Mendocino County Employees Retirement Association

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| **Date:** | August 21, 2024 |
| **To:** | Board of Retirement |
| **From:** | F. Robert Reveles, Retirement Financial Investment Officer |
| **Subject:** | Second Quarter Real Estate Update and Managers Characteristics |

**Recommended Action:**

Receive and file.

**Fiscal and Financial Impacts:**

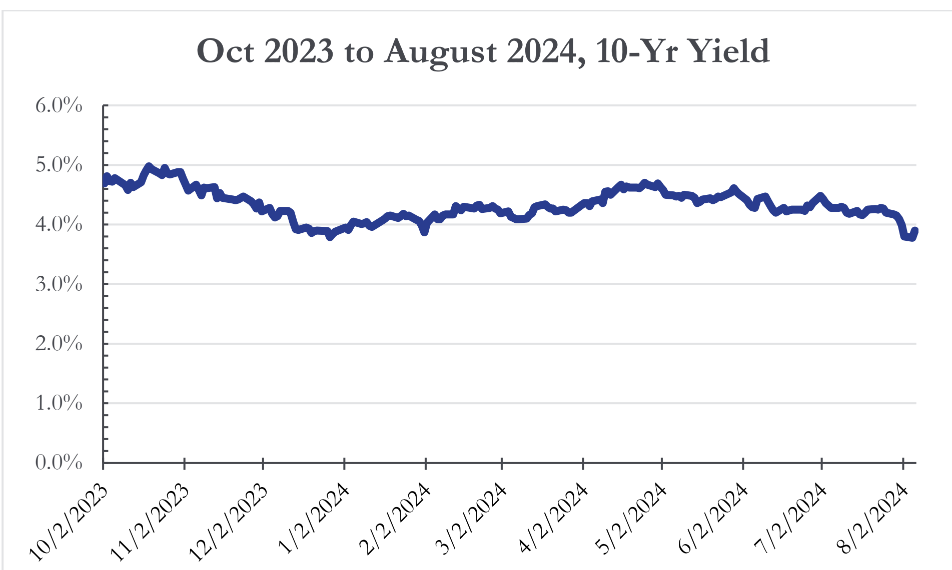
There is no financial impact to receiving this informational item.

**Strategic Plan Importance and Risk Assessment:**

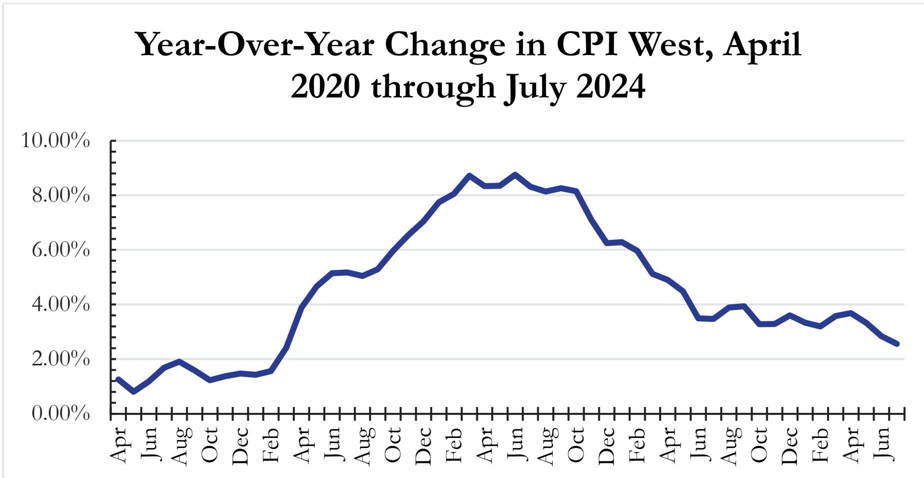
This report pertains to Goal 1 – Protect the Plan's long-term financial health and Goal 2 – Strengthen Risk Oversight.

**Background and Discussion:**

The completion of the second quarter of 2024 saw the real estate composite return 0.05%, the first positive return in 7 quarters, outperforming the NFI-ODCE benchmark by 87 basis points. (The quarterly the NFI-ODCE net return was negative 0.82%.) The upward pressure on the 10-year Treasury Note yield is subsiding, settling in around 4.0% in early August. Stability (or stopping the rise) of the 10-year yield is important for real estate valuations going forward. This stability reflects in our managers quarterly appreciation returns of -0.83% for Barings and -0.87% for RREEF. An updated chart showing changes in the 10-year yield since the October 2023 high is below.

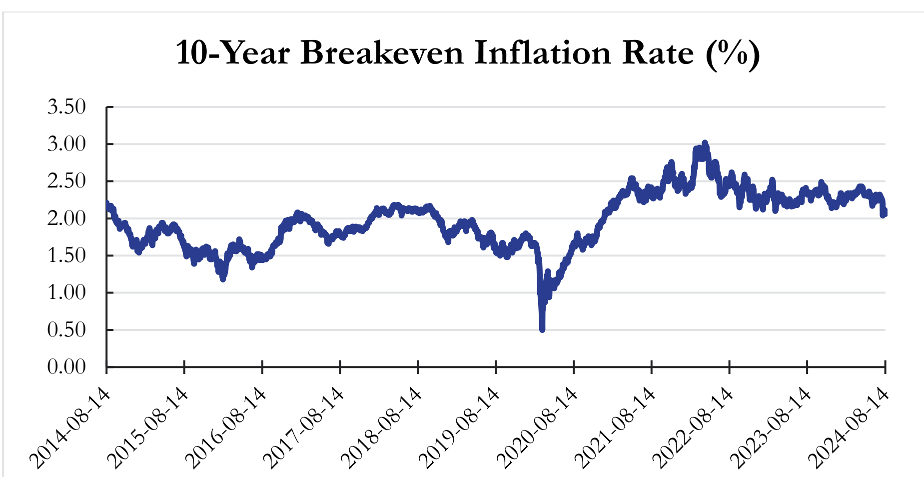


In another positive development, headline year-over-year CPI-West increases finally fell back below 3% during the quarter, a feat last seen in March 2021. The drop indicates that inflation is coming back down to reasonable levels. Increased inflation was the primary factor leading to the Federal Reserve raising interest rates.




Though the Federal Reserve can influence short term interest rates through the Federal Funds Effective Rate, the Fed has significantly less influence at the longer end of the yield curve. One significant influence on the 10-year Treasury yield is inflation expectations.

Federal Reserve Economic Data (FRED) published by the St. Louis Fed for 10-year inflation breakeven rates are charted below. Breakeven inflation rates can give us an indication of what bond market participants expect inflation will average over any given period. The chart below shows between 2014-2020 the 10-year breakeven inflation rate ranged between 1.50% and 2%, while in more recent periods the rate is between 2% and 2.50%. Right now, year-over-year changes in CPI are approaching 10-Year breakeven rates. The convergence of CPI and breakeven rates is a positive development for stability of the 10-Year Treasury yield.



## Manager Updates

Both funds continued progress toward their long-term strategic goals of shifting sector and geographic exposures, stabilizing assets through lease-ups and renewals, growing income with asset improvements, and lowering leverage through deliberate acquisitions and dispositions.

## Barings:

Barings continues planned exits from the Central Business District (CBD) office sector with transfer of its Washington D.C. office building back to the lender (the transfer had no impact on performance because the asset had already been valued down to the loan balance) and sale of its New York and LA buildings shortly after the close of the quarter. The New York building was owned outright. This leaves one highly impaired CBD office asset in San Francisco. The fund is actively looking to sell this asset before the loan comes due this fall; once this building is sold the fund will have no CBD office exposure. The fund expects to have around 6% office exposure by the end of 2024.

Within the industrial portfolio the fund continues lease-up activity. In Florida the fund leased 107,000 square feet of a newly developed industrial building. The lease represents nearly 60% of the building. Overall during the quarter the fund executed leases on over 540,000 square feet of industrial space; the quarterly leases constitute almost 13% of the leasable space in the industrial portfolio.

The fund is working toward completion of renovations at multiple assets. During the quarter in Boston, common area renovations yielded a 150-basis point increase in occupancy at an apartment asset. In Denver and another Boston property, planned apartment renovations should make the units more competitive and are expected to boost both occupancy and received rents. In LA, the fund hopes to complete renovations on an industrial campus acquired in Q1 2022. The asset has strong demand from technology, manufacturing, and aerospace users.

In Texas the fund sold two assets – a 270-unit apartment complex and 400,000 square foot industrial warehouse. Both assets, having been held over the last 9 years, are expected to generate limited income growth and needed significant capital investment. The apartment complex was the oldest apartment asset in the fund. The fund held no debt against the assets and the sales generated over $107 million for the fund.

## RREEF:

RREEF is shifting regional exposure from the Pacific coast to the Sunbelt. Sunbelt states like Texas, Florida, South Carolina are expected to see continued population growth due to various climatic and economic factors. The strategy is targeting numerous developmental strategies in the region. For example, in Florida they are focusing on deploying over $240 million dollars in multi-family residential townhome units over the next 24 months. Near Tampa they are building 186 townhome units expected to be completed by Q2 2025. Near Orlando they have two separate projects in the pipeline that will add almost 600 rentable units by the end of 2024 and 2026. Residential exposure today is concentrated in Florida, Texas, North Carolina, Colorado, and Arizona.

In Texas the fund recently acquired over 325,000 square feet of industrial space near the Dallas-Fort Worth International Airport. The fund is overweight the Dallas industrial market and believes this acquisition, and the local industrial economy in general, will provide stable long-term cashflows. The asset has a weighted-average lease term of 9.2 years.

The fund sold two buildings during the quarter, an office building in NY and an apartment complex in VA. The NY office sector, having been heavily impacted by work from home policies, offers very little expected rent growth. The sales raised a total of $219 million.

## Additional Risk Statistics:

Below follows a table with additional risk statistics on our real estate managers.

The NCREIF Fund Index-Open End Diversified Core Equity (NFI-ODCE) benchmark is down 20.54% over the same period.

| For the period Q1 2012 through Q2 2024 | Barings | RREEF |
|---|---|---|
| Net Asset Value ($B) | $ 2.0 | $ 12.0 |
| Leverage | 29.0% | 23.0% |
| Trailing 12 Month Distribution Yield | 3.4% | 3.8% |
| Tracking Risk | 2.8% | 2.3% |
| Recent Drawdown (7 quarters) | 27.5% | 19.4% |
| Annualized Standard Deviation | 6.2% | 5.8% |
| Correlation with S&P 500 | (0.1852) | (0.1921) |
| Correlation with S&P 500 (before current drawdown) | (0.0971) | 0.0012 |

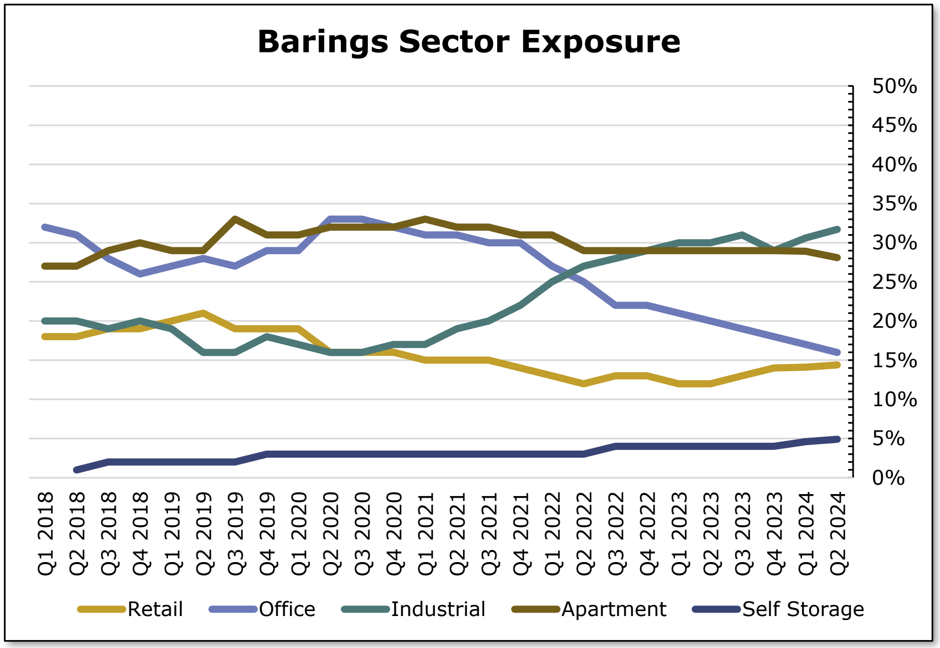
**Attachment(s):**

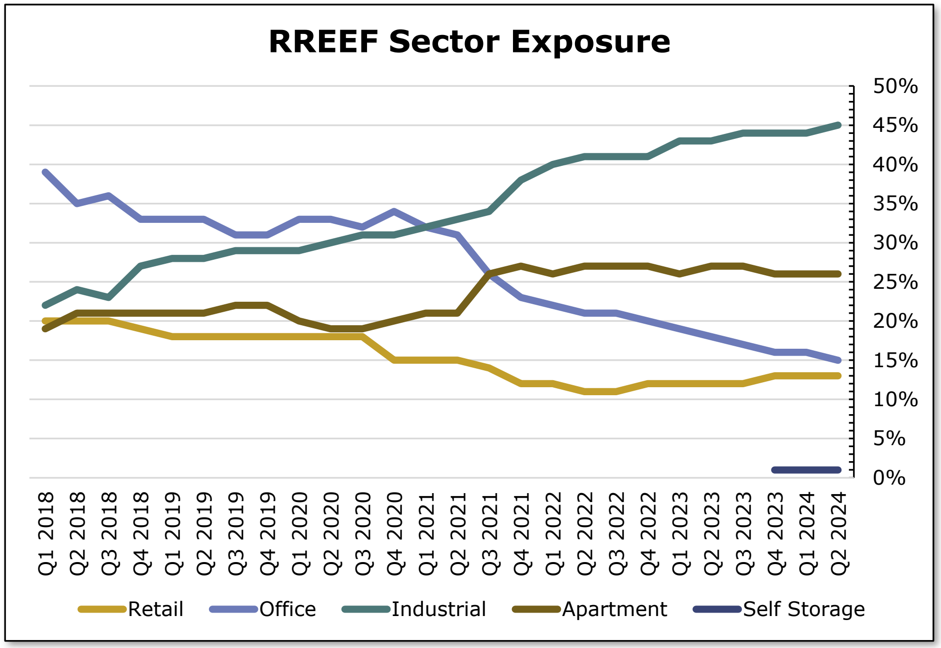
1. Real Estate Portfolio Characteristics – 6/30/24

MENDOCINO COUNTY EMPLOYEES
RETIREMENT ASSOCIATION

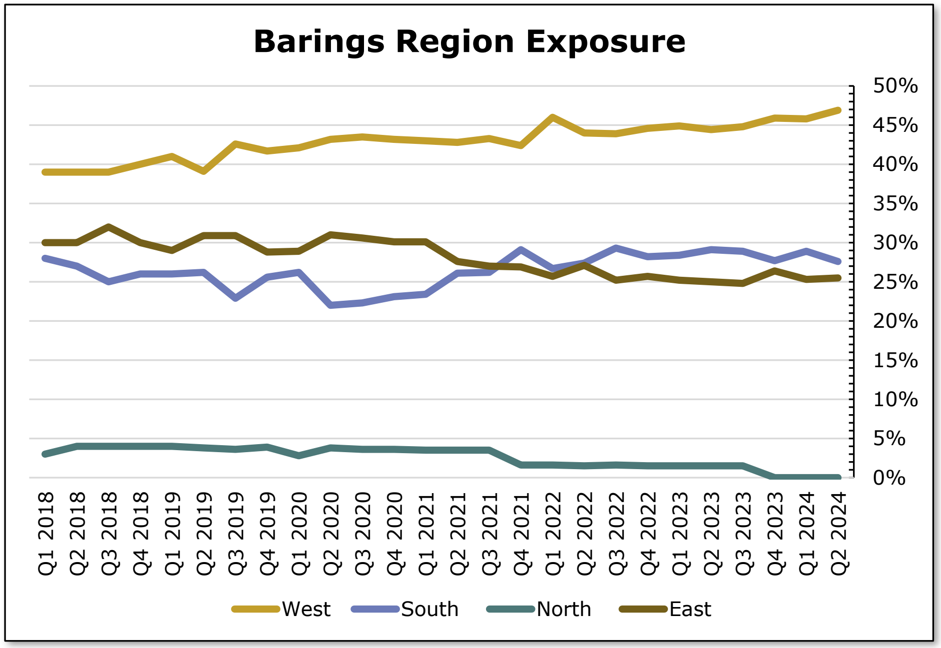
# Real Estate
# Characteristics

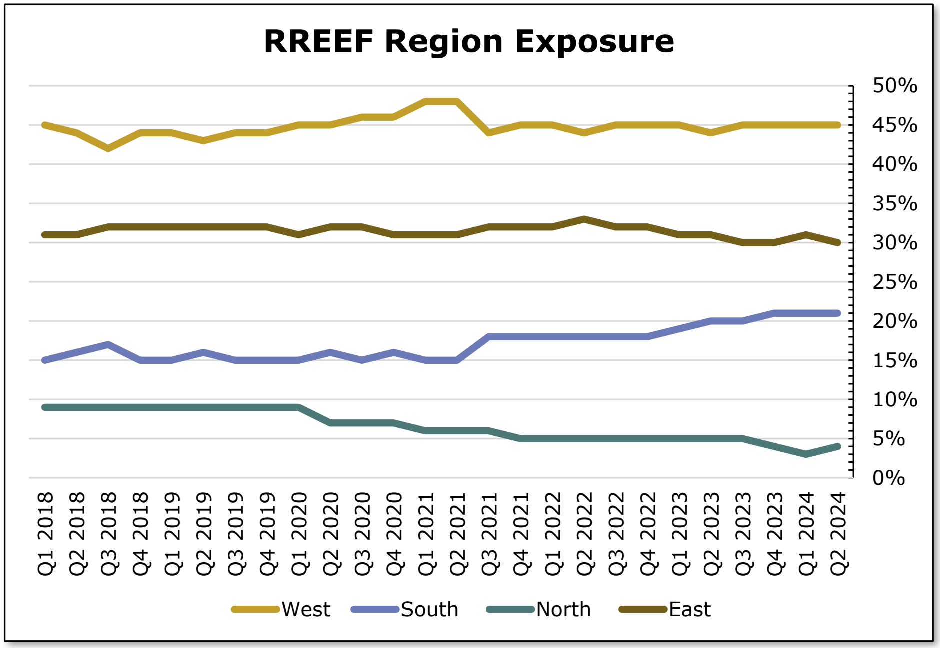
# Sectors – 6/31/24



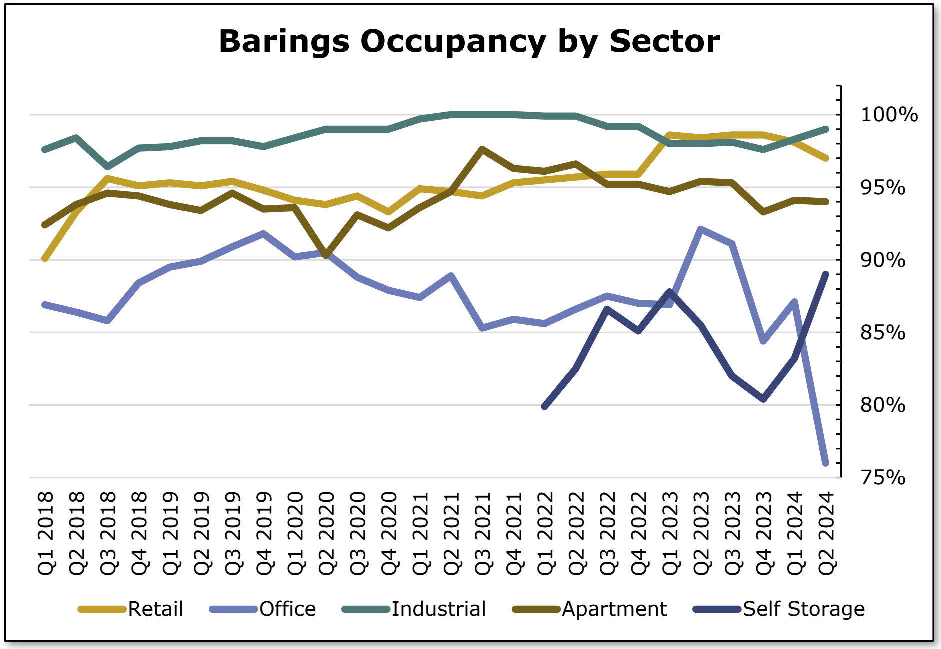



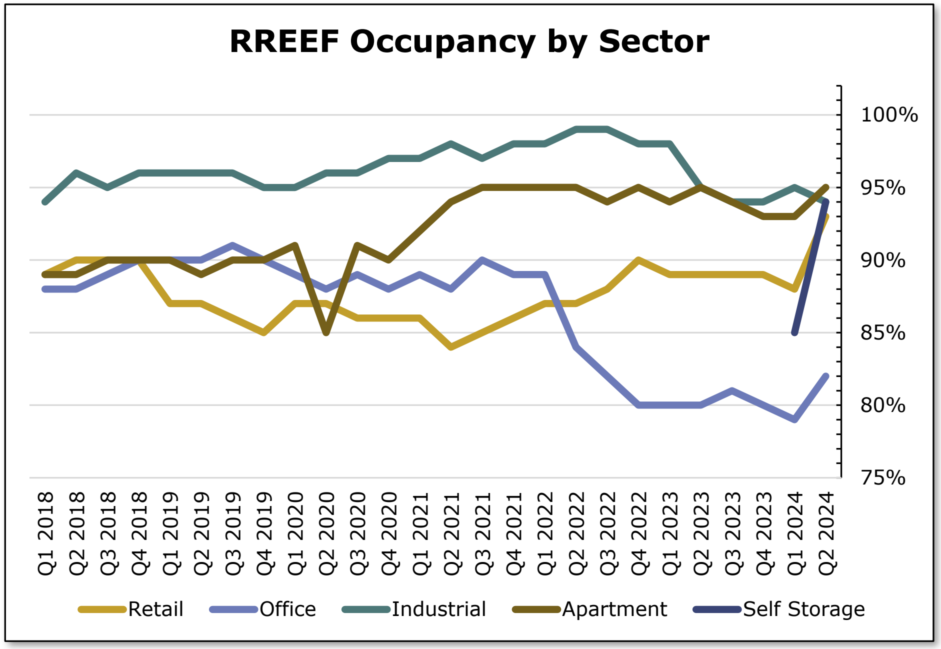
# Regions – 6/31/24



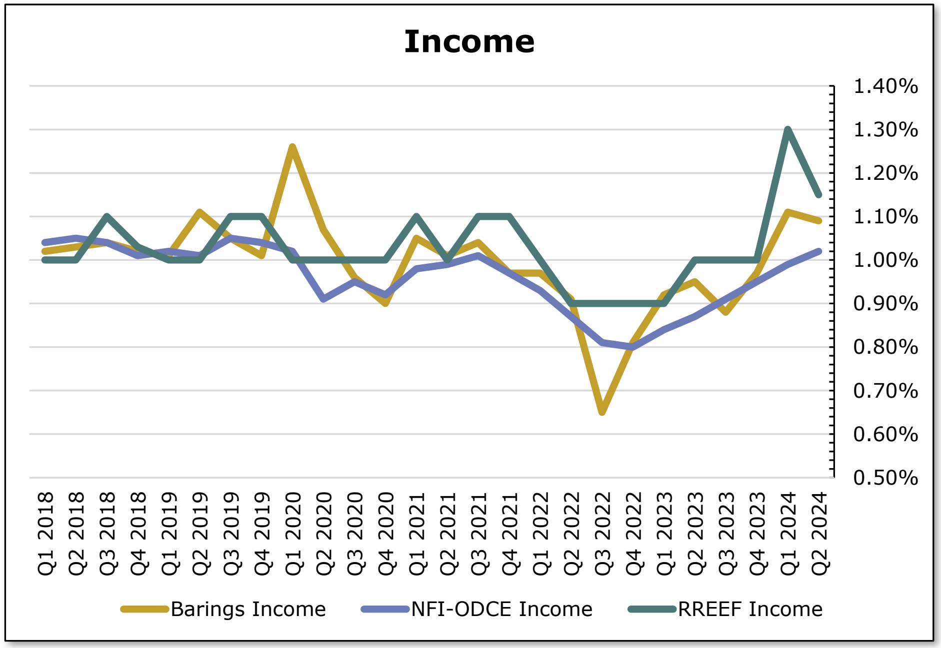



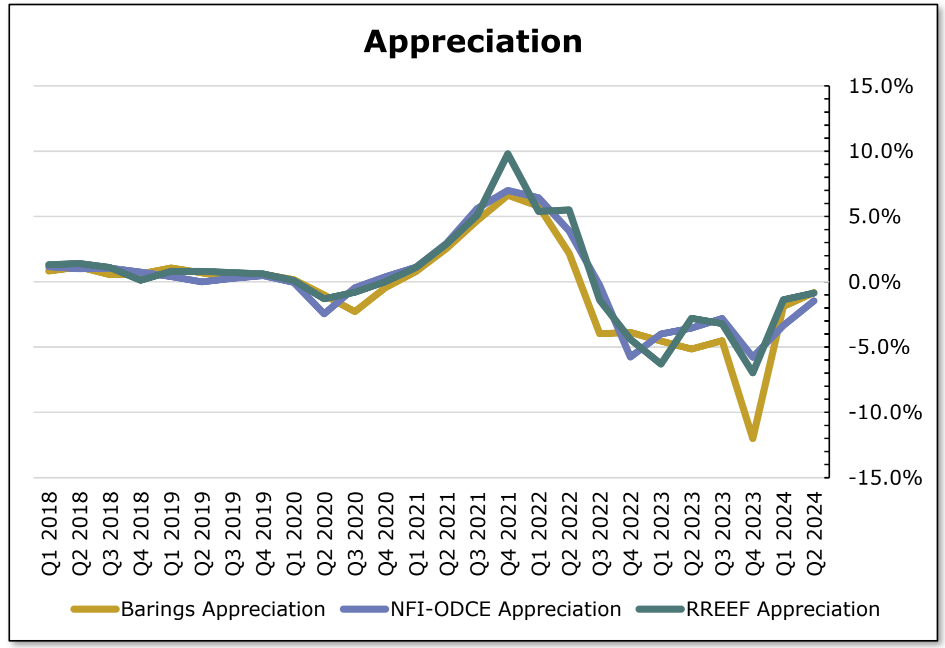
# Occupancy Rates – 6/31/24



# Income and Appreciation Returns (Gross) – 6/31/24



# Net Returns – 6/31/24

| Barings Fund Level Net Returns - June 30, 2024 | | | |
|---|---|---|---|
| **Period** | **Income** | **Appreciation** | **Total** |
| Trailing 12 months | 3.43% | -18.72% | -15.29% |
| Trailing 36 months | 3.12% | -6.38% | -3.26% |
| Trailing 60 months | 3.27% | -3.76% | -0.49% |
| Trailing 120 months | 3.46% | 0.59% | 4.05% |

| RREEF Fund Level Net Returns – June 30, 2024 | | | |
|---|---|---|---|
| **Period** | **Income** | **Appreciation** | **Total** |
| Trailing 12 months | 3.61% | -12.28% | -8.67% |
| Trailing 36 months | 3.14% | -1.04% | 2.10% |
| Trailing 60 months | 3.17% | 0.05% | 3.22% |
| Trailing 120 months | 3.34% | 2.96% | 6.30% |

| NFI-ODCE Net Returns - June 30, 2024 | | | |
|---|---|---|---|
| **Period** | **Income** | **Appreciation** | **Total** |
| Trailing 12 months | 3.06% | -13.06% | -10.00% |
| Trailing 36 months | 2.83% | -1.81% | 1.02% |
| Trailing 60 months | 2.93% | -0.66% | 2.27% |
| Trailing 120 months | 3.23% | 2.24% | 5.47% |

# "Weighted Average Lease Term - WALT"

WALT measures the weighted average remaining contract lease term for all tenants at a property.

$$Weighted\ Average\ Lease\ Term = \frac{\sum(Annual\ Rent\ * Remaining\ Lease\ Term)}{\sum Annual\ Rent\ of\ all\ tenants}$$

$1.\ Multiply\ the\ current\ annual\ rent\ by\ the\ remaining\ lease\ term\ for\ each\ tenant$

$2.\ Sum\ the\ totals\ for\ all\ tenants$

$3.\ Divide\ the\ sum\ by\ the\ sum\ of\ current\ annual\ rent\ of\ all\ tenants$

MCERA WALT of non-cancellable lease term on a Fiscal year basis (including MCERA rents) = ~7.0 years