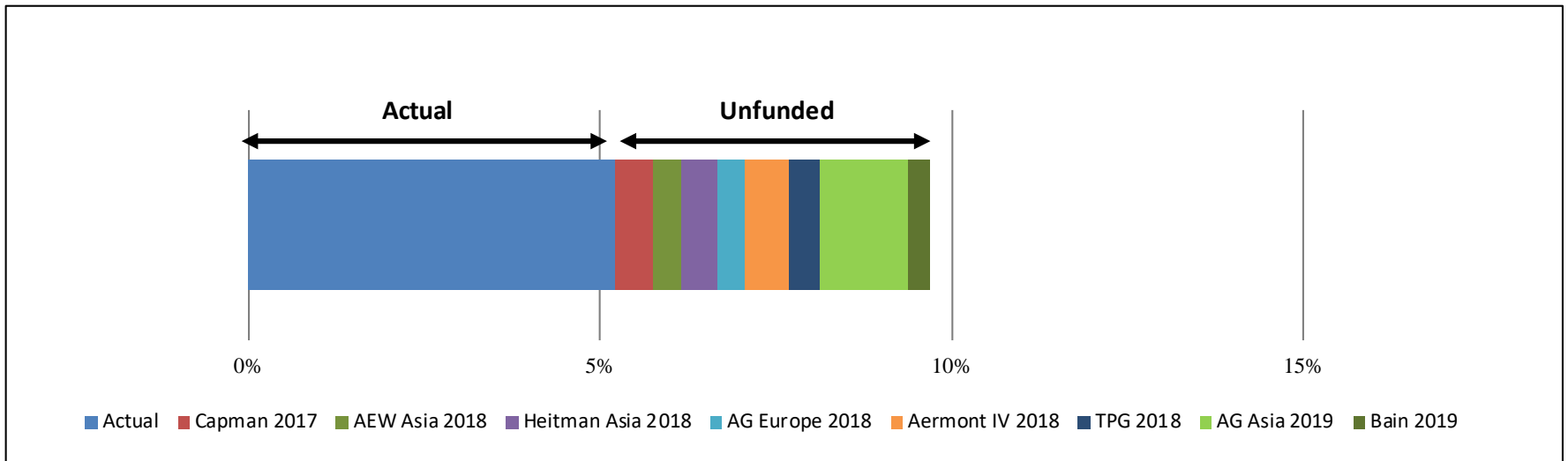
As of September 30, 2018 \$ in millions



* FY23 includes two large loans marked in orange outline for: (i) \$150 million; and (ii) \$275 million.

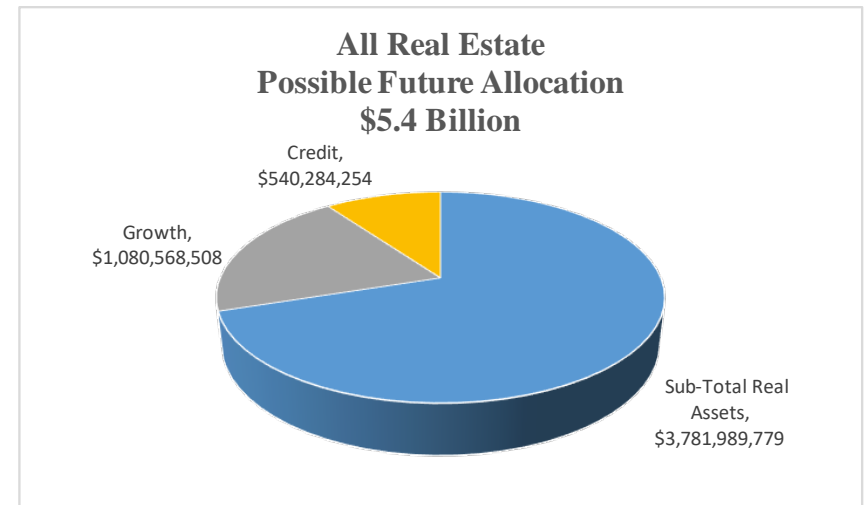
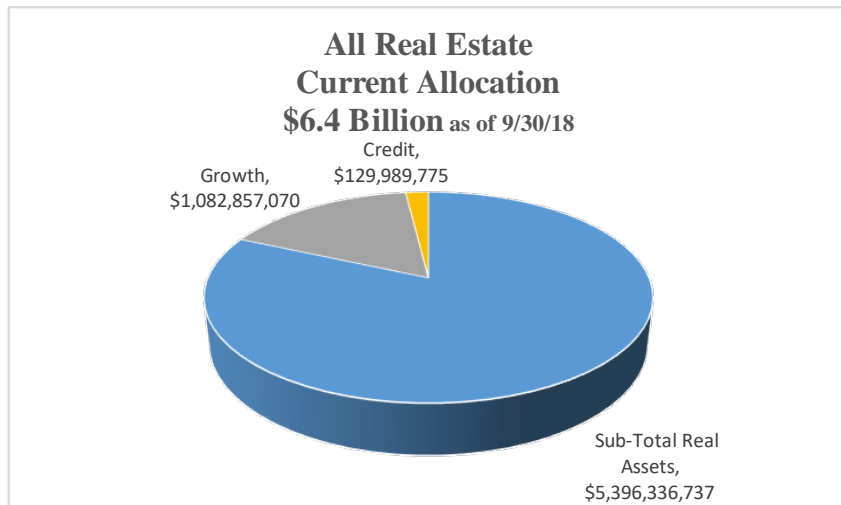


Real Estate International Exposure



Rebalance Illustration (All Real Estate)

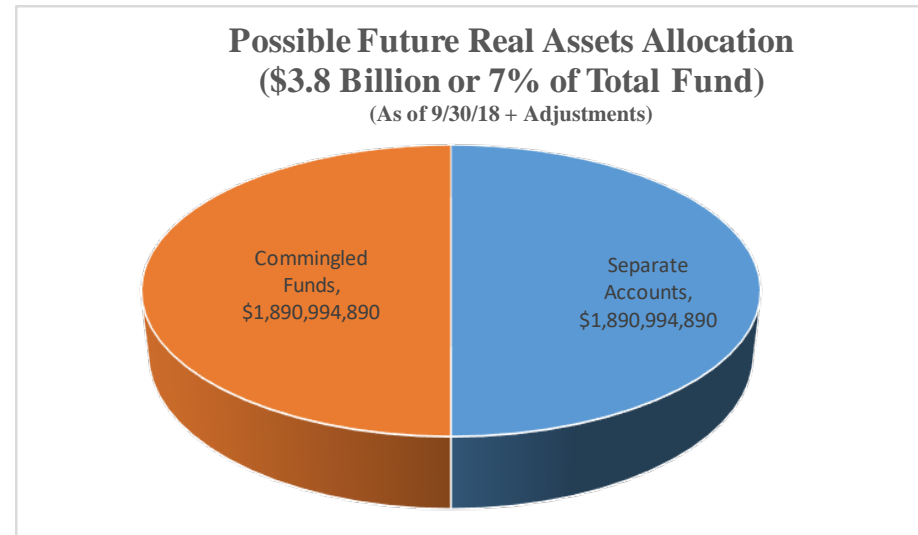
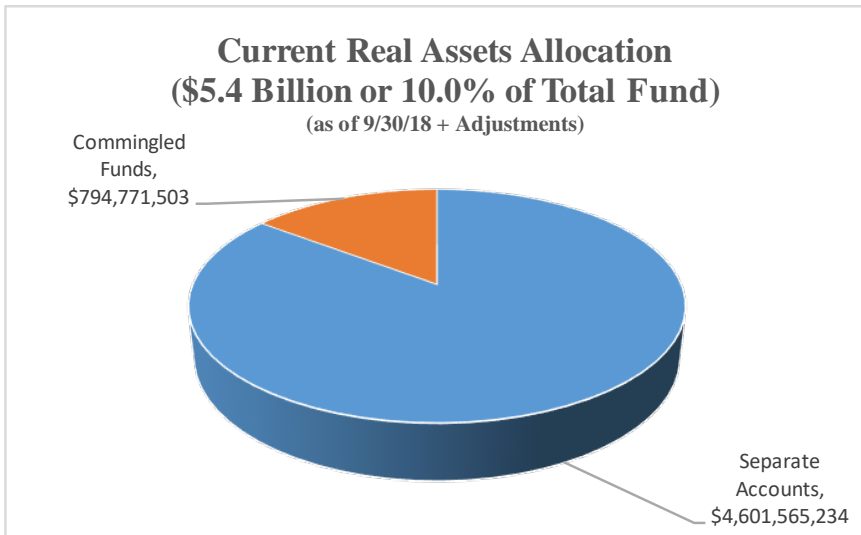
- Increase Exposure To Credit (See note)
- Decrease Exposure to Real Assets



Note: Real estate is modeled at 1/3 of the 3% allocation to illiquid credit.

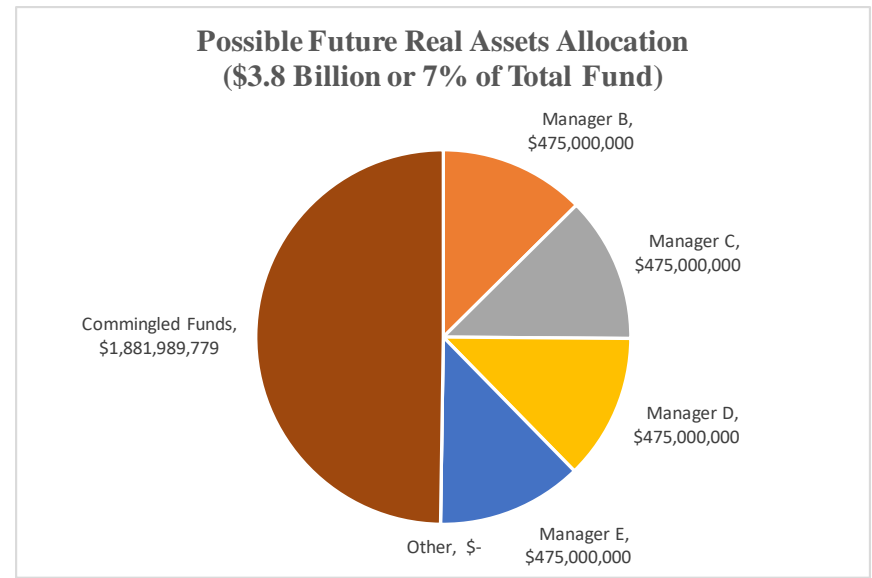
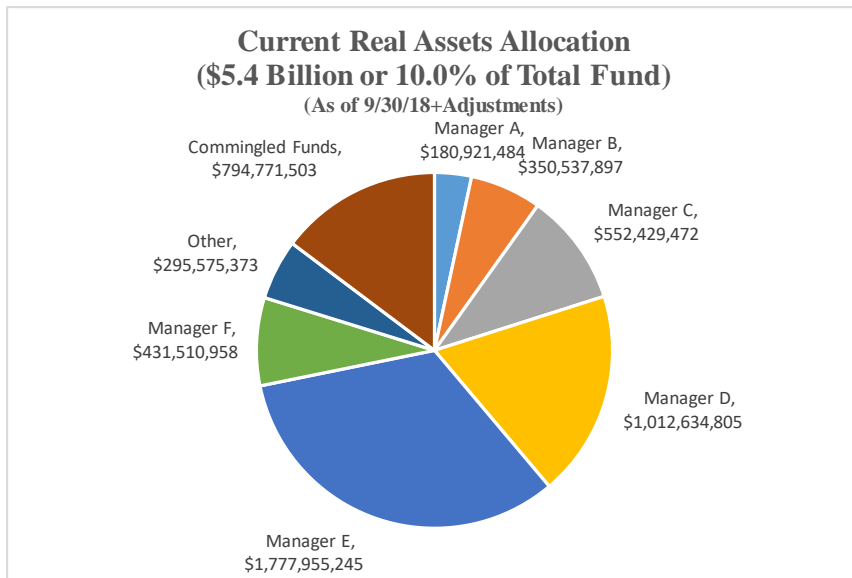
Rebalance Illustration— Real Assets

- Decrease Exposure to Real Assets
- Consider Using More Open-End Fund Vehicles
 - May improve
 - Liquidity
 - Diversification
 - Performance



Rebalance Illustration— Real Assets Continued

- Sample of Potential Structure of Real Assets
 - 50% Commingled funds
 - Diversity
 - 50% to limited number of Separate Account managers
 - Alpha generators



Memorandum

To: LACERA Real Assets Committee (“RAC”)
From: Townsend *Jennifer D. Stevens*
Date: April 10, 2019
Re: Real Estate Structure Review

In 2018, Townsend completed a multi-stage Performance Attribution Project related to the LACERA Individually Managed Account (“IMA”) Program and opined on the resulting changes to the LACERA Real Estate program structure. This memorandum provides a status report on the recommendations set forth in 2018 and outlines a set of recommendations for the LACERA RAC to consider in conjunction with the 2019 Real Estate Structure Review.

Real Estate Market Commentary

In 2018, U.S. private real estate markets continued their positive run for the ninth straight year. Mid-range return expectations for real estate have decreased since last year. Townsend’s private real estate and real asset return forecasts as of January 2019 are set forth below. These are net levered return expectations.

Risk & Return	Core	Value	Opportunistic	REITs	Timber	Row Crop	Perm Crop	Private Infrastructure
Expected Net Return	5.7%	6.2%	8.7%	6.0%	5.8%	6.0%	11.0%	7.0%
Standard Deviation	6.5%	9.1%	10.4%	21.0%	5.0%	4.3%	10.7%	7.5%

Additional market commentary is available in Townsend’s View of The World, provided separately to LACERA Staff.

Townsend 2019 Recommendations & Status Report

- 1. Terminate Underperforming IMA Managers**
 - Consider direct asset sales and/or portfolio sales
 - Consider transfer to Open-End Commingled Funds

Status Report: Ongoing. As a result of this analysis, in 2018 LACERA transferred assets away from underperforming managers and presented Phase 1 of the Core Open-End Commingled Fund allocation

effort, a commitment to IDR's Core Index Fund. Townsend recommends proceeding with Phase 2 of the program by further reducing the IMA exposure through asset sales and/or manager terminations and re-allocating to Core and Core Plus Open-End Commingled funds as capital becomes available.

2. Retain Outperforming IMA Managers

- Restructure IMA Contracts for Retained IMA Managers,
- Hold IMA Managers Accountable for Performance,
- Set IMA Primary and Secondary Performance Target,
- Recommend managers sell assets that will not meet future performance targets,
- Continue approving dollars available for deployment of capital on an annual basis, while limiting Non-Core exposure. Note: ODCE allows for Non-Core of up to 20%.

Status Report: Ongoing. In 2018, LACERA amended contracts with IMA managers, setting performance targets for each account. Townsend and LACERA Staff will monitor and report the performance of the IMA managers quarterly.

3. Establish Mix of Open-End Commingled Funds & Separate Accounts for US Core Investment Portfolio

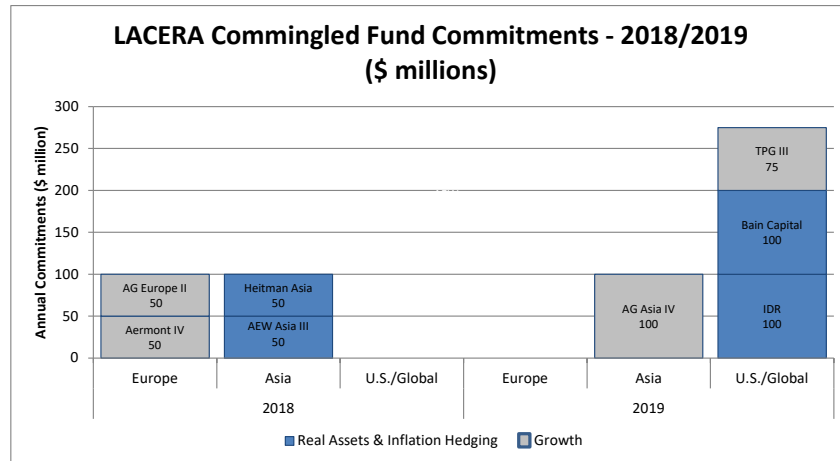
- Compliment IMA Exposure with Commingled Fund Exposure
- Allow for periodic rebalancing of positions to achieve competitive risk adjusted returns and/or take advantage of market opportunity

Status Report: Ongoing. As a result of this analysis, LACERA presented Phase 1 of the Core Open-End Commingled Fund allocation effort, a commitment to IDR's Core Index Fund. Townsend recommends proceeding with Phase 2 of the program by further reducing the IMA exposure through asset sales and/or manager terminations and re-allocating to Core and Core Plus Open-End Commingled funds as capital becomes available.

4. Re-introduce US Closed-End Non-Core Commingled Funds

- Target specific Non-Core strategies that cannot be replicated in IMA format (specific examples provided to the LACERA Real Estate Committee)

Status Report: Ongoing. In 2018 and 2019, LACERA invested in several commingled funds (both US and International).



2019/2020 Recommendations

1. Further Reduce IMA Exposure with a goal of introducing OEFCs
2. Evaluate OECF universe & select potential partners
 - a. Focus on complimentary diversification to existing LACERA positions
 - b. Target managers with the ability to outperform the ODCE
 - c. Increase net return potential by focusing on favorable fee structures (where possible)
3. Revisit International Implementation Plan to take into account the new asset allocation targets for real estate
4. Be mindful of reduced real estate allocation, as well as maintaining adequate vintage year diversification in late cycle deployment. Regarding the Staff recommendation to authorize up to \$500 Million in new allocation for the IMA managers, Townsend recommends offsetting new capital allocation allowances with asset sales, keeping in mind the overall goal of reducing in the size of Real Assets and Inflation Hedging category.

Functional Asset Class/Strategy	Current Market Value		Target		Difference
	\$	%	\$	%	
Real Assets and Inflation Hedges	\$5,218	9.1%	\$3,999	7.0%	(\$1,218)
Growth	\$794	1.4%	\$1,143	2.0%	\$349
Credit	\$130	0.2%	\$571	1.0%	\$441
Total	\$6,141	10.7%	\$5,713	10.0%	(\$428)

*Source: LACERA


5. Revisit LACERA IMA Appraisal Policies; Revise as necessary to reflect best practices


Recommendation

Townsend reviewed the 2019 LACERA Real Estate Structure Review and concurs with the LACERA Staff Report. Townsend recommends that the LACERA RAC approve the Real Estate Structure Review and advance it to the Board of Investments for consideration.

March 29, 2019

TO: Each Member
Real Assets Committee

FROM: John McClelland 
Principal Investment Officer

James Rice 
Principal Investment Officer

FOR: April 10, 2019 Real Assets Committee

SUBJECT: **2019 REAL ASSETS COMMITTEE
WORK PLAN OVERVIEW**

BACKGROUND

Attached for your review and discussion is an overview of the 2019 Real Assets Committee's current and ongoing initiatives as well as anticipated dates and agenda items for 2019.

Attachment

Noted and Reviewed:



Jonathan Grabel
Chief Investment Officer

2019 Committee Work Plan Overview

Real Assets Committee

April 10, 2019

John McClelland, Principal Investment Officer
Jim Rice, Principal Investment Officer



Key Current and Ongoing Projects-Real Estate

The Real Estate team has numerous projects both upcoming and in motion to achieve LACERA's strategic asset allocation of the Plan Trust

Optimization Structure Reviews

- **Structure Review Update-** Rebalance to asset allocation targets. Maintain vintage year exposure
- **Operating Prodecures Review-** present suggested changes to Committee and Board
- **Investment Structure-** Review continued use of Title Holding Entities

Opportunity Ongoing Searches

- **Review domestic commingled funds-** Evaluate value-add and opportunistic funds for investment
- **International Real Estate:** Evaluate Asian, European and Latin American funds for investment
- **Administrative Services RFI-** Complete RFI and assess retaining a service provider

Education

- **ODCE Funds:** Study universe of ODCE funds and evaluate how they may be used to improve performance.
- **Office and Retail:** Evaluate historical return attributes and consider whether to target additional investment



Key Current and Ongoing Projects-Real Assets

The Real Assets team has numerous projects both upcoming and in motion to achieve LACERA's strategic asset allocation of the Plan Trust

Optimization Structure Reviews

- **Investment Structure:** Development of new program: Review of private asset commitment pacing, near term opportunity set. Determination of relative focus on core, value added, and growth investment opportunities.
- **Operating Procedures Development:** present suggested procedural framework consistent with existing and anticipated investment structure

Opportunity Ongoing Searches

- **Completion portfolio:** Implementation of managed portfolio of public market equities in infrastructure and natural resources
- **Private Investments:** Starting process for evaluation of commitment recommendations to the Board of Investments.

Education

- **Real Assets Infrastructure and Natural Resources:** Review of landscape of opportunity set, risk and return expectations of investment areas, and identification of most timely or significant areas for near term investment focus.

Anticipated 2019 Agenda Items for Oversight

Staff is proposing the following meetings for the Real Assets Committee to exercise oversight of key initiatives and necessary advancements*

Committee Meeting

Anticipated Agenda Items

April 10, 2019

- Real estate structure review update
 - Real Assets workplan
-

September 11, 2019

- Real estate Operating Procedures Review
 - Real Assets (excluding Real Estate) Structure Review
 - Real Assets Education: Infrastructure and Natural Resources
 - Real Assets Operating Procedures Development
-

* Additional items and reports may be added, as appropriate

