



Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 13

MEETING DATE: July 19, 2017

SUBJECT: Proposed Revisions to SCERS' Real Estate Program

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

RECOMMENDATION

SCERS' investment staff ('Staff') and Townsend Group ('Townsend') recommend that the Board:

1. Approve a structure and orderly transition that, when completed, provides that SCERS' Core real estate exposure will be managed through Core comingled funds and no longer include Core separate accounts.
2. Authorize Staff and Consultant to develop and execute a Core implementation plan for the transition of the existing Core separate account program according to the implementation protocols within the Real Estate Investment Policy Statement ('IPS').
3. Beginning in the second half of calendar year 2017, maintain and report on SCERS' Non-Core and Non-U.S. real estate exposure as part of the Real Estate asset class within SCERS' Real Return asset category, rather than the Opportunities asset category.
4. Approve the Real Estate portfolio construction targets and ranges for Core Real Estate, Non-Core Real Estate and Non-U.S. Real Estate as proposed.
5. Establish a Primary Policy Index Real Estate Benchmark using existing Core and Non-Core benchmarks and weights.
6. Establish a Secondary Custom Global Benchmark for the total Real Estate Program that reflects SCERS' exposure to Non-U.S. Real Estate.
7. Approve the proposed revisions to the Real Estate IPS.

PURPOSE

To conform the Real Estate asset class structure and Real Estate Investment Policy Statement ('IPS') to the strategic asset allocation adopted by the Board in January 2017 and enhance efficiency in managing SCERS' Real Estate program.

DISCUSSION

At the June Board meeting, Staff and Townsend provided a review and analysis of several structural considerations related to SCERS’ Real Estate asset class. The key implementation considerations identified for the Real Estate asset class were:

1. Core Real Estate – the mix between separate accounts and commingled funds
2. Non-Core Real Estate – the appropriate categorization of SCERS’ non-core/non-U.S. real estate exposure
3. Benchmarks – potential addition of a global benchmark for SCERS’ total real estate program

More detailed information and discussion related to these considerations can be found within the materials provided for the ‘Real Estate Program Discussion’ item as part of the June 21, 2017 Board meeting agenda.

This memorandum will also discuss the proposed modifications to the IPS for the Real Estate asset class.

REAL ESTATE STRUCTURE RECAP

As you will recall, SCERS’ allocation to the Real Estate asset class within SCERS’ recently approved asset allocation is 7%. The Real Estate allocation is within SCERS’ Real Return asset category, which also includes target allocations of 7% Real Assets, 2% Commodities and up to 3% TIPS (0% target).

The Real Return asset category seeks to achieve multiple investment objectives as outlined below:

- Attractive returns on a real (net of inflation) basis and a hedge against inflation risk;
- Diversification for SCERS’ portfolio, including low or negative correlation to equities;
- Moderate income and cash flow generation; and
- Greater consistency in the return distribution and muted downside risk.

SCERS’ aggregate Real Estate portfolio is currently comprised of core and non-core real estate (value-add, opportunistic, and

SCERS Real Estate Program				
	Asset Class	Target	Range	Actual
Core	Real Assets	7%	4% to 9%	6.4%
Non-Core	Opportunities	N/A	0% to 5%	2.1%
Public REITs	Equities	2.25%	N/A	2.4%

non-U.S.) investments, including market participation in commercial office, industrial, retail, and residential real estate property types. These investments may comprise open-end commingled funds, closed-end commingled funds and separate direct ownership accounts.

Other permissible investment vehicles include fund-of-funds, co-investments, and secondary purchases.

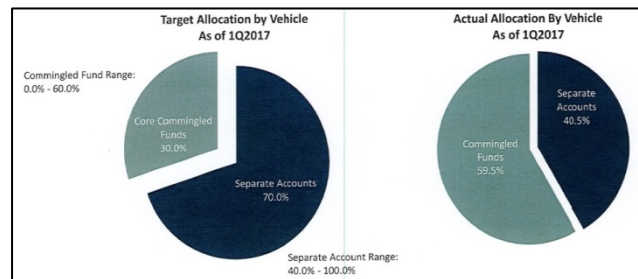
CORE REAL ESTATE PORTFOLIO COMPOSITION

RECOMMENDATION:

Staff and Townsend recommend that the Board approve a structure and orderly transition that, when completed, provides that SCERS' Core real estate exposure will be managed through Core commingled funds and no longer include Core separate accounts.

DISCUSSION:

SCERS currently invests in core real estate through two investment vehicles. These include (1) Separate accounts and (2) Core open-ended funds ('OECFs'). The current weighting as of 2Q17 to separate account properties is 41.6% and to core commingled funds is 58.4%. The target weights for these segments within SCERS' Real Estate investment policy statement is 70% separate accounts and 30% commingled funds, but separate accounts can range between 40% and 100%, and commingled funds can range between 0% and 60%. The core commingled fund exposure has increased over the past few years due to individual property dispositions within the separate accounts, combined with a higher level of allocations to core open-end funds.



As referenced at the June Board meeting, an advantage of a core separate account program is the ability to exercise greater discretion and control over investment decisions, in particular, asset acquisitions and dispositions, and use of leverage. However, the disadvantage of a separate account is the considerable time and effort necessary to administer the program, the specialized skills necessary to make informed decisions, and portfolio concentration risk.

At the June meeting, Townsend and Staff presented the narrow dispersion of returns (1.25%) between top-quartile and bottom-quartile core real estate managers, compared to the wider dispersion of returns for non-core real estate managers and strategies, to illustrate the greater potential for alpha generation (excess returns over the asset class benchmark) within non-core real estate compared to core real estate, especially considering the time and resources required to implement a core real estate separate account program. The Townsend analysis also demonstrated that SCERS' OECF's have outperformed its separate accounts over most reporting periods.

It was also shown that SCERS' average separate account annual fee including the performance fee equals 1.3%, while SCERS' core commingled fund managers earn an average annual fee of 0.75%.

Staff and Townsend believe that core real estate exposure through OECFs provides SCERS access to top fund managers and a portfolio of core assets diversified across vintage years, property type, and geographic location that otherwise would be challenging for SCERS to replicate through a separate account structure. A separate account requires considerable Staff time and effort, whereas a OECF program has the added benefit of making more efficient use of Staff resources.

IMPLEMENTATION OF CORE PORTFOLIO COMPOSITION RECOMMENDATION:

Staff and Townsend recommend that the Board authorize Staff and Consultant to develop and execute a Core implementation plan for the transition of the existing Core separate account program according to the implementation protocols within the Real Estate Investment Policy Statement ('IPS').

The implementation will entail a thoughtful process to phase out SCERS' separate account exposure. SCERS currently has a total of six separate account properties (five with BlackRock and one with Barings). The details of an orderly transition out of separate account assets and into OECFs will need to be worked out, but as outlined in the Townsend presentation, there are two potential options for implementation:

1. Sell separate account assets individually or as portfolios.
 1. With this option, SCERS and Townsend would ask SCERS' separate account managers to present a plan for an orderly sale of the remaining assets in SCERS' separate account portfolio.
 1. Advantages:
 - SCERS may receive more competitive market pricing.
 - SCERS' managers have more granular knowledge of the existing portfolio to optimize pricing during asset sales.
 2. Disadvantages:
 - The selling of assets individually could translate to an episodic disposition pace, which could increase the risk of owning separate account assets for an extended period.
 - There are the potential for pre-payment penalties associated with loans on several of SCERS' individual assets.
 - There is transaction costs associated with the disposition of assets that SCERS would incur.
 - SCERS could encounter timing challenges redeploying proceeds into OECFs at the same pace as asset sales.
 3. Timing Estimate:
 - 12-36+ months
 2. Transfer separate account assets to OECFs in exchange for shares in OECFs.
 1. Townsend and Staff would survey the universe of OECF managers to determine whether any are interested in an exchange program.
 1. Advantages:
 - SCERS would receive immediate exposure to a diversified OECF, without the timing/pacing challenges identified above and fewer transaction costs.

- Could potentially be a quicker process than selling asset individually or as a portfolio.
 - SCERS may save on commissions typically paid to a third party in an outright sale.
2. Disadvantages:
 - SCERS would receive appraisal pricing for a transfer, which could potentially generate less value than actively marketing the assets to ready and willing buyers.
 - OECF managers may not accept all assets.
 3. Timing Estimate:
 - 90-120 Days

NON-CORE/NON-U.S. REAL ESTATE CLASSIFICATION

RECOMMENDATION:

Staff and Townsend recommend that the Board beginning in the second half of calendar year 2017, maintain and report on SCERS' Non-Core and Non-U.S. real estate exposure as part of the Real Estate asset class within SCERS' Real Return asset category, rather than the Opportunities asset category.

DISCUSSION:

Within the current Real Estate structure, core real estate, which typically possess a lower risk and return profile than non-core real estate, resides within SCERS' Real Estate asset class. However, non-core real estate, which includes investments to value-add and opportunistic real estate strategies, is allocated to SCERS' Opportunities portfolio to reflect a higher risk and return profile relative to core real estate. This profile includes a lower level of cash yield and income generation; a higher level of capital appreciation potential; lower occupancy levels; and an increased level of leverage. These characteristics can magnify the risk and return of non-core investments throughout the business and real estate cycles. However, as Townsend points out, non-core real estate still meets the key objectives of SCERS' Real Return asset category (of which the Real Estate asset class is a part), including: (1) Attractive returns on a real (net of inflation) basis and a hedge against inflation risk; (2) Diversification for SCERS' portfolio; and (3) Moderate income and cash flow generation.

You will recall that global (non-U.S.) real estate investments are also allocated in the Opportunities portfolio along with non-core real estate. Global investments provide an opportunity to capitalize on relative value differences when they arise abroad relative to the U.S. real estate market, even though non-U.S. real estate can include both core and non-core investments.

A question to ask is whether non-core and non-U.S. real estate are appropriately categorized in the Opportunities portfolio, and whether all real estate (outside of SCERS' dedicated REIT exposure with the public equity portfolio) should instead be categorized under the Real Estate asset class within the Real Return asset category, regardless of the risk/return or geographic profile of the real estate. Re-classifying non-core and non-U.S. real estate into the Real

Return asset category would assist SCERS with more effectively accounting for real estate exposures, and rebalancing the portfolio with long-term strategic goals and objectives.

IMPLEMENTATION OF NON-CORE/NON-U.S. REAL ESTATE CLASSIFICATION RECOMMENDATION:

Staff and Townsend recommend that the Board approve the Real Estate portfolio construction targets and ranges for Core Real Estate, Non-Core Real Estate and Non-U.S. Real Estate as proposed below:

SCERS' Real Estate Portfolio Construction:

	Minimum	Target	Maximum
Total Real Estate Program	5.0%	7.0%	9.0%
	Minimum	Target	Maximum
Core Real Estate	50%	65%	80%
Non-Core Real Estate	20%	35%	50%
Non-U.S. Real Estate	0%	0%	30%

Within SCERS' current Real Estate structure, there is currently no specific target allocation and range of exposure for non-core real estate, whereas SCERS' core real estate is part of the Real Return asset category, and given a target weight of 7% relative to total plan assets. SCERS' non-core real estate currently resides within the Opportunities portfolio, which can range between 0% and 5% of total plan assets, but does not have a dedicated target or range.

The proposed targets of 65% core and 35% non-core (relative to the target total real estate allocation of 7%), with a range of 50% to 80% for core and 20% to 50% for non-core, gives SCERS the flexibility to manage real estate exposures throughout a real estate cycle, but also ensures that the core real estate portfolio stays at 50% or above at all times. The non-U.S. range of 0% to 30% is the same as within the current structure.

REAL ESTATE BENCHMARKING

RECOMMENDATION:

Staff and Townsend recommend that the Board establish a Primary Policy Index Real Estate Benchmark using existing Core and Non-Core benchmarks and weights, and establish a Secondary Custom Global Benchmark for the total Real Estate Program that reflects SCERS' exposure to Non-U.S. Real Estate.

DISCUSSION:

Since SCERS' current core and non-core exposure is isolated in different parts of SCERS' total portfolio, they are given different benchmarks. The current core real estate benchmark is the NCREIF Fund Index – Open End Diversified Core Equity ('NFI-ODCE') and the non-core

real estate benchmark is NFI-ODCE +100 bps. With the proposed classification of non-core real estate into the Real Estate asset class within the Real Return asset category, where core real estate also resides, and the proposed target allocations of 65% core and 35% for non-core real estate, respectively, having a blended primary benchmark for the Real Estate asset class makes sense. Therefore, it is proposed that SCERS utilize a blended primary policy index benchmark for the Real Estate asset class, using the current core and non-core benchmarks and the targeted weighting for each segment. This equates to a weighting of 65% NFI-ODCE and 35% NFI-ODCE + 1% as the primary policy index benchmark.

Staff and Townsend believe that there should also be a secondary benchmark for the Real Estate asset class, to represent the non-U.S. exposure within the Real Estate program. This proposed secondary benchmark includes a customized blend of U.S. and non-U.S. exposure based on SCERS' weighting to each geographic location. The non-U.S. component would be based off of the Global Real Estate Fund Index ('GREFI'), which comprises performance of non-listed real estate funds across the globe, and which includes performance of 470+ positions in Asia Pacific, Europe, U.S. and funds with a global strategy. The proposed secondary benchmark will be a 'floating' benchmark based on the average capital invested in each region, each quarter.

IPS MODIFICATIONS

RECOMMENDATION:

Staff and Townsend recommend that the Board approve the proposed revisions to the Real Estate IPS.

DISCUSSION:

Staff and Townsend have revised the IPS for Real Estate to incorporate the recommendations above. The revisions include removing the language specific to core separate accounts and the targeted weights and ranges to separate accounts. It also incorporates the classification of non-core/non-U.S. real estate in the Real Estate asset class, including targets and ranges for each. In addition the IPS updates the proposed changes to the benchmarks for the asset class.

In addition to reflecting the more significant changes above, the broader revisions to the Real Estate IPS have been incorporated to better clarify existing language or general updates to the IPS, since the document was created in 2013

Included with this memorandum and the Townsend presentation, are two versions of the Real Estate IPS for the Board to review. One is the proposed revised IPS, and the other is a 'redline' version that tracks all of the changes between the original Real Estate IPS and the proposed revised IPS.

ATTACHMENTS

Townsend presentation with proposed revisions for the Real Estate asset class structure and IPS

Revised Real Estate IPS

'Redline' Real Estate IPS

Prepared by:

Reviewed by:

/S/
Steve Davis
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Interim Chief Executive Officer

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JR Pearce
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TOWNSEND[®]
GROUP

**Sacramento County Employees' Retirement System
Real Estate Investment Policy Statement Recommendations**

July 19, 2017



Introduction

- **At the June Board meeting, SCERS' Staff and Townsend provided a review and analysis of structural considerations for SCERS' Real Estate program.**
 - Implementation considerations included:
 - Core Real Estate – the mix between separate accounts and commingled funds
 - Non-Core Real Estate – the appropriate categorization of non-core/non-U.S. real estate exposure
 - Keep within SCERS' Opportunities portfolio or move to SCERS' Real Estate asset class within the Real Return asset category
 - Benchmarks – potential addition of a global benchmark
- **July Board meeting – provide formal Real Estate recommendations to the Board related to asset class structural changes, and Real Estate IPS modifications.**

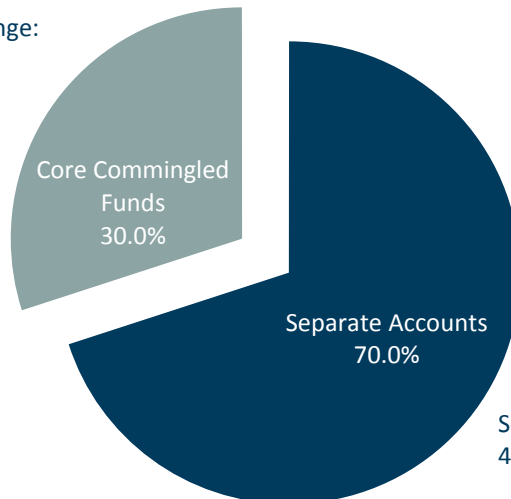
SCERS' Real Estate Portfolio Composition

SCERS' Core Portfolio Composition Recommendation

- The SCERS Core Portfolio represents 6.4% of the Total Plan which is well within the established range of 4.0% to 9.0%
 - Two Core Separate Accounts/Individually Managed Accounts (“IMAs”) containing six assets, and seven Core Open-End Commingled Fund (“OECFs”) make up the Core Portfolio today.
 - The current IPS described targets and ranges for both Core vehicles, as shown below.
 - This will allow for future execution flexibility and reflect the intention of the SCERS real estate program to focus on OECFs going forward.
- **SCERS' Staff and Townsend recommend a gradual transition from a combination of Core separate accounts and Core commingled funds, to managing the Core real estate exposure through a Core commingled fund program.**
 - SCERS' Staff and Townsend recommend revising the Real Estate IPS to reflect this, including removal of the Core vehicle constraints below.

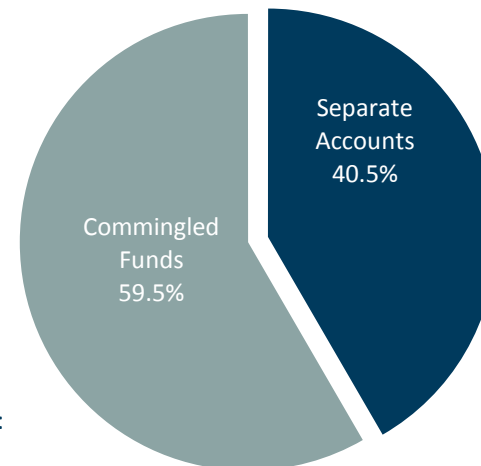
**IPS Target Allocation by Vehicle
As of 1Q2017**

Commingled Fund Range:
0.0% - 60.0%



Separate Account Range:
40.0% - 100.0%

**Current Allocation By Vehicle
As of 1Q2017**



SCERS' Real Estate Portfolio Composition

SCERS' Core Portfolio Implementation Plan

- Communicate to SCERS' IMA Managers that SCERS should be removed from acquisition rotation programs.
- Thoughtfully phase out SCERS' IMA exposure and continue primary investment in Core OECF investment program.
- SCERS Core Program Implementation Options:
 1. Sell IMA assets individually or as portfolios.
 - Ask SCERS' IMA Managers to present a plan for an orderly sale of the remaining assets in the SCERS IMA Portfolio.
 - » Advantages: SCERS may receive competitive market pricing; SCERS' managers have knowledge of existing portfolio.
 - » Disadvantages: SCERS may face challenges selling assets and risks owning IMA assets for an extended period; pre-payment penalties associated with individual assets; SCERS will face transaction costs; SCERS may face challenges redeploying proceeds from asset sales.
 - » Timing Estimate: 12-36+ Months
 2. Transfer IMA assets to OECFs in exchange for shares.
 - Survey universe of OECF managers to determine whether they are interested in an exchange program.
 - » Advantages: SCERS will receive immediate exposure to a diversified OECF; SCERS may save on commissions typically paid to a third party in an outright sale.
 - » Disadvantages: SCERS will receive appraisal pricing for transfer; OECF managers may not accept assets.
 - » Timing Estimate: 90-120 Days

SCERS' Real Estate Portfolio Composition

SCERS' Non-Core/Non-U.S. Portfolio Classification Recommendation

- Non-Core Real Estate includes both Value-Add and Opportunistic Real Estate strategies.
- Currently, Non-Core and Non-U.S. Real Estate are included in SCERS' Opportunities category, with an allowable range of 0.0% to 5.0%.
 - As of the Fourth Quarter, the Non-Core/Non-U.S. Real Estate Portfolio was well within its established range, representing 2.2% of the Total Plan. Including all approved unfunded commitments through December 31, SCERS has an aggregate exposure of 3.8% to Non-Core/Non- U.S. opportunities (with 2.2% in Value-Add and 1.6% in Opportunistic exposure).
- The objectives of the SCERS Real Return asset category, which includes the Real Estate asset class, are listed below, and Non-Core Real Estate meets the criteria:
 - Inflation Hedge
 - Diversification
 - Cash Flow Element
- **SCERS' Staff and its Consultants recommend moving Non-Core and Non-U.S. Real Estate from Opportunities to the Real Estate asset class, housed within SCERS' Real Return asset category.**

SCERS' Real Estate Portfolio Composition

SCERS' Real Estate Portfolio Implementation

- Due to the multiple categorizations for Real Estate within SCERS' Total Plan, there are no current allocations set forth in the IPS for Core and Non-Core investment allocations.
 - Non-U.S. does not have a target allocation, but can range between 0% and 30%.
- SCERS' Staff and Townsend recommend the following targets and ranges for the Real Estate asset class, which were derived through an efficient frontier exercise.
 - The targets and ranges suggested below will result in an expected net return range of 6.68% - 7.55% and volatility ranging from 9.83% to 11.27%. This is in line with the long term historical return of the NFI-ODCE (dating back to 1978), 7.31% Net.

Recommended SCERS Real Estate Portfolio Construction

SCERS' Real Estate Portfolio	Minimum	Target	Maximum
Core Real Estate	50%	65%	80%
Non-Core Real Estate	20%	35%	50%
Non-U.S. Real Estate	0%	0%	30%

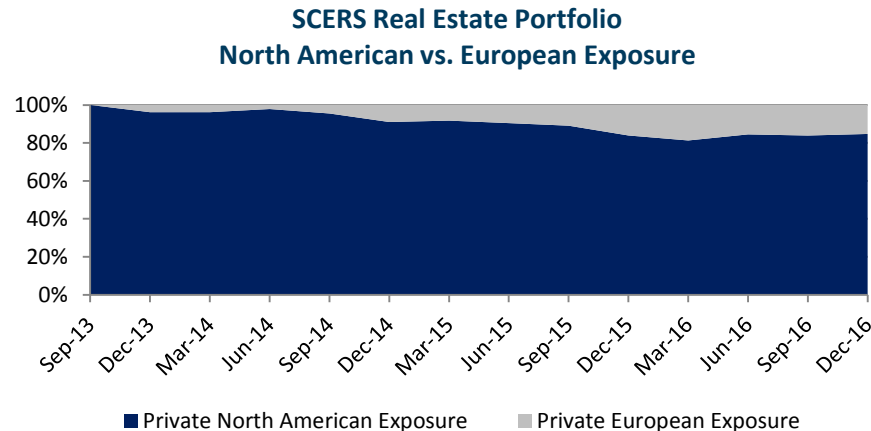
Townsend Efficient Frontier – Real Estate

Expected Return	Standard Deviation	Core	Non-Core
6.5%	9.0%	100.0%	0.0%
6.8%	9.6%	88.9%	11.1%
7.2%	10.3%	77.8%	22.2%
7.5%	11.1%	66.7%	33.3%
7.8%	12.0%	55.6%	44.4%
8.2%	12.9%	44.4%	55.6%
8.5%	13.9%	33.3%	66.7%
8.8%	14.9%	22.2%	77.8%
9.2%	15.9%	11.1%	88.9%
9.5%	16.9%	0.0%	100.0%

SCERS' Real Estate Benchmarking

SCERS' Benchmarking

- 84.2% of the SCERS Private Real Estate Portfolio is invested within North America (including <1% within Mexico through CIM VIII).
- The current benchmarks for SCERS' Private Real Estate Portfolio are US-based and include:
 - NFI-ODCE (Core),
 - NFI-ODCE + 100 basis points (Non-Core).
- A Secondary Custom Global Benchmark may include:
 - INREV, the European Association for Investors in Non-listed Real Estate Vehicles, publishes a quarterly index called Global Real Estate Fund Index (GREFI), which includes performance of non-listed real estate funds across the globe and is created by ANREV, INREV and NCREIF. The GREFI includes performance of 470 + positions in Asia Pacific, Europe, U.S. and funds with a global strategy.
- **SCERS Staff and Townsend recommend a blended Primary Policy Index Benchmark for Real Estate that is weighted with the new targets of 65% Core (NFI-ODCE), 35% Non-Core (NFI-ODCE + 100 basis points).**
- **Townsend and Staff recommend the adoption of a secondary benchmark which includes a customized blend of US and ex-US exposure based on SCERS' weightings to each location.**



Recommendations



Conclusions

Recommendations

1. Approve a prudent transition from a combination Core separate and commingled fund program, to managing the Core real estate exposure through a Core commingled fund program.
 - Includes removing specific language and guidelines for Core Separate Accounts from SCERS’ Real Estate IPS.
2. Issue authority to Staff and Consultant to devise a Core implementation plan for the transition of the separate account program, according to the implementation protocols within the Real Estate IPS.
3. Move SCERS’ Non-Core and Non-U.S. real estate exposure from the Opportunities category to the Real Estate asset class within SCERS’ Real Return asset category, and make related changes to the Real Estate IPS.
4. Approve the Real Estate Portfolio Construction Framework.

SCERS' Real Estate Portfolio Construction:	Minimum	Target	Maximum
Core Real Estate	50%	65%	80%
Non-Core Real Estate	20%	35%	50%
Non-U.S. Real Estate	0%	0%	30%

5. Create a Primary Policy Index Real Estate Benchmark using existing Core and Non-Core benchmarks.

Existing SCERS Real Estate Benchmarks	
Core	NFI - ODCE (Net)
Non-Core	NFI - ODCE + 100 basis points (Net)
Proposed SCERS Primary Real Estate Benchmark	
Total Real Estate Program	65% NFI-ODCE + 35% NFI-ODCE + 100 basis points (Net)

6. Consider a Secondary Custom Global Benchmark for the Private Real Estate Portfolio to reflect its global composition.
7. Approve the revised Real Estate IPS
 - Revisions are primarily focused on above recommendations, but also includes clarifying language and general updates since IPS was created in 2013

REAL ESTATE INVESTMENT POLICY STATEMENT

A. Investment Objectives

Real estate investments are housed within a dedicated Real Estate asset class within SCERS' Real Return asset category. Real Estate is comprised of core and non-core real estate, and may include both U.S and non-U.S investments. The investment objective of the Real Estate program is to provide: (1) A hedge against inflation risk; (2) A higher level of income and cash flow generation; (3) Greater consistency in the return distribution and muted downside risk; and (4) A diversifier for SCERS' total fund, particularly compared to equities.

Given the above investment objective, the performance of the Real Estate program will be compared against the following benchmarks:

1. Performance of core and core plus real estate investments are expected to exceed the NCREIF Fund Index – Open-End Diversified Core Equity ('NFI-ODCE'), net of fees.
2. Performance of non-core real estate investments are expected to exceed the NFI-ODCE by 100 basis points, net of fees.
3. Performance of the Total Real Estate program is expected to exceed a blended benchmark which consists of the following components: 65% core (NFI-ODCE) and 35% non-Core (NFI-ODCE + 100 basis points). This blended benchmark will serve as the Policy Index for SCERS' Real Estate asset class.
4. A customized secondary benchmark will be used to measure performance of SCERS' global exposures. The secondary benchmark will include a customized blend of U.S. and non-U.S. exposure, with the non-U.S. component using the Global Real Estate Fund Index ('GREFI') with SCERS' weighting to each geographic location. The secondary benchmark will be a 'floating' benchmark based on SCERS' average capital invested in each region, each quarter.

B. Investment Guidelines

1. Investment Strategies:

Investments in real estate can be made across a broad array of investment strategies:

a. *Core and Core Plus Real Estate.*

Core and core plus real estate will typically possess a lower risk and return profile than non-core value-add or opportunistic investments due to attributes that can include a higher level of cash yield and income generation; a lower level of capital appreciation potential; location in a primary metropolitan area; greater occupancy levels; and a lower level of leverage.

Core and core plus real estate include investments in operating and substantially leased properties of institutional quality, consisting primarily of investments in traditional property types (office, industrial, retail and for-rent multifamily). Core investments have moderate levels of associated leverage (generally below 40%).

Core plus real estate investments offer the opportunity to enhance returns by: (1) Alleviating an identifiable deficiency (in an asset's capital structure, in an asset's physical structure, in an asset's operation, etc.); and/or (2) Benefitting from market inefficiency. These investments may use slightly more leverage than core real estate investments to improve returns and may include some non-traditional property types.

b. *Non-Core (Value-Add and Opportunistic) Real Estate.*

In addition to some of the characteristics of core real estate outlined above, non-core investments offer the opportunity to enhance returns through factors that can include: (1) Investing in assets with greater deficiencies (such as substantial vacancy, the need for substantial renovation, etc.); (2) Accepting different types of risks (such as development risk, redevelopment risk, repositioning, etc.); (3) Focusing more on non-traditional property types that may have greater operating risks (such as hotels); (4) Accepting greater capital market risk (for example, by acquiring assets with complex capital structures that may be difficult to unwind); and (5) Seeking areas of greater market inefficiency.

Value-add and opportunistic real estate will typically possess a higher risk and return profile compared to core real estate due to considerations that can include a lower level of cash yield and income generation; a higher level of capital appreciation potential; location in a secondary market; lower occupancy levels; and an increased level of leverage. In many cases non-core real estate investments attempt to capitalize on an enhanced level of distress in specific properties or

wider market dislocation. These characteristics can magnify the risk and return of value-add and opportunistic investments throughout the business and real estate cycles.

c. *Public Real Estate Investment Trusts ('REITs').*

Public REIT investments are non-control positions in real estate investment trusts containing real estate operating companies. REIT vehicles offer investors daily liquidity and all investment property types are available. Long term historical averages suggest that REITs have a limited correlation to private real estate. Rather, because public REITs are traded on stock exchanges and raise capital via the equity markets (IPOs and secondaries), they are highly correlated to small- and mid-cap equities. REITs will comprise a small portion of SCERS' Real Estate program, if any.

d. *Debt Investments with Underlying Real Estate Exposure.*

Debt investments may be classified by SCERS' investment staff ('Staff') and consultant as falling into one of the traditional core/core plus or non-core investment strategies based on the composition of the underlying collateral.

2. Investment Vehicles:

The vehicles for real estate investments reflect the broad scope of investments.

Investments include private market participation in commercial, industrial and residential real estate properties. These investments may comprise open-end commingled funds and closed-end commingled funds, including commingled vehicles such as limited partnerships, limited liability companies or offshore corporations. The majority of SCERS' core real estate exposure will be attained through core open-end commingled funds ('COECFs'), while the majority of SCERS' non-core real estate exposure will be attained through closed-end commingled funds ('CECFs') generally through limited partnerships.

Investments in core real estate can also be made through core separate account ('CSA') relationships established with fiduciary oversight managers. These managers make commitments to physical assets such as properties, limited partnerships, or other entities such as limited liability companies or offshore corporations. While SCERS has maintained significant separate account exposure in the past, separate accounts will likely not represent a meaningful portion of the Real Estate program from 2017 forward, unless existing separate account assets have not yet been sold or transferred.

SCERS may also invest directly in fund-of-funds (FoF) vehicles. In these vehicles, the FoF invests in partnerships on a discretionary basis. FoFs will own the underlying partnerships and SCERS obtains contractual rights to the FoFs' portfolio through a limited partnership. A FoF will often have investors other than SCERS.

Co-investments and secondary purchases are also permitted and covered in more detail in the section, 'Secondary investments and Co-investments'.

Investments can also include publicly traded REITs in open-end commingled funds, closed-end commingled funds and separate direct ownership accounts.

Investments may be made in either U.S. or non-U.S. domiciled entities or assets.

3. Global Real Estate:

Investments in global real estate (ex-U.S.) are permissible in order to improve diversification and enhance returns on an opportunistic basis. However, the Real Estate program will maintain a disproportionate weighting toward the United States due to the following factors: (1) The absence of currency risk and associated costs; (2) The absence of withholding taxes; (3) High transparency; (4) A well-developed system of property rights and a well-developed legal system; and (5) A deep and liquid market. Accordingly, the SCERS Real Estate program (core, core plus and non-core real estate) may target exposure to investments outside the United States, with a permissible range of 0% to 30%.

Global real estate investing shares many of the same risks as investing in domestic real estate:

- Occupancy of buildings and vacancy rates
- Location of building(s) and surrounding areas
- Building and property type and use
- Illiquidity
- Macroeconomic (changes in interest rates, inflation, GDP growth, unemployment)
- Supply and demand of competitive stock or space
- Leverage

In addition, investing in global real estate carries additional unique risks:

- Macroeconomic risk will differ by country and geopolitical landscape (changes in interest rates, inflation, GDP growth, unemployment)

- Currencies may provide a diversification to SCERS' total fund but also can pose a risk when countries devalue their currencies vis-à-vis the USD
- Transparency can become problematic in less developed countries
- The high dispersion of returns presents opportunities for active managers to add value but can also present greater volatility

Careful selection of managers and countries through a thorough investment process is critical in order to benefit from global real estate opportunities while also mitigating these risks.

While a range of 0%-30% for the global real estate component allows SCERS to take advantage of lower values and specific market opportunities abroad when they arise outside of the U.S., it is important to note that it is not a required allocation, but rather, allows the flexibility to invest in non-U.S. markets when the risk and return characteristics are superior. In addition, providing an allowable range therefore produces competition for space between U.S. and non-U.S. investments. It is anticipated that global real estate opportunities will arise that are both core and non-core (value-add and opportunistic).

4. Risk and Diversification:

a. Real Estate program structure - Diversification by sub-asset class and investment strategy including target allocation and ranges.

The Real Estate program will be diversified across investment strategies and geographies. The Real Estate program has a target allocation of 7%, with a permissible range of 5% to 9%. The Real Estate program targets an allocation of 65% to core and 35% to non-core investments, with the permissible ranges as displayed below. The non-U.S. target is 0%, with a range between 0% and 30%.

The table below highlights the target allocation and permissible ranges for core, non-core real estate, as well as for geographic exposure.

SCERS' Real Estate Portfolio Construction:

	Minimum	Target	Maximum
Total Real Estate Program	5.0%	7.0%	9.0%
	Minimum	Target	Maximum
Core Real Estate	50%	65%	80%
Non-Core Real Estate	20%	35%	50%
Non-U.S. Real Estate	0%	0%	30%

Within the core real estate portfolio, exposure will primarily be comprised of Core Open-End Commingled Funds ('COECFs'), which provide SCERS with diversified exposure to stabilized properties and an element of liquidity. The majority of non-core real estate exposure will be attained through closed-end fund vehicles.

b. Real Estate program leverage.

Leverage on the Real Estate program can magnify both returns and losses. However, adding a moderate level of debt to a long-term real estate strategy has shown that it can be additive to returns over the long-term. Therefore, allowing flexibility to add debt during the expansionary phase of the cycle subject to a maximum limit will help ensure that a debt strategy will be accretive to returns. With this in mind, the loan-to-value ('LTV') limits for the Real Estate program are as follows:

- 40% maximum LTV for total core real estate program
- 75% maximum LTV for total non-core real estate program

These limits should provide adequate flexibility for the Real Estate program to operate through the real estate cycle, taking advantage of expansionary periods, but at the same time not increasing leverage beyond a point that will cause significant losses in a downturn in the cycle. However, if conditions warrant, Staff and consultant will approach the Board for approval of any exceptions to these debt guidelines.

c. Diversification of the real estate portfolio across property type and geography.

SCERS' Real Estate program will maintain diversification by property type and geography.

The core and non-core real estate portfolio will target weightings by property type and geography to be within +/- 10% of the NFI-ODCE Index. Exceptions may exist at different points in the market cycle, particularly with respect to targeted investments in the non-core real estate space, and will be monitored by Staff and consultant and reported to the Board in the quarterly performance report for real estate. An explicit exception is the non-U.S. real estate exposure, which may range from 0%-30%. When investments are made internationally, SCERS' Real Estate portfolio will potentially deviate from its primary real estate benchmark.

d. Diversification by vintage year.

SCERS will strive to limit the potential for investments during any given year in the business cycle to negatively impact the long-term results, by investing across business cycles and vintage years. It is anticipated that SCERS will commit to private real estate, particularly non-core investments, over multiple years, whereby the aggregate amount will be spread across the entire business cycle. This will serve to limit the exposure or risk to investing and relying on the performance of private real estate funds in any given year of the business cycle. The Board will determine with Staff and Consultant the funding allocation for real estate each year in conjunction with its annual review of the Real Estate Asset Allocation Structure and Twelve Month Real Estate Investment Plan (see Section D 'Implementation Protocol').

e. Diversification by investment manager and general partner.

SCERS will invest across a number of investment entities to mitigate the potential negative impact of a concentrated portfolio of investment managers. The optimum number of investment vehicles in the portfolio and the maximum exposure to any one investment vehicle will vary with time and will be evaluated as part of the Real Estate program structure (see Section D 'Implementation Protocol'). One single investment position shall be limited to 2.5% of the net asset value ('NAV') of SCERS' total fund. SCERS will strive to maintain ongoing long-term relationships with an expected range of 10 to 20 investment managers.

5. Secondary Investments and Co-investments:

Secondary investments are made when an investor purchases the limited partnership interest of another investor in an existing fund. A co-investment is a direct investment in an underlying portfolio security (property) where a real estate manager offers investors the opportunity to invest directly in an underlying security (property) alongside the fund investment. Investments may be made in companies that are either U.S. or non-U.S. domiciled. Neither secondary investments nor co-investments are considered separate investment strategies within real estate. For example, a secondary or co-investment could be in any of the strategies including core and non-core real estate. Therefore, secondary and co-investments will be categorized according to the underlying strategy and geography and will conform to the guidelines outlined in the above section on risk and diversification. SCERS will seek secondary investments and co-investments on an opportunistic basis. It is expected that these investments will constitute a small portion of the overall Real Estate program, if any.

6. Investment Vehicle Concentration:

SCERS will not comprise more than 20% of any one investment vehicle at the initiation of the investment that is a limited partnership, limited liability company, or offshore corporation. An exception to this guideline is an investment in a customized FoF or a separate account, where SCERS is the sole investor. In these circumstances, SCERS will endeavor to ensure that it does not generate a majority of the firm's overall profits.

7. Liquidity:

Overall, the Real Estate program will maintain varying levels of liquidity based on the underlying sub-asset classes:

- a. Core real estate investments in pooled vehicles such as fund-of-funds and open-end commingled funds are generally more liquid than closed-end non-core investments, but less liquid in nature than publicly traded real estate (i.e., REITs). Liquidity is generally based on fund specific redemption schedules, which are typically monthly and quarterly, subject to lock-up periods and investor-level gates. Separate accounts properties generally have less liquidity, and can require a price discount to be sold.
- b. Non-core real estate investments have limited liquidity. They are often invested in closed-end investment vehicles that have long expected holding periods such as 5-13 years. Investments are typically held until maturity and selling prior to maturity may result in realizing a sales price that reflects a discount to fair market value. Liquidity risk is managed by minimizing the possibility of forced sales that may arise from exceeding maximum exposure limits or lowering asset allocation targets to private real estate investments.

In order to better assess liquidity needs, a capital budget and cash flow forecast will be developed over a long-term horizon and updated as necessary (see Section D 'Implementation Protocol').

8. Distributed Securities:

SCERS will avoid the direct receipt of distributed securities from individual real estate funds. However, if such receipt is unavoidable, SCERS will direct the sale of securities distributed by its investment vehicles as soon as practically possible, while striving to not impair the value of the security.

9. Performance Evaluation:

- a. Performance of the Real Estate program will be evaluated quarterly against the asset class benchmarks in this IPS.

- b. Individual investment vehicle performance will be evaluated on a quarterly basis compared to the performance of respective peer universes and vintage years (whenever possible), as provided in the investment objective section.
- c. It is recognized that immature private real estate investments may have a “J-Curve effect”, whereby there are low to negative returns in the initial years due to the payment of investment management fees during a period when investments are typically carried at cost and returns have not been realized.

10. Physical Rebalancing:

It is anticipated that the majority of changes to rebalance the Real Estate portfolio will be made on a long-term basis due to: (1) The illiquidity of the private non-core real estate assets with typical investment horizons of 513 years; and, (2) The significant discount that can be applied if and when real estate or private real estate holdings are liquidated in the secondary market. Accordingly, when target allocation levels are exceeded, it is anticipated that reducing exposures will be carried out within a long-term time frame that is practical based on the illiquidity of the real estate vehicles.

C. Monitoring

Through the monitoring process, Staff and consultant will extend the initial due diligence into a formal quarterly, semi-annual, and annual process which regularly seeks to determine whether the manager is meeting the Real Estate program’s investment objectives and other requirements. In the broadest sense, the monitoring process is intended to determine whether the initial reasons for selecting the strategy and investment vehicle remain valid. The monitoring process will disclose whether there has been any material deviation from the investment philosophy and process; the personnel responsible for managing the investment vehicle are still in place; the organization continues to be stable; performance and risk meet expectations; and the investment vehicle manager adheres to its investment and other requirements. The underlying principle of the monitoring program is to determine whether all risks to which SCERS is exposed through the use of outside investment advisors have been identified, understood, and, to the extent possible, controlled. The monitoring process focuses on four areas:

- Compliance with reporting and valuation requirements;
- Continuity of investment philosophy and process;
- Stability of personnel and organization; and
- Performance and risk management

Staff and consultant will aggregate investment vehicle data and perform analysis on the overall Real Estate program, paying careful attention to individual investment vehicle allocations and strategy/sector concentrations to strive to achieve proper diversification across the Real Estate program. Staff and consultant also will conduct due diligence with the respective investment vehicle managers to understand the underlying drivers of performance. Additionally, Staff and consultant will conduct portfolio reviews and on-site due diligence as necessary. Site visits will also be performed to confirm that appropriate infrastructure is in place to support the investment process. Staff and consultant will provide the Board with regular performance reports and advise the Board of other matters as appropriate.

If, during the monitoring process, SCERS identifies areas of the Real Estate program that are not compliant with the objectives, guidelines and constraints, identified in this investment policy statement, then reasonable efforts will be made to cure the deficiency. These reasonable efforts will consider the illiquidity of the asset class and transaction costs to be incurred compared to the risk of non-compliance.

D. Implementation Protocol

The following implementation protocol describes the allocation of investment authority and responsibilities between SCERS' Board, Staff and consultants. Overall, the real estate implementation protocol delegates the most time intensive elements of the process to Staff and consultant, while preserving the Board's oversight of the overall Real Estate program.

On an annual basis, the Board will approve the long-term Real Estate Asset Allocation Structure and Twelve Month Investment Plan as developed and presented by Staff and Consultant. The long-term Real Estate Asset Allocation Structure will articulate the long-term direction and objectives of the real estate program. The Twelve Month Investment Plan will articulate the direction over the next year in taking the necessary steps to achieve the above objectives of the long-term Real Estate Asset Allocation Structure. Once approved by SCERS' Board, these plans serve as the framework for investment implementation decisions made by Staff and consultant regarding real estate investments.

The execution of the long-term Asset Allocation Structure and Twelve Month Investment Plan, including 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.

The key features of the Real Estate implementation protocol are as follows:

- Staff and consultant will identify the most qualified candidates for a prospective real estate investment commitment based on: (a) The real estate asset allocation structure approved by the Board; and (b) The twelve month real estate investment plan approved by the Board (which takes into account SCERS' existing real estate investments and prioritizes and targets optimal new investment opportunities expected to come to market in the next twelve months).
- Staff will prepare a report for the Board outlining why a given real estate manager has been identified for closer scrutiny for a possible commitment. SCERS' consultant will also provide an investment due diligence report.
- Staff and consultant will pursue more extensive due diligence on the manager candidate, including conducting extended interviews with the portfolio managers and other key members of the investment team. Legal counsel will begin reviewing the documentation for the possible commitment and preliminary negotiation of deal terms will take place.
- If/When: (a) The due diligence process is completed; (b) Deal terms have been determined; (c) Staff and consultant have concluded that a commitment should be made; then (d) Staff will prepare a report for the Board outlining the basis for the decision, the proposed commitment amount, and the target date for closing on the commitment.
- At any point in the process, questions or concerns by a Board member regarding a proposed investment or proposed manager can be communicated to the Chief Executive Officer ('CEO'). The CEO will be responsible for assuring that a prompt response is provided. The CEO will also provide the full Board with the response. If the Board member is not satisfied with the response, the Board member can request that the matter be brought to the full Board for consideration. In such a case, the CEO will refer the matter to the Board President who will determine whether the manager search process should be suspended until the matter is resolved. As a general rule, it is anticipated that the process of identifying and vetting a proposed investment will take place over a period of time sufficient to allow, if necessary, for full Board consideration of questions or concerns before a commitment is finalized.
- Absent questions or concerns by the Board, the proposed investment will be finalized and the necessary documentation executed.
- Staff and consultant will then provide the Board with an updated status report on the investment.

Staff and consultant also possess authority to make adjustments to the Real Estate portfolio in order to assure that the portfolio is optimally aligned to achieve the objectives of the Real Estate asset class and overall Real Return asset

category. This includes, but is not limited to the authority to: (1) Trim or add to existing investment mandates; (2) Terminate and/or replace an existing manager; (3) Submit redemption requests; (4) Determine the appropriate sources for funding a new mandate or adding to an existing mandate; and (5) Determine the appropriate application of any returned capital.

As with new investments, such decisions will be made within the framework of the Real Estate asset class plan approved by the Board. If and when Staff and consultant determine that such actions are necessary, a timely report will be prepared for the Board outlining why the action is deemed necessary and how it impacts the Real Estate portfolio.

HISTORY OF SCERS RETIREMENT BOARD ACTION:

Amended July 19, 2017

Adopted July 11, 2013

REAL ESTATE INVESTMENT POLICY STATEMENT

~~Real estate investments are a sub-asset class integrated into three of SCERS' asset classes, including real assets, equities and opportunities. However, due to the nature of the real estate cycle, the underlying specific characteristics of real estate, and its significant allocation to SCERS' total fund, a separate investment policy statement ('IPS') for the sub-asset class is necessary to supplement the plans for the major asset classes of which real estate is a component. Accordingly, many of the components of the real estate IPS will draw from the major asset classes and the real estate IPS will refer to SCERS' legacy IPS, real assets IPS and opportunities IPS, in particular.~~

A. Investment Objectives

~~Real estate investments are housed within a dedicated Real Estate asset class within SCERS' Real Return asset category. Real Estate is comprised of core and non-core real estate, and may include both U.S and non-U.S investments. The investment objective of the Real Estate program is to provide: (1) A hedge against inflation risk; (2) A higher level of income and cash flow generation; (3) Greater consistency in the return distribution and muted downside risk; and (4) A diversifier for SCERS' total fund, particularly compared to equities.~~

~~Given the above investment objective, the performance of the Real Estate program will be compared against the following benchmarks:~~

- ~~1. Core and core plus real estate are a sub-asset class of SCERS' real assets portfolio. Accordingly, the investment objectives are consistent with those set forth in SCERS' real assets IPS. Please refer to the real assets IPS for further detail.~~
- ~~2. Value-add and opportunistic real estate are a sub-asset class of SCERS' opportunities portfolio. Accordingly, the investment objectives are consistent with those set forth in SCERS' opportunities IPS. Please refer to the opportunities IPS for further detail.~~
- ~~3. Real estate investment trusts ('REITs') are a sub-asset class of SCERS' equities portfolio. Accordingly, the investment objectives are consistent with those set forth in SCERS' legacy IPS. Please refer to the legacy IPS for further detail.~~

~~Given real estate's investment objectives, the performance of the real estate program will be compared against the major asset class benchmarks where real estate resides including equities, real assets and opportunities. In addition, the~~

~~performance of real estate will be compared against the sub-asset class benchmarks as specified below:~~

1. Performance of core and core plus real estate investments are expected to exceed the NCREIF Fund Index – Open-End Diversified Core Equity ('NFI-ODCE'), net of fees.

~~2. Performance of non-core value-add and opportunistic real estate investments are expected to exceed the NFI-ODCE by 100 basis points, net of fees.~~

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~~3. Performance of the Total Real Estate program is expected to exceed a blended benchmark which consists of the following components: 65% core (NFI-ODCE) and 35% non-Core (NFI-ODCE + 100 basis points). This blended benchmark will serve as the Policy Index for SCERS' Real Estate asset class.~~

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~~4. A customized secondary benchmark will be used to measure performance of SCERS' global exposures. The secondary benchmark will include a customized blend of U.S. and non-U.S. exposure, with the non-U.S. component using the Global Real Estate Fund Index ('GREFI') with SCERS' weighting to each geographic location. The secondary benchmark will be a 'floating' benchmark based on SCERS' average capital invested in each region, each quarter.~~

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~~3. Performance of domestic REITs are expected to exceed the FTSE EPRA/NAREIT Index and performance of international REITs is expected to exceed the FTSE NAREIT Global ex-US REIT Index.~~

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B. Investment Guidelines

1. Investment Strategies:

Investments in real estate can be made across a broad array of investment strategies:

a. Core and Core Plus Real Estate.

Core and core plus real estate will typically possess a lower risk and return profile than non-core value-add or opportunistic investments due to attributes that can include a higher level of cash yield and income generation; a lower level of capital appreciation potential; location in a primary metropolitan area; greater occupancy levels; and a lower level of leverage.

~~They~~ Core and core plus real estate include investments in operating and substantially leased properties of institutional quality, consisting primarily of investments in traditional property types (office, industrial, retail and for-rent multifamily). Core investments have moderate levels of associated leverage (generally below 40%).

Core plus real estate investments offer the opportunity to enhance returns by: (1) Alleviating an identifiable deficiency (in an asset's capital structure, in an asset's physical structure, in an asset's operation, etc.); and/or (2) Benefitting from market inefficiency. These investments may use slightly more leverage than core real estate investments to improve returns and may include some non-traditional property types.

~~Accordingly, core and core plus real estate is allocated to the real assets asset class due to its ability to help fulfill the role and objectives of real assets which include: (1) A hedge against inflation risk; (2) A higher level of income and cash flow generation; (3) Greater consistency in the return distribution and muted downside risk; and (4) A diversifier for SCERS' total fund, particularly vis-à-vis equities.~~

b. Non Core (Value-Add and Opportunistic) Real Estate.-(Non-Core)-

In addition to some of the characteristics of core real estate outlined above, Non-core investments offer the opportunity to enhance returns through factors that can include: (1) Investing in assets with greater deficiencies (such as substantial vacancy, the need for substantial renovation, etc.); (2) Accepting different types of risks (such as development risk, redevelopment risk, repositioning, etc.); (3) Focusing more on non-traditional property types that may have greater operating risks (such as hotels); (4) Accepting greater capital market risk (for example, by acquiring assets with complex capital structures that may be difficult to unwind); and (5) Seeking areas of greater market inefficiency.

Value-add and opportunistic real estate will typically possess a higher risk and return profile compared to core real estate due to considerations that can include a lower level of cash yield and income generation; a higher level of capital appreciation potential; location in a secondary market; lower occupancy levels; and an increased level of leverage. In many cases non-core real estate investments attempt to capitalize on an enhanced level of distress in specific properties or wider market dislocation. These characteristics can magnify the risk and return of value-add and opportunistic investments throughout the business and real estate cycles.

~~Accordingly, value-add and opportunistic real estate is allocated to the opportunities portfolio to reflect its characteristics including: (1) The capability for these investments to perform well during certain points of the real estate cycle, but not all periods; and (2) The capability to help fulfill the role of the opportunities asset class to enhance risk adjusted returns by investing in tactical opportunities. To illustrate these points, following a real estate crisis, commercial property prices on value-add and opportunistic investments often 'over-correct' and fall much further than core real estate due to a flight to safety by market participants. The much reduced prices then provide some margin of safety in acquiring value-add and opportunistic properties which can increase significantly in value as economic conditions improve and market participants seek to increase risk in an expansionary environment. However, the reverse affect (magnification of losses) is true for value-add and opportunistic investments following a peak in the real estate cycle.~~

c. *Public Real Estate Investment Trusts ('REITs').*

Public REIT investments are non-control positions in real estate investment trusts containing real estate operating companies. REIT vehicles offer investors daily liquidity and all investment property types are available. Long term historical averages suggest that REITs have a limited correlation to private real estate. Rather, because public REITs are traded on stock exchanges and raise capital via the equity markets (IPOs and secondaries), they are highly correlated to small- and mid-cap equities. ~~REITs will comprise a small portion of SCERS' Real Estate program, if any. Due to this high correlation and beta to equity markets, public REITs are a part of the equities asset class.~~

d. *Debt Investments with Underlying Real Estate Exposure.*

Debt investments may be classified by SCERS' investment staff ('Staff') and consultant as falling into one of the traditional core/core plus or non-core investment strategies based on the composition of the underlying collateral.

2. Investment Vehicles:

The vehicles for real estate investments reflect the broad scope of investments.

Investments include private market participation in commercial, industrial and residential real estate properties. These investments may comprise open-end commingled funds and closed-end commingled funds, including commingled vehicles such as limited partnerships, limited liability companies or offshore corporations. The majority of SCERS' core real estate exposure will be

~~attained through core open-end commingled funds ('COECFs'), while the majority of SCERS' non-core real estate exposure will be attained through closed-end commingled funds generally through limited partnerships.~~

~~SCERS may also invest~~Investments in core real estate can also be made through core separate account ('CSA') relationships established with ~~one or more~~ fiduciary oversight managers. These managers ~~will~~ make commitments to physical assets such as properties, limited partnerships, or other entities such as limited liability companies or offshore corporations. While SCERS has maintained significant separate account exposure in the past, separate accounts will likely not represent a meaningful portion of the Real Estate program from 2017 forward, unless existing separate account assets have not yet been sold or transferred.

SCERS may also invest directly in fund-of-funds (FoF) vehicles. In these vehicles, the FoF invests in partnerships on a discretionary basis. FoFs will own the underlying partnerships and SCERS obtains contractual rights to the FoFs' portfolio through a limited partnership. A FoF will often have investors other than SCERS.

Co-investments and secondary purchases are also permitted and covered in more detail in the section, 'Secondary investments and Co-investments'.

Investments can also include publicly traded REITs in open-end commingled funds, closed-end commingled funds and separate direct ownership accounts.

Investments may be made in either U.S. or non-U.S. domiciled entities or assets.

~~3. Guidelines for Real Estate Separate Accounts:~~

~~Among SCERS' goals for the real estate separate account program are to increase competition for the best risk-adjusted returns; maintain greater oversight and control over the investment discretion of the managers of the core separate accounts ('CSAs'); and to achieve better alignment of interests with SCERS' CSAs. To address these considerations, the following broad guideline objectives have been developed for the core separate account program:~~

~~a. Greater oversight and control by Staff and consultant over the investment discretion of CSA managers in areas such as: (1) Property acquisition and disposition decisions; (2) Use and level of debt on individual properties and the portfolio; and (3) Strategic plans for the individual real estate assets (e.g. leasing strategy/plan). This will be further described in the implementation protocol section.~~

~~b. Competition for allocations of capital:~~

~~i. CSAs will not have fixed allocations, but rather will receive greater amounts of capital based on the merits of potential acquisitions of properties which will provide the most value to SCERS.~~

~~ii. CSAs with expertise spanning beyond traditional core real estate will have the opportunity to utilize those capabilities in both core and non-core areas. For example, SCERS will consider a CSA managers' proposal to 'manufacture' core by purchasing a non-core property and developing it into a core property.~~

~~It should be noted that in the event one of SCERS' CSA managers assists in advising SCERS in 'manufacturing' a core asset, a determination would be made if the asset is currently core or non-core. Non-core properties will be allocated to and will follow the opportunities portfolio guidelines, meaning the asset will compete for space and be allocated to SCERS' opportunities portfolio based on the anticipated higher risk and return characteristics. Once it is developed into a core property, a decision would be made whether to allocate it to SCERS' core portfolio or dispose of the property for a gain or loss.~~

~~iii. SCERS will maintain at least two CSAs to foster competition and benefit from the diversification in differences between CSA deal sourcing networks and pipelines.~~

~~c. Greater alignment of interest. The fee and incentive structure will be set in such a way to best align the CSA managers' interest with SCERS goals, including considerations surrounding acquiring properties, disposing of properties, and management of properties for optimal income.~~

~~d. As necessary and appropriate, the guidelines for real estate separate accounts will also be included in the investment management agreement with the separate account advisors.~~

4.3. ~~Private~~ Global Real Estate:

Investments in global real estate (ex-U.S.) are permissible in order to improve diversification and enhance returns on an opportunistic basis. However, the

~~Real Estate~~ program will maintain a disproportionate weighting toward the United States due to the following factors: (1) The absence of currency risk and associated costs; (2) The absence of withholding taxes; (3) High transparency; (4) A well-developed system of property rights and a well-developed legal system; and (5) A deep and liquid market. Accordingly, the SCERS ~~private Real Estate~~ program (core, core plus and non-core real estate) may target exposure to investments outside the United States, with a permissible range of 0% to 30%.

~~The rationale for investing in global real estate on an opportunistic basis rather than an ongoing basis is further explained below.~~

~~While real estate income or yield is highly correlated across developed markets and many developing markets, the degree of price appreciation (or depreciation) varies considerably over a cycle. This presents investors with an opportunity to capitalize on depressed market values and relative value differences when they arise abroad and relative to the domestic real estate market. For example, distressed sales in the U.S. may be abating while they are just beginning to rise in Europe and may provide better opportunities relative to the U.S. in the non-core distressed area.~~

~~Despite possessing high correlation in the income streams and low correlations in the price appreciation component of returns, overall returns of global real estate tends to exhibit less correlation between countries and thus a global real estate portfolio can add to diversification of SCERS' real estate portfolio.~~

Global real estate investing shares many of the same risks as investing in domestic real estate:

- Occupancy of buildings and vacancy rates
- Location of building(s) and surrounding areas
- Building and property type and use
- Illiquidity
- Macroeconomic (changes in interest rates, inflation, GDP growth, unemployment)
- Supply and demand of competitive stock or space
- Leverage

In addition, investing in global real estate carries additional unique risks:

- Macroeconomic risk will differ by country and geopolitical landscape (changes in interest rates, inflation, GDP growth, unemployment)

- Currencies may provide a diversification to SCERS' total fund but also can pose a risk when countries devalue their currencies vis-à-vis the USD.
- Transparency can become problematic in less developed countries.
- The high dispersion of returns presents opportunities for active managers to add value but can also present greater volatility. ~~as outlined on page 6 of the attached presentation.~~

Careful selection of managers and countries through a thorough investment process ~~is will be~~ critical in ~~order to benefit~~ benefiting from global real estate opportunities while also mitigating these risks.

While a range of 0%-30% for the global real estate component ~~will~~ allows SCERS to take advantage of lower values and specific market opportunities abroad when they arise outside of the U.S., it is important to note that it is not a required allocation, but rather, allows the flexibility to invest in non-U.S. markets when the risk and return characteristics are superior. In addition, providing an allowable range therefore produces competition for space between U.S. and non-U.S. investments. ~~It is anticipated that global real estate opportunities will arise that are both core and non-core (value-add and opportunistic).~~

~~It is anticipated that global real estate opportunities will arise that are both core and non-core (value-add and opportunistic) and the investment process will differ accordingly. Non-core global investment opportunities will compete for space in SCERS' opportunities portfolio and thus they will compete across all of SCERS' asset classes for an allocation.~~

5.4. Risk and Diversification:

- a. *Real eEstate program structure - Diversification by sub-asset class and investment strategy including target allocation and ranges.*

~~The rReal eEstate program will be diversified across investment strategies and geographies. across SCERS' portfolio. The Real Estate program has a target allocation of 7%, with a permissible range of 5% to 9%. The Real Estate program targets an allocation of 65% to core and 35% to non-core investments, with the permissible ranges as displayed below. The non-U.S. target is 0%, with a range between 0% and 30%.~~

The table below highlights the target allocation and permissible ranges for ~~core, non-core real estate, as well as for geographic exposure, real-estate strategies in equities, real assets and opportunities.~~

SCERS' Real Estate Portfolio Construction:

	Minimum	Target	Maximum
Total Real Estate Program	5.0%	7.0%	9.0%
	Minimum	Target	Maximum
Core Real Estate	50%	65%	80%
Non-Core Real Estate	20%	35%	50%
Non-U.S. Real Estate	0%	0%	30%

Within the core real estate portfolio, exposure will primarily be comprised of Core Open-End Commingled Funds ('COECFs'), which provide SCERS with diversified exposure to stabilized properties and an element of liquidity. The majority of non-core real estate exposure will be attained through closed-end fund vehicles.

	SCERS Classification	Target Allocation	Permissible Range
Private Core Real Estate	Real-Assets	7%	4% to 9%
Private Non-Core Real Estate	Opportunities	N/A	0% to 5%
Public REITs	Equities	2.25%	N/A

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~~**b. Core real estate structure – Diversification by core separate accounts and core commingled open-end funds.**~~

~~The core real estate structure targets an allocation of 70% to CSAs with a range of plus or minus 30% and the balance of the allocation mix comprised of core commingled open-end funds ('COECFs').~~

<i>Core Real Estate Program - Allocation by Vehicle</i>		
	Target	Range
Core Portfolio		
Commingled Funds	30%	+/- 30%
Separate Accounts	70%	+/- 30%

~~The main advantage of a core separate account program is the ability to exercise greater discretion and control. Since real estate follows long-term cycles of boom and bust, it is important to maintain investment discipline and not get caught up in chasing returns. This can be accomplished by: (1) Limiting strategy drift from investing in 'non-core' strategies; (2) Maintaining valuation discipline by not purchasing properties that become overvalued, particularly at the end of cycles; (3)~~

~~Comparing and investing in the best assets by assessing relative value across assets with similar risk/return characteristics such as infrastructure or energy; and (4) Limiting the use of leverage to the appropriate properties and for the portfolio in total, and leveraging properties into the cycle and deleveraging out of the cycle.~~

~~The other main advantage of separate accounts is in customization and the ability to tailor the program to the needs of SCERS. For example, while a COEF might have the incentive to sell properties due to redemption issues, in a core separate account SCERS can benefit from holding an anchor core property indefinitely. Finally, it is typical for separate accounts to have lower fees compared to COEFs.~~

~~The higher levels of engagement in the decision-making process of SCERS' core separate accounts has resulted in a corresponding higher level of outperformance compared to the benchmark (i.e., +2.5% per year versus the since inception excess return of +1.1%).~~

~~The main risks of a core separate account program center around the potential for greater volatility and less diversification compared to the indices. SCERS' CSA program will not be as diversified across property types, geographic regions or building sizes compared to many COEFs with larger assets under management. In addition, while separate accounts can liquidate and sell properties at any time, it will generally be less liquid compared to COEFs. Finally, oversight and management of SCERS' core separate accounts require significant resources and expertise.~~

~~The excess returns historically derived from SCERS' CSAs have been achieved with a slightly elevated level of volatility compared to the benchmark. However, the excess returns are higher than the increase in volatility; and rolling five year returns show that the volatility of SCERS' CSAs is very consistent with upside volatility more prevalent and no prolonged periods of underperformance.~~

~~Since many of the main benefits of COEFs are the disadvantages of separate accounts and vice versa, COEFs will be paired with CSAs to mitigate the risks of the overall core real estate portfolio and provide greater diversification.~~

~~The 30% target allocation to COEFs will help balance and diversify the risks of SCERS' CSA program while preserving the ability to enhance returns. Also, the target allocation of 70%/30% to CSAs/COEFs will provide sufficient flexibility to pursue the best risk adjusted opportunities.~~

~~For example, after a real estate crash it is often possible to enter COEFs at discounts to true NAVs as the real estate values and prices are marked up, whereas it can be difficult to purchase properties for CSAs because the transaction volume is diminished. Conversely, at the latter parts of the real estate cycle, COEFs may have entry queues and more capital to deploy compared to the opportunities prevalent in the marketplace, whereas CSAs can be more nimble and selective in pursuing the best opportunities. Accordingly, providing flexibility to choose the best investment approach, whether CSA or COEF, will be an important option that changes over the cycle and depending on specific opportunities offered in the real estate marketplace.~~

~~e.b.~~ Core Real Estate program leverage.

Leverage on ~~the individual core real estate properties and collectively for the core Real Estate program portfolio~~ can magnify both returns and losses. However, adding a moderate level of debt to a long-term core real estate strategy has ~~been shown to be~~ that it can be additive to returns over the long-term. Therefore, allowing flexibility to add debt during the expansionary phase of the cycle subject to a maximum limit will help ensure that a debt strategy will be accretive to returns. With this in mind, the loan-to-value ('LTV') limits for the ~~core Real Estate program portfolio~~ are as follows:

- ~~• 30% maximum LTV for individual CSAs~~
- ~~• 60% maximum LTV per property within CSAs~~
- ~~• 40% maximum LTV for total core real estate program (including CSAs and COEFs)~~
- 75% maximum LTV for total non-core real estate program
- ~~•~~

These limits should provide adequate flexibility for the ~~core Real Estate~~ program to operate through the real estate cycle, taking advantage of expansionary periods, but at the same time not increasing leverage beyond a point that will cause significant losses in a downturn in the cycle. However, if conditions warrant, Staff and consultant will approach the Board for approval of any exceptions to these debt guidelines.

~~e.c.~~ Diversification of the real estate portfolio across property type and geography.

SCERS' ~~Real Estate~~ program will maintain diversification by property type and geography.

The core and non-core real estate portfolio (~~'private real estate portfolio'~~) will target weightings by property type and geography to be within +/- 10%

of the NFI-ODCE Index. Exceptions may exist at different points in the market cycle, particularly with respect to targeted investments in the non-core real estate space, and will be monitored by Staff and consultant and reported to the Board in the quarterly performance report for real estate. ~~In particular, it is anticipated that due to the size of SCERS' CSAs, geographic diversification within the above bands may be difficult to achieve over certain periods. In addition, since global~~ An explicit exception is the non-U.S. real estate exposure, which may range from 0%-30%. ~~When investments are made internationally, SCERS' Real Estate portfolio will~~ potentially deviate from its primary real estate benchmark, the NFI-ODCE.

~~The public REIT Portfolio, due to its underlying characteristics and reliance on managers for stock selection, will remain unconstrained.~~

~~e. Position size limit.~~

~~The position size limits are based on providing flexibility in seeking the best risk-adjusted returns, while also balancing the need for diversification across positions such that no single position will drive SCERS' overall real estate and total fund performance. Accordingly, in order to maintain diversification across positions, the real estate portfolio including core real estate, non-core real estate and public REITs will adhere to the single asset position size limit set by the legacy investment policy statement of less than 2.5% of the NAV of SCERS' total fund. Accordingly, a single property within a CSA or investment in a commingled fund whether open-end or close-end shall be less than 2.5% of the NAV of SCERS total fund. However, it is not anticipated that any one property or fund commitment will reach or approach this constraint because of the diversification targets.~~

~~f. Diversification by lease and debt renewal terms.~~

~~SCERS will strive to limit the potential for investments during any given year in the business cycle to negatively impact the long-term results by investing in underlying properties that, in aggregate, spread the risk of lease renewals and debt renewals across a number of years in the business cycle.~~

~~g.d. Diversification by vintage year.~~

SCERS will strive to limit the potential for investments during any given year in the business cycle to negatively impact the long-term results, by investing across business cycles and vintage years. It is anticipated that SCERS will commit to private real estate assets, particularly non-core investments, over multiple years, whereby the aggregate amount will be

spread across the entire business cycle. This will serve to limit the exposure or risk to investing and relying on the performance of private real ~~estate assets~~ funds in any given year of the business cycle. The Board will determine with Staff and Consultant the funding allocation for ~~private~~-real estate each year in conjunction with its annual review of the Real Estate Asset Allocation Structure and Twelve Month Real Estate Investment Plan (see Section D 'Implementation Protocol').

~~4.e.~~ Diversification by investment manager and general partner.

SCERS will invest across a number of investment entities to mitigate the potential negative impact of a concentrated portfolio of investment managers. The optimum number of investment vehicles in the portfolio and the maximum exposure to any one investment vehicle will vary with time and will be evaluated as part of the ~~r~~Real ~~e~~Estate program structure (see Section D 'Implementation Protocol'). One single investment position shall be limited to 2.5% of the net asset value ("NAV") of SCERS' total fund. SCERS will strive to maintain ongoing long-term relationships with an expected range of 10 to 20 investment managers.

6.5. Secondary Investments and Co-investments:

Secondary investments are made when an investor purchases the limited partnership interest of another investor in an existing fund. A co-investment is a direct investment in an underlying portfolio security (property) where a ~~real estate private-real assets~~ manager offers investors the opportunity to invest directly in an underlying security (property) alongside the fund investment. Investments may be made in companies that are either U.S. or non-U.S. domiciled. Neither secondary investments nor co-investments are considered separate investment strategies within real estate. For example, a secondary or co-investment could be in any of the strategies including core and non-core real estate. Therefore, secondary and co-investments will be categorized according to the underlying strategy and geography and will conform to the guidelines outlined in the above section on risk and diversification. SCERS will seek secondary investments and co-investments on an opportunistic basis. It is expected that these investments will constitute a small portion of the overall ~~r~~Real ~~e~~Estate program, if any.

7.6. Investment Vehicle Concentration:

SCERS will not comprise more than 20% of any one investment vehicle at the initiation of the investment that is a limited partnership, limited liability company, or offshore corporation. An exception to this guideline is an investment in a customized FoF or a separate account, where SCERS is the sole investor. In these circumstances, SCERS will endeavor to ensure that it does not generate a majority of the firm's overall profits.

8-7. Liquidity:

Overall, the ~~r~~Real ~~e~~Estate ~~program~~portfolio will maintain ~~low levels~~varying levels of liquidity based on the underlying sub-asset classes: ~~of liquidity overall due to the predominance of core real estate and private real assets, however, liquidity varies among the underlying sub-asset classes:~~

~~a. REITs are anticipated to be very liquid; while~~

~~a. Private~~Core real estate investments in ~~separate accounts and investments in~~ pooled vehicles such as fund-of-funds and ~~open-end~~ commingled funds are ~~generally more liquid than closed-end non-core investments, but~~ generally less liquid in nature ~~than publicly traded real estate (i.e., REITs). Liquidity is generally based on fund specific redemption schedules, which are typically monthly and quarterly, subject to lock-up periods and investor-level gates. Separate accounts properties generally have less liquidity, and can require a price discount to be sold. (might require a price discount to be sold and can vary in regards to liquidity by vehicle and market environment).~~

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~~b. Non-core real estate investments have limited liquidity. They are often invested in closed-end investment vehicles that have long expected holding periods such as 5-13 years. Investments are typically held until maturity and selling prior to maturity may result in realizing a sales price that reflects a discount to fair market value. Liquidity risk is managed by minimizing the possibility of forced sales that may arise from exceeding maximum exposure limits or lowering asset allocation targets to private real estate investments.~~

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~~b-c.~~

In order to better assess liquidity needs, a capital budget and cash flow forecast will be developed over a long-term horizon and updated as necessary (see Section D 'Implementation Protocol').

9-8. Distributed Securities:

SCERS will avoid the direct receipt of distributed securities from individual ~~private~~ real estate funds. However, if such receipt is unavoidable, SCERS will direct the sale of securities distributed by its investment vehicles as soon as practically possible, while striving to not impair the value of the security.

10-9. Performance Evaluation:

a. Performance of the ~~r~~Real ~~e~~Estate program will be evaluated quarterly against the ~~sub~~-asset class benchmarks in this IPS, ~~and the asset class benchmarks established for equities, real assets and opportunities.~~

- b. Individual investment vehicle performance will be evaluated on a quarterly basis compared to the performance of respective peer universes and vintage years (whenever possible), as provided in the investment objective section.
- c. It is recognized that immature private real estate investments may have a “J-Curve effect”, whereby there are low to negative returns in the initial years due to the payment of investment management fees during a period when investments are typically carried at cost and returns have not been realized.

14-10. Physical Rebalancing:

It is anticipated that the majority of changes to rebalance the ~~private~~ Real eEstate portfolio will be made on a long-term basis due to: (1) The illiquidity of the ~~core real estate and~~ private non-core real estate assets with typical investment horizons of ~~55-1340~~ years; and, (2) The significant discount that can be applied if and when real estate or private real estate holdings are liquidated in the secondary market. Accordingly, when target allocation levels are exceeded, it is anticipated that reducing exposures will be carried out within a long-term time frame that is practical based on the illiquidity of the real ~~estate assets~~ vehicles.

~~It is anticipated that rebalancing the REIT portfolio will be made in accordance with SCERS' legacy IPS (i.e., SCERS' GIO will re-balance the asset allocation to target ranges at least annually or at any time the allocations go outside the minimum and maximum ranges).~~

C. Monitoring

Through the monitoring process, Staff and consultant will extend the initial due diligence into a formal quarterly, semi-annual, and annual process which regularly seeks to determine whether the manager is meeting the Real eEstate program's investment objectives and other requirements. In the broadest sense, the monitoring process is intended to determine whether the initial reasons for selecting the strategy and investment vehicle remain valid. The monitoring process will disclose whether there has been any material deviation from the investment philosophy and process; the personnel responsible for managing the investment vehicle are still in place; the organization continues to be stable; performance and risk meet expectations; and the investment vehicle manager adheres to its investment and other requirements. The underlying principle of the monitoring program is to determine whether all risks to which SCERS is exposed through the use of outside investment advisors have been identified, understood, and, to the extent possible, controlled. The monitoring process focuses on four areas:

- Compliance with reporting and valuation requirements;
- Continuity of investment philosophy and process;
- Stability of personnel and organization; and
- Performance and risk management-

Staff and consultant will aggregate investment vehicle data and perform analysis on the overall ~~rReal eEstate program~~ portfolio, paying careful attention to individual investment vehicle allocations and strategy/sector concentrations to strive to achieve proper diversification across the ~~rReal eEstate~~ program. Staff and consultant also will conduct due diligence with the respective investment vehicle managers to understand the underlying drivers of performance. Additionally, Staff and consultant will conduct portfolio reviews and on-site due diligence as necessary. Site visits will also be performed to confirm that appropriate infrastructure is in place to support the investment process. Staff and consultant will provide the Board with regular performance reports and advise the Board of other matters as appropriate.

If, during the monitoring process, SCERS identifies areas of the ~~rReal eEstate~~ program that are not compliant with the objectives, guidelines and constraints, identified in this investment policy statement, then reasonable efforts will be made to cure the deficiency. These reasonable efforts will consider the illiquidity of the asset class and transaction costs to be incurred compared to the risk of non-compliance.

D. Implementation Protocol

The following implementation protocol describes the allocation of investment authority and responsibilities between SCERS' Board, Staff and consultants. Overall, the real estate implementation protocol delegates the most time intensive elements of the process to Staff and consultant, while preserving the Board's oversight of the overall ~~rReal eEstate~~ program.

On an annual basis, the Board will approve the long-term Real Estate Asset Allocation Structure and Twelve Month Investment Plan as developed and presented by Staff and Consultant. The long-term Real Estate Asset ~~Allocation Structure~~ Allocation Structure will articulate the long-term direction and objectives of the real estate -program. The Twelve Month Investment Plan will articulate the direction over the next year in taking the necessary steps to achieve the above objectives of the long-term Real Estate Asset Allocation Structure. Once approved by SCERS' Board, these plans serve as the framework for investment implementation decisions made by Staff and consultant regarding real estate investments.

~~The execution of the long-term Real Estate Asset Allocation Structure and Twelve Month Investment Plan include two sets of implementation protocols regarding the selection of investment managers.~~

~~The first set of implementation protocols is designed for investments in open-end and closed-end commingled funds and fund-of-funds in the private real estate portion of the real estate portfolio as outlined below.~~

~~The execution of the long-term Asset Allocation Structure and Twelve Month Investment Plan, including 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.~~

~~The key features of the Real Estate implementation protocol are as follows: With respect to potential new real estate investments, the investment implementation protocol will operate as follows:~~

- ~~• Staff and consultant will identify the most qualified candidates for a prospective real estate investment commitment based on: (a) The real estate asset allocation structure approved by the Board; and (b) The twelve month real estate investment plan approved by the Board (which takes into account SCERS' existing real estate investments and prioritizes and targets optimal new investment opportunities expected to come to market in the next twelve months).~~
- ~~• Staff and consultant will identify the most qualified candidates for a prospective real estate commitment based on: (a) The allocation model for the real estate sub-asset class approved by the Board; and (b) The twelve month real estate investment plan approved by the Board (which takes into account other real assets investments).~~
- Staff will prepare a report for the Board outlining why a given real estate manager has been identified for closer scrutiny for a possible commitment. SCERS' consultant will also provide an investment due diligence report.~~investment strategy and operational due diligence reports.~~
- Staff and consultant will pursue more extensive due diligence on the manager candidate, including conducting extended interviews with the portfolio managers and other key members of the investment team. Legal counsel will begin reviewing the documentation for the possible commitment and preliminary negotiation of deal terms will take place.
- If/When: (a) The due diligence process is completed; (b) Deal terms have been determined; (c) Staff and consultant have concluded that a commitment should be made; then (d) Staff will prepare a report for the Board outlining the

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basis for the decision, the proposed commitment amount, and the target date for closing on the commitment.

- At any point in the process, questions or concerns by a Board member regarding a proposed investment or proposed manager can be communicated to the Chief Executive Officer ('CEO'). The CEO will be responsible for assuring that a prompt response is provided. The CEO will also provide the full Board with the response. If the Board member is not satisfied with the response, the Board member can request that the matter be brought to the full Board for consideration. In such a case, the CEO will refer the matter to the Board President who will determine whether the manager search process should be suspended until the matter is resolved. As a general rule, it is anticipated that the process of identifying and vetting a proposed investment will take place over a period of time sufficient to allow, if necessary, for full Board consideration of questions or concerns before a commitment is finalized.
- Absent questions or concerns by the Board, the proposed investment will be finalized and the necessary documentation executed.
- Staff and consultant will then provide the Board with an updated status report on the investment.

Staff and consultant also possess authority to make adjustments to the ~~fReal eEstate~~ portfolio in order to assure that the portfolio is optimally aligned to achieve the objectives of the ~~fReal eEstate sub-asset class~~ and overall ~~Real Return asset category, real-asset class~~. This includes, but is not limited to the authority to: (1) Trim or add to existing investment mandates; (2) Terminate and/or replace an existing manager; (3) Submit redemption requests; (4) Determine the appropriate sources for funding a new mandate or adding to an existing mandate; ~~(5) Determine whether leverage should be removed, reduced or added to a real estate investment;~~ and (5~~6~~) Determine the appropriate application of any returned capital.

As with new investments, such decisions will be made within the framework of the ~~fReal eEstate sub-asset class~~ plan approved by the Board. If and when Staff and consultant determine that such actions are necessary, a timely report will be prepared for ~~you~~the Board outlining why the action is deemed necessary and how it impacts the ~~fReal eEstate~~ portfolio.

~~The second set of implementation protocols is designed for investments in SCERS' direct ownership of real estate properties in the core separate account component of the sub-asset class structure and is outlined below.~~

~~Because a real estate separate account is comprised of a portfolio of real estate properties managed by a portfolio manager, but directly owned by a single investor, it can operate differently than commingled funds. The manager is~~

~~required to manage the assets in accordance with parameters established by the owner/investor rather than the manager, plus the owner/investor can control the level of discretion given to the manager in carrying out its responsibilities.~~

~~For example, at one end of the spectrum, the separate account manager can be given full investment discretion, similar to that of the manager in a commingled fund. At the other end of the spectrum, the separate account manager can be given very limited investment discretion, with the owner/investor retaining substantial control over investment decisions. Multiple options exist in between, whereby the owner/investor can establish the level of discretion it wants to delegate and retain, respectively.~~

~~SCERS' CSA managers will continue to exercise discretion in managing SCERS' accounts and continue to be held to a fiduciary standard of care with respect to exercising such discretion. However, Staff and consultant are authorized to exert control and influence the manager's decisions via a greater level of active engagement in the decision-making process. Because the discretion of the CSA manager is limited, this may be referred to as 'actively managed discretion' or 'discretion in a box'. As the terms suggest, the manager continues to have substantial responsibilities and discretion, and must adhere to fiduciary standards of care in carrying out its duties, but Staff and consultant have the ability to veto certain proposed actions or direct that they be re-worked.~~

~~The areas where Staff and consultant are anticipated to be more actively involved are 'high level' portfolio management decisions, and will include but are not limited to the following: (1) Property acquisitions and dispositions, including comparing valuations on an absolute basis and relative to other asset class opportunities under consideration; (2) Use and level of leverage; and (3) Business plans for the individual real estate assets. The separate account manager is required to develop and bring forward recommended decisions and full analyses in these areas, but Staff and consultant will conduct an independent review and analysis before the manager is authorized to go forward with its plan.~~

HISTORY OF SCERS RETIREMENT BOARD ACTION:

Amended July 19, 2017

Adopted July 11, 2013