Date: June 19, 2024
To: Board of Retirement
From: F. Robert Reveles, Retirement Financial Investment Officer
Subject: First Quarter Real Estate Update and Managers Characteristics

Recommended Action:

Receive and file.

Fiscal and Financial Impacts:

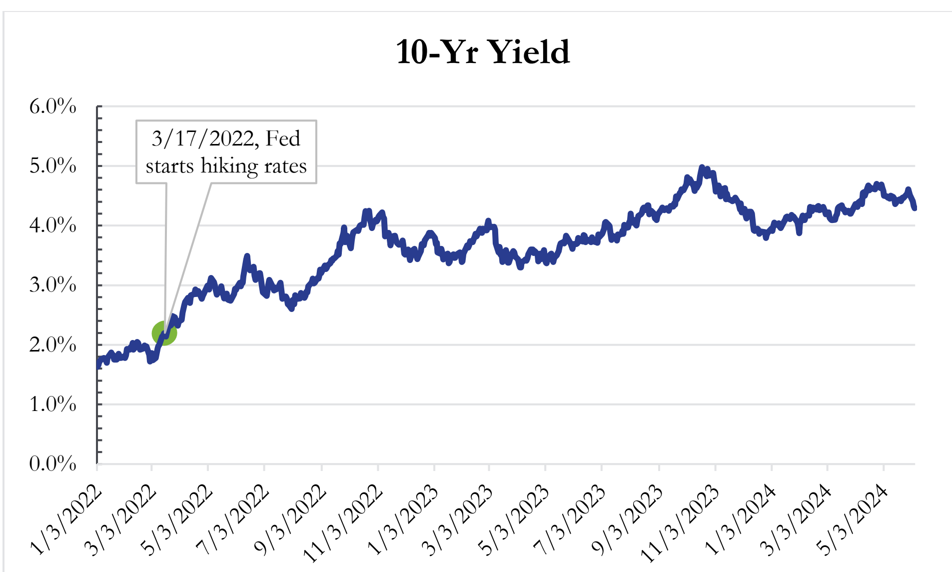
There is no financial impact to receiving this informational item.

Strategic Plan Importance and Risk Assessment:

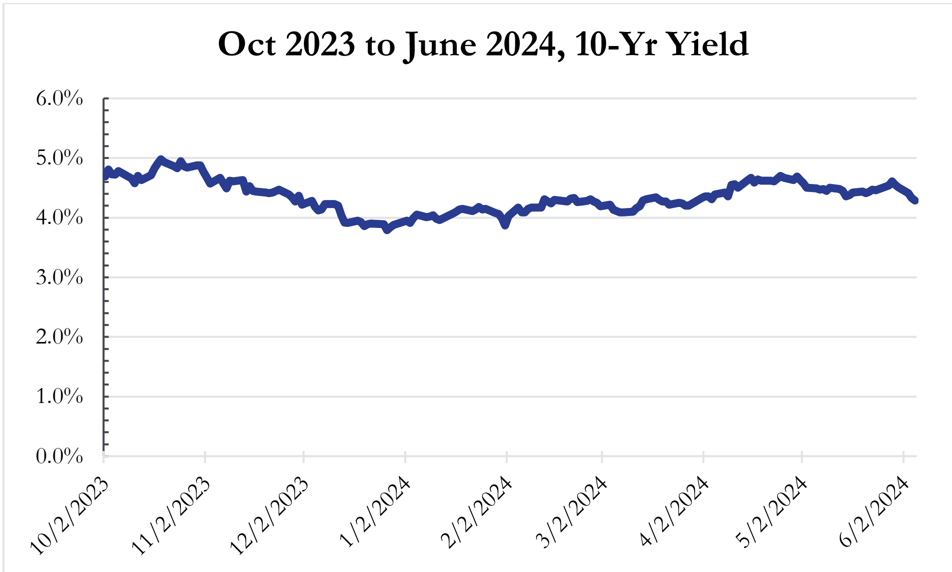
This report pertains to Goal 1 – Protect the Plan's long-term financial health and Goal 2 – Strengthen Risk Oversight.

Background and Discussion:

During the first quarter of 2024 the real estate market appears to be nearing a bottom. After six quarters of low single digit negative returns (aside Q4 2023), the real estate composite returned (only) negative 0.59%. This is the longest streak of losses in real estate since the Global Financial Crisis (GFC), which saw 8 quarters of negative returns. Since September 2022 real estate valuations have felt consistent downward pressure, in part, because of rising Treasury yields.



However, since the October high of 4.98%, yields have steadied. Steady yields are a necessary component for long term business expansion and planning.



With higher yields comes higher costs which in turn lowers transaction activity. Though all sectors have been affected, transaction activity in the apartment and the office sectors have been impacted the most. In the apartment sector, supply continues to outpace demand leading to increasing vacancy rates. (For the last 10 quarters according to Barings Real Estate Research) Rising vacancy rates lead to lower rent growth. Higher yields, more supply, and lower expected rent growth decrease the attractiveness of the apartment subsector and lower transaction volume.

Similar dynamics are affecting the Office subsector. The ability to work from home has businesses reevaluating how much office space they really need. This reevaluation is increasing vacancies to the highest levels in 22 years. (According to CBRE Econometric Advisors)

Both our managers are positioning their portfolios for future trends. They have materially lowered office exposure, with plans to continue to do so, and increased industrial exposure. The industrial sector is expected to benefit from rising e-commerce usage by consumers and efforts to reshore supply chains. Regionally they continue to focus on the West and South, either fully exiting or wanting to exit the North (Rust Belt). The population migration into the Sun Belt over the past few years is forecast to continue and should be a tailwind to the industrial and apartment sectors. Both managers hope to take advantage of new Millennial household formations expected to take place in the future by focusing low density housing like garden-style apartments.

Lastly, below is a table with some additional information on our real estate managers that could be reported to the Board quarterly in a table format, or graphical format depending on the Board's preference. Some context on the numbers:

We expect leverage to be less than 35%. Before the recent rate hikes both managers had leverage within the range of 17% to 22%.

Distribution yields are slightly elevated due to the recent decrease in Net Asset Value. Prior to the recent rate hike cycle, yields ranged between 2.8% to 3.25%.

Tracking risk should be between 2% and 6%.

The NCREIF Fund Index-Open End Diversified Core Equity (NFI-ODCE) benchmark is down 20% over the same period.

For the period Q1 2012 through Q1 2024	**Barings**	**RREEF**
Net Asset Value ($B)	$ 2.6	$ 12.7
Leverage	31.1%	22.5%
Trailing 12 Month Distribution Yield	3.2%	3.5%
Tracking Risk	2.9%	2.3%
Current Drawdown (7 quarters)	27.5%	19.4%
Annualized Standard Deviation	6.3%	5.9%
Correlation with S&P 500	(0.1849)	(0.1919)
Correlation with S&P 500 (before current drawdown)	(0.0971)	0.0012

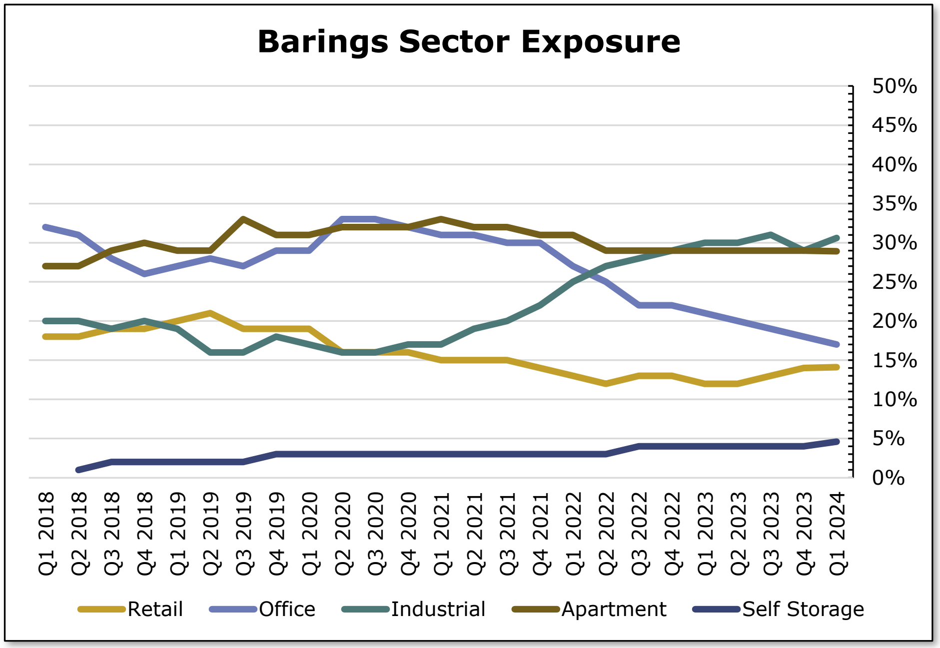
Attachment(s):

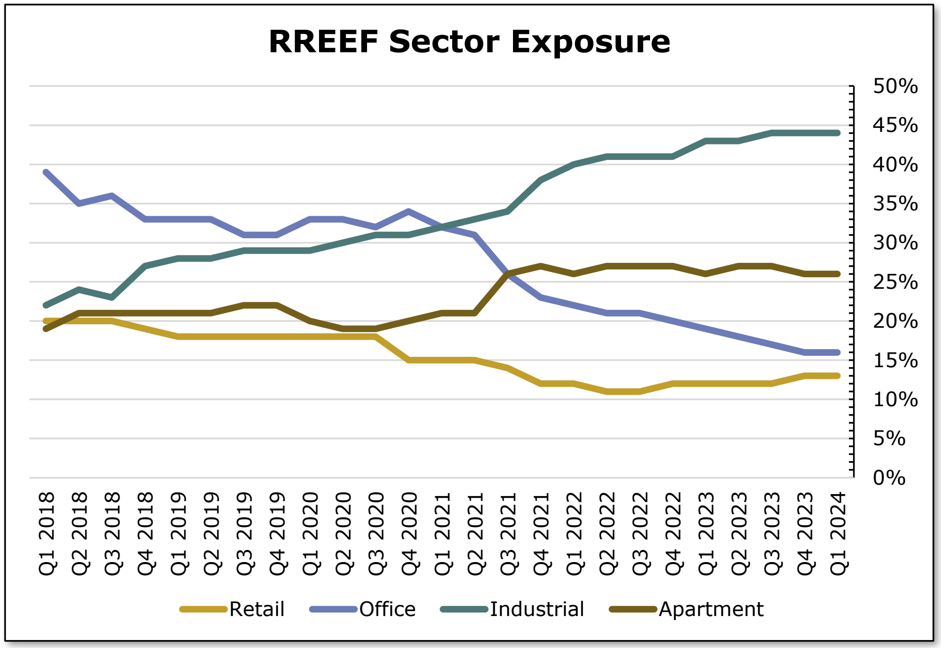
1. Real Estate Portfolio Characteristics – 3/31/24

Mendocino County Employees
Retirement Association

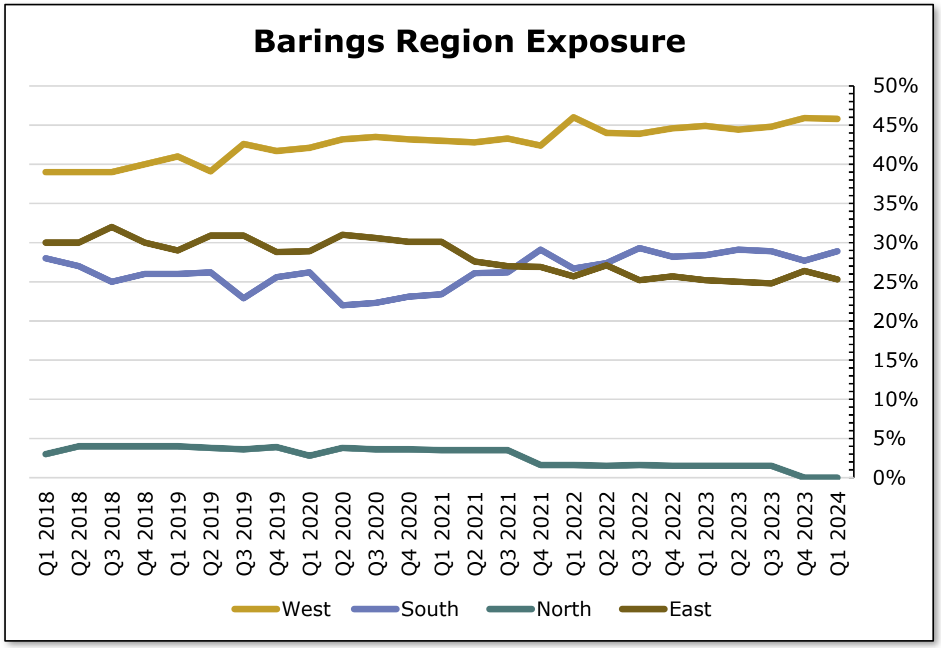
Real Estate Characteristics

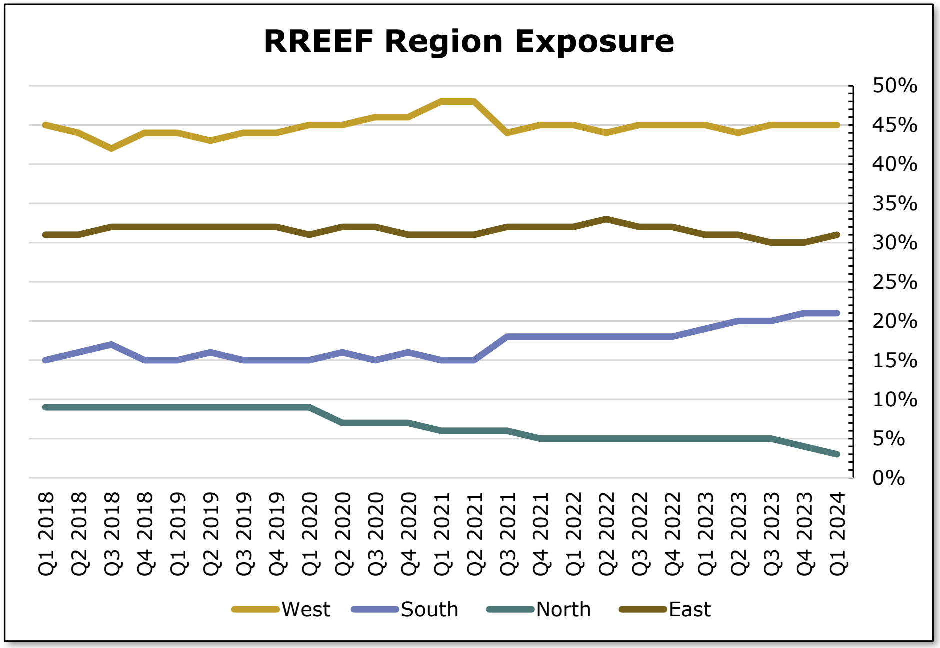
Sectors – 3/31/24



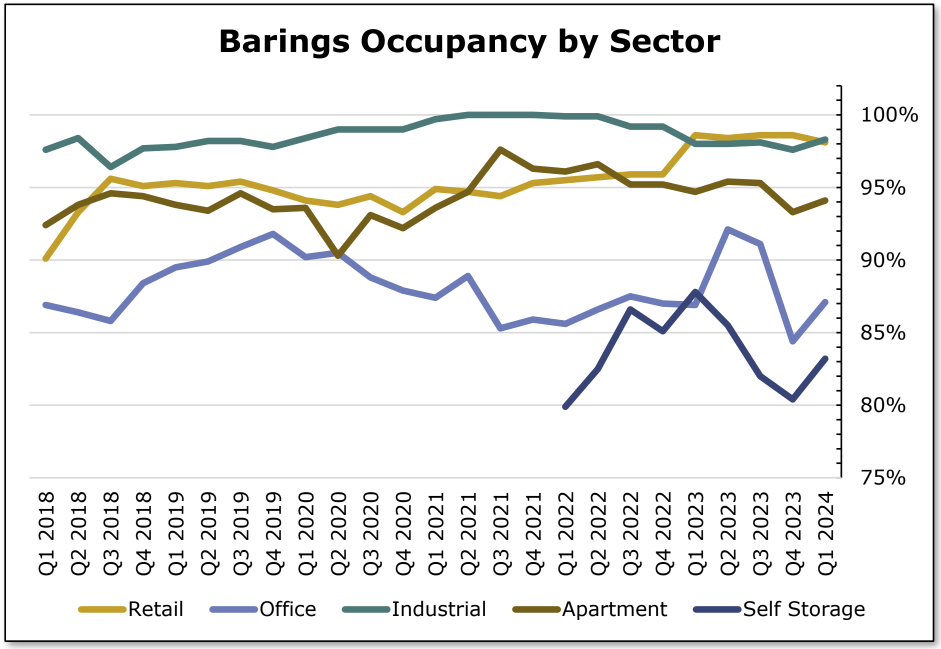


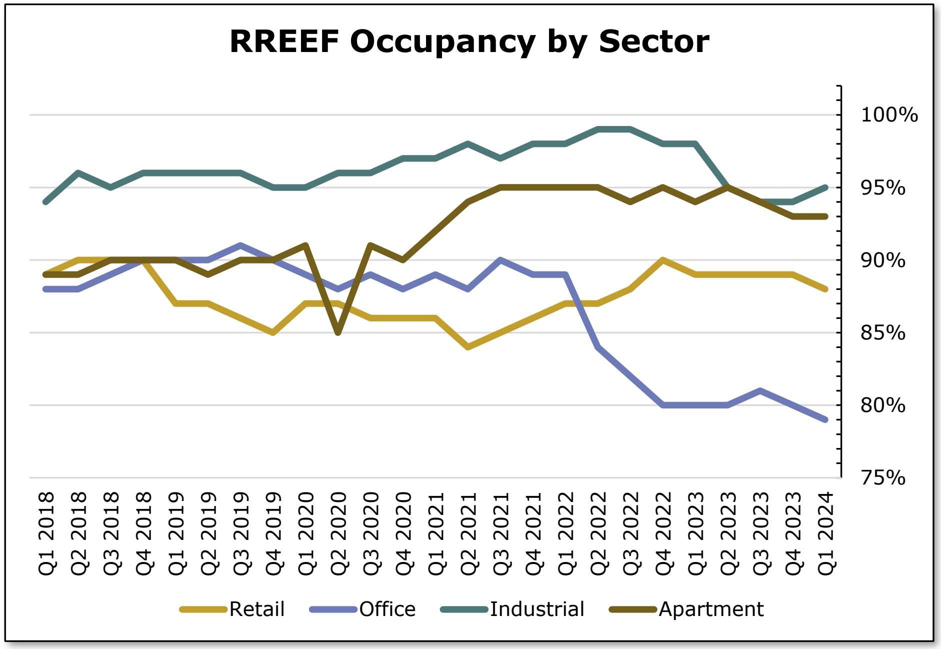
Regions – 3/31/24



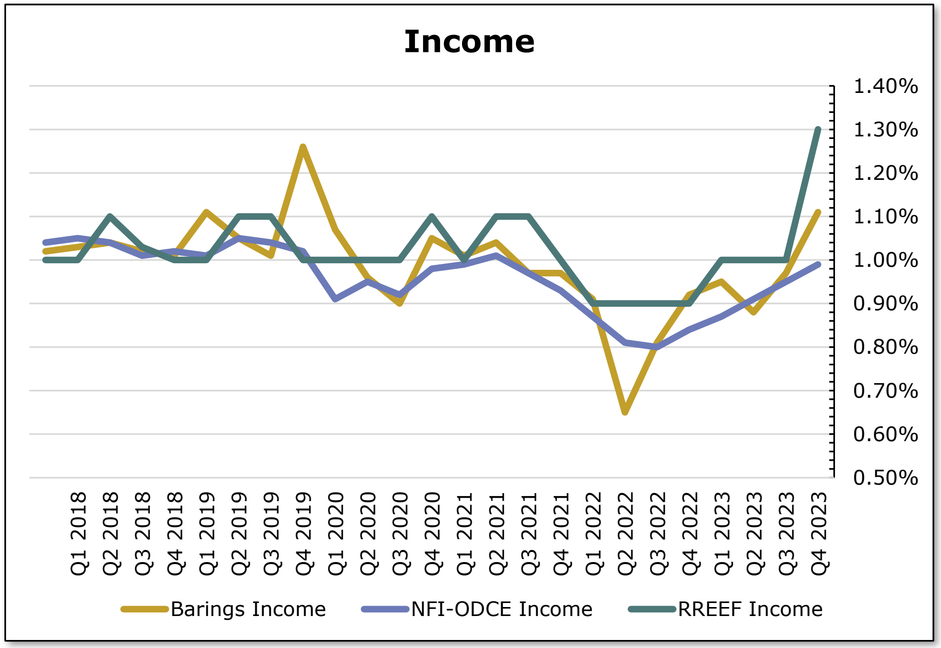


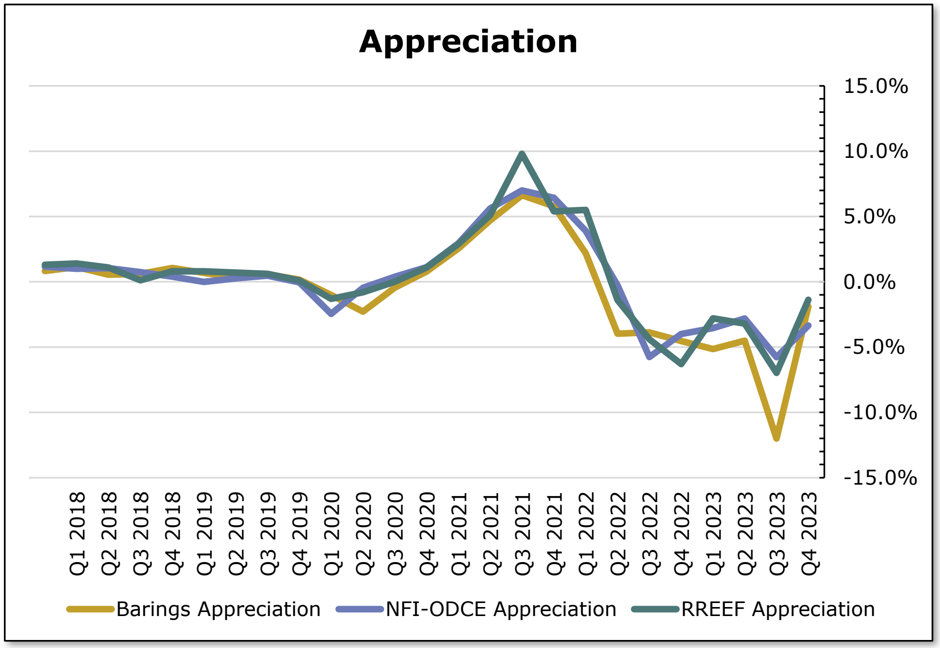
Occupancy Rates – 3/31/24





Income and Appreciation Returns (Gross) – 3/31/24





Gross Returns – 3/31/24

Barings Gross Returns - March 31, 2024

Period	Income	Appreciation	Total
Trailing 12 months	3.97%	-22.46%	-18.49%
Trailing 36 months	3.78%	-5.32%	-1.54%
Trailing 60 months	3.98%	-3.48%	0.50%
Trailing 120 months	4.25%	0.83%	5.08%

RREEF Gross Returns – March 31, 2024

Period	Income	Appreciation	Total
Trailing 12 months	4.40%	-14.10%	-9.70%
Trailing 36 months	4.10%	0.20%	4.30%
Trailing 60 months	4.10%	0.40%	4.50%
Trailing 120 months	4.30%	3.20%	7.50%

NFI-ODCE Gross Returns - March 31, 2024

Period	Income	Appreciation	Total
Trailing 12 months	3.77%	-15.05%	-11.28%
Trailing 36 months	3.69%	-0.32%	3.37%
Trailing 60 months	3.81%	-0.35%	3.46%
Trailing 120 months	4.17%	2.59%	6.76%