

Real Assets Annual Program Review

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June 20, 2023

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Program Overview



Market Environment



Portfolio Performance and Risk Analysis



Key Initiatives



Program Overview

Role

- Real Assets' role is to provide stable and predictable cash yield, diversification of equity risk, and inflation protection
- Returns predominantly derived from income
- Real Estate provides stable cash yield under long term leases with good credit tenants
- Infrastructure focuses on large scale, essential and defensive assets with proven revenue models

Key Metrics

- NAV in billions*: RA \$71.2, RE \$56.8, Infrastructure \$14.1
- 27 Partners and 65 Partnerships

Investment Beliefs

- A long investment horizon is a responsibility and an advantage (*IB 2*)
- CalPERS will take risk only where we have a strong belief we will be rewarded for it (*IB 7*)
- Costs matter and need to be effectively managed (*IB 8*)
- Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives (*IB 10*)

*As of 3/31/23



Strategy and Portfolio Positioning

Positioning

- Emphasis on Core is consistent with the Role
 - Real Estate targets Core, well-located assets with strong competitive positions and defensive characteristics
 - Infrastructure targets essential, durable/long-lived assets and interests in portfolio companies

Strategy

- Increase allocation to Infrastructure portfolio
- Target select tactical opportunities in Real Estate
- Focus on separate accounts, commingled funds, co-investments and directs
- Increase focus on sustainable investment opportunities including energy transition, renewables, carbon-neutral and sustainability certified assets
- Restructure fees to improve alignment with managers

Market Environment

Current Concerns

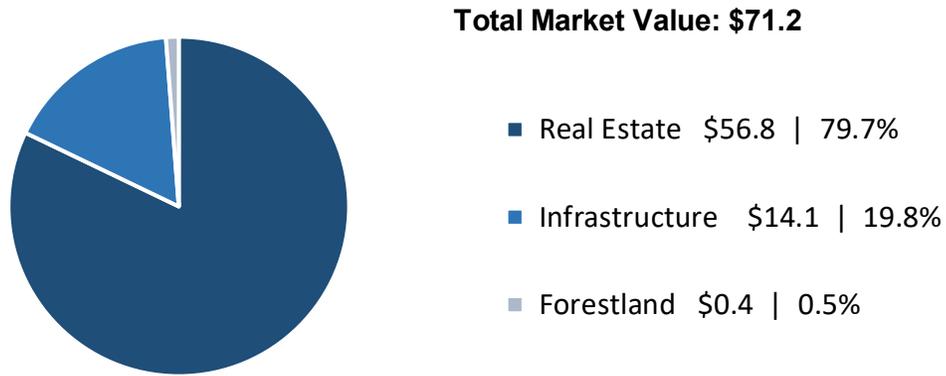
- Raising interest rates created upward pressure on cap rates which has resulted in lower asset values
- Transactions market experiencing material decline in volume, widening bid-ask spreads
- Refinancing risk in office and select retail sub-sectors
 - Decreased Office demand resulting in widening spread between Class A and Class B Office valuations
- Despite pressure on valuations, fundamentals remain stable (except for office)
 - Rising inflation led to higher rents (RE) and contractual payments (Infra) offsetting downward valuation pressure

Deployment Themes

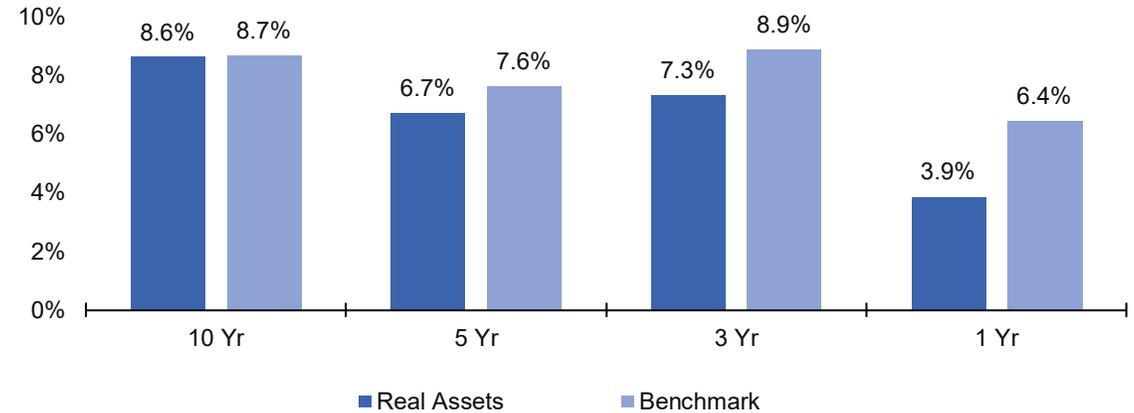
- Increased allocations to private assets leading to high levels of dry powder, tempered by denominator
- Market participants continue to favor Industrial, Multifamily and Digital Infrastructure
- Higher interest rates have sidelined investors that rely on leverage
- Near term RE debt more attractive due to banks withdrawing from the market

Portfolio Performance and Risk Analysis*

Asset Class Allocation (\$ Billion)

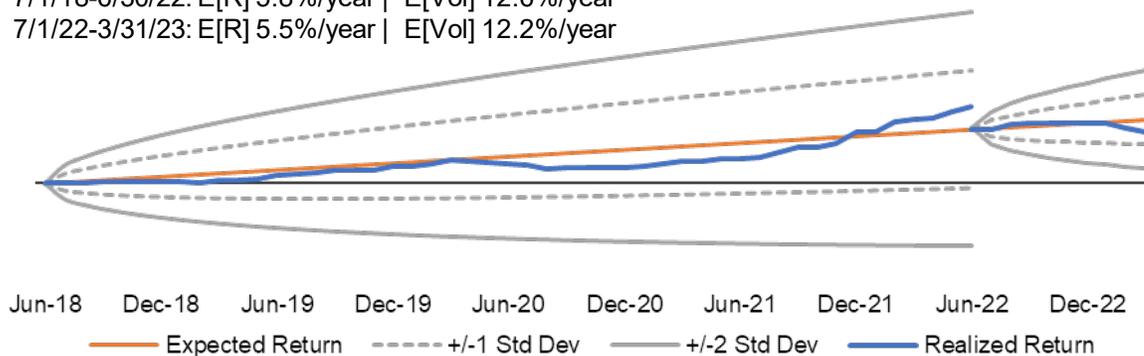


Total Return



BM Outcomes vs 2022 SAA Expectations

7/1/18-6/30/22: E[R] 5.8%/year | E[Vol] 12.6%/year
 7/1/22-3/31/23: E[R] 5.5%/year | E[Vol] 12.2%/year



Key Metrics



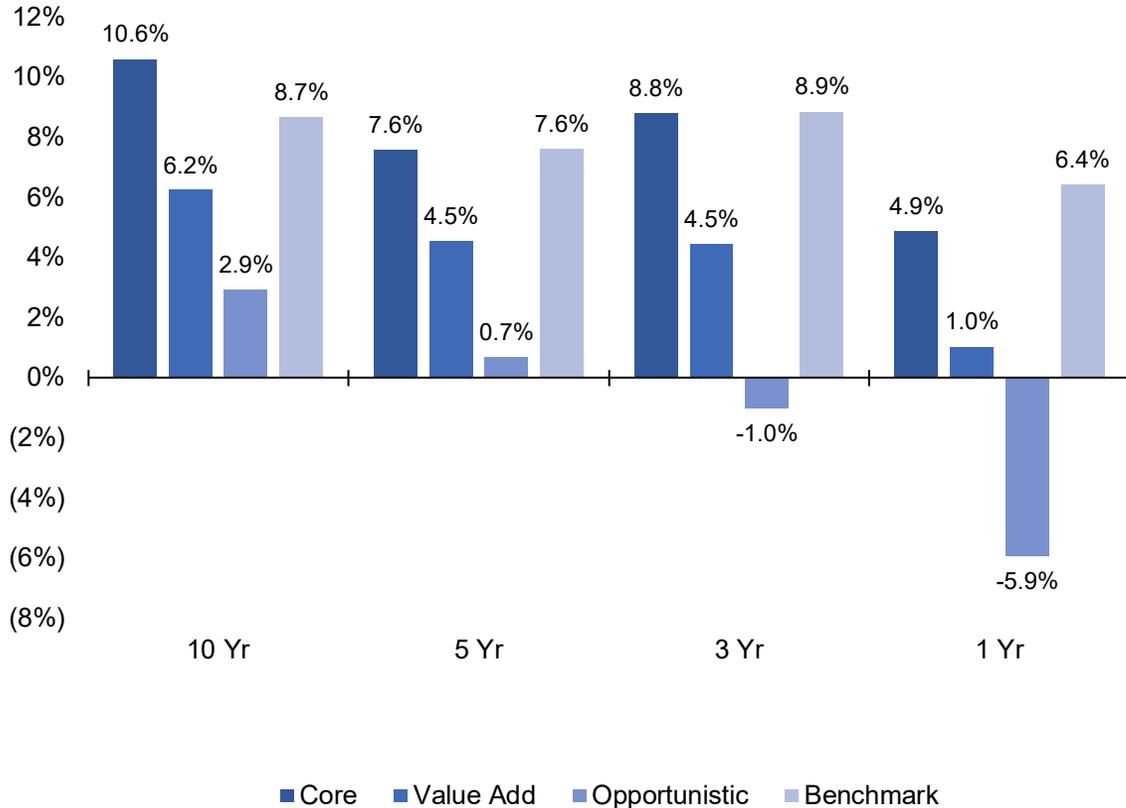
*3/31/23 performance based on 12/31/22 financial statements

¹Chart shown from 7/1/2018, the effective date of the asset allocation approved during FY 17/18. Cumulative expected return and standard deviation are based on the 2017 SAA expectations for the period 7/1/2018-6/30/22 and on the 2021 SAA expectations for the period 7/1/2022-3/31/2023.

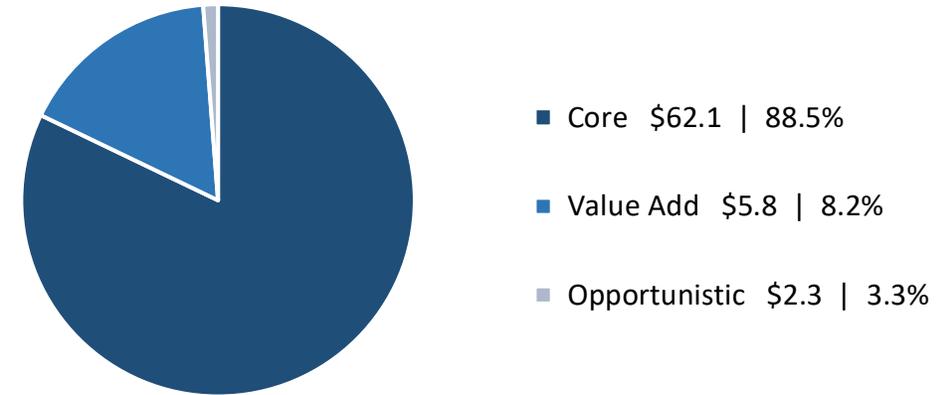


Performance and Allocation Analysis

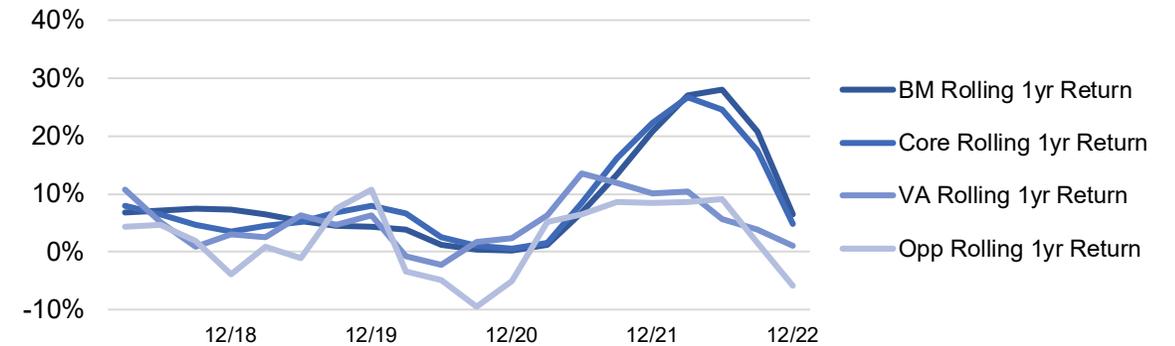
Total Return



Exposure by Risk (\$ Billion)



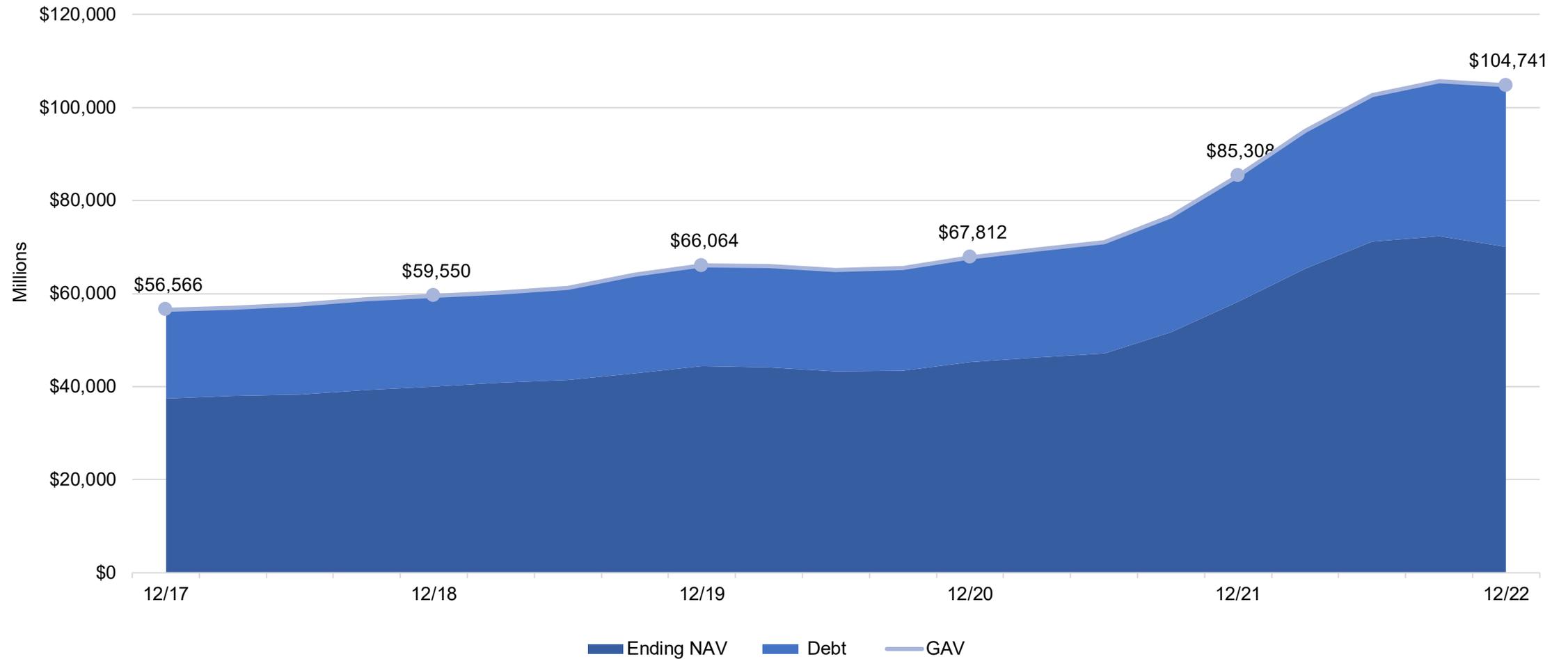
Rolling 1-Year Net Returns vs Policy Benchmark*



*As of 12/31/22

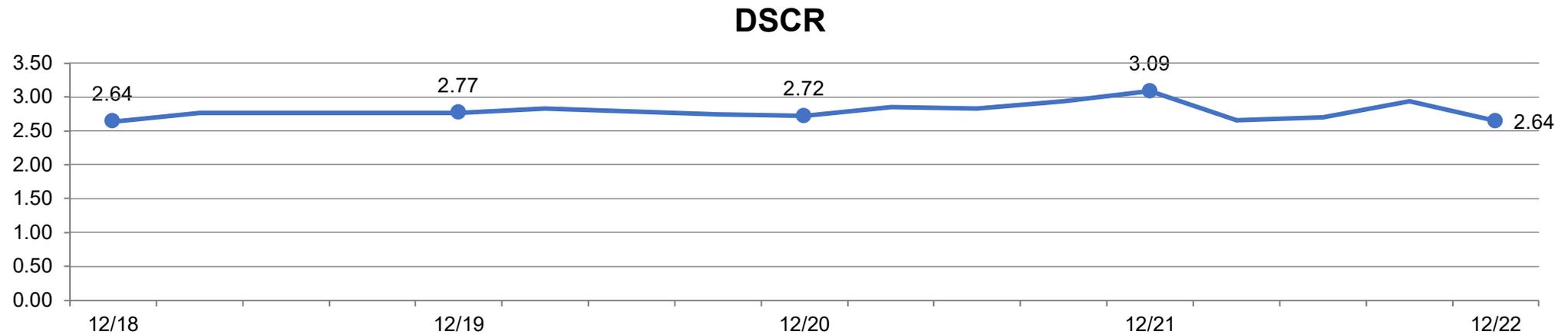
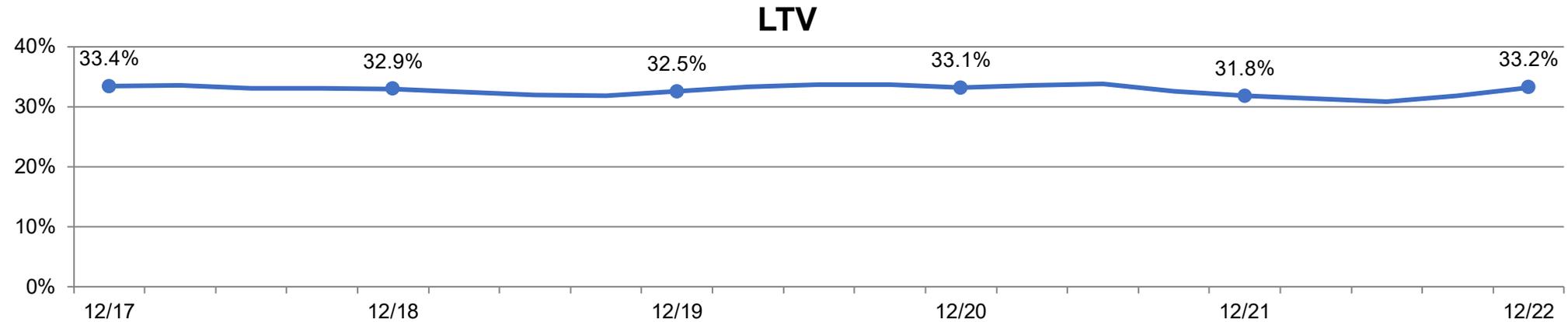


Gross Asset Value & Net Asset Value Trends





Loan to Value & Debt Service Coverage Ratio Trends



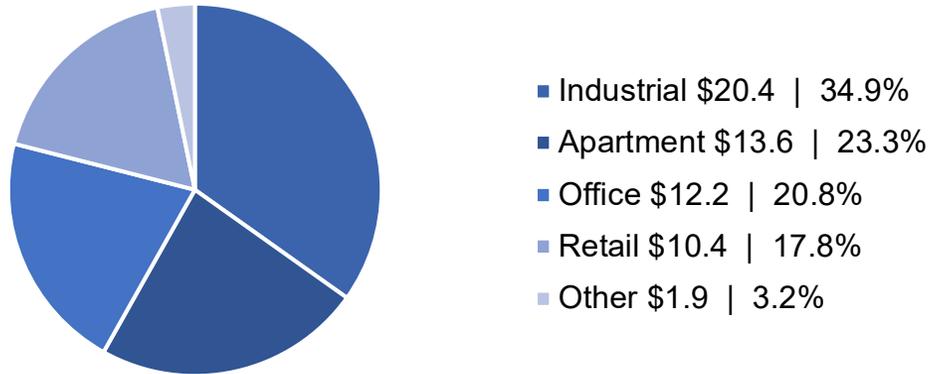
Portfolio Analysis

Real Estate

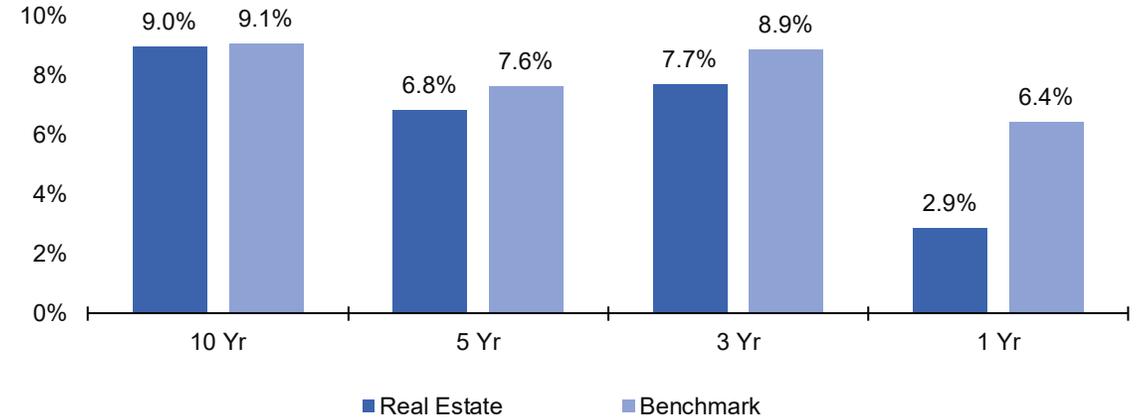


Portfolio Performance | Real Estate

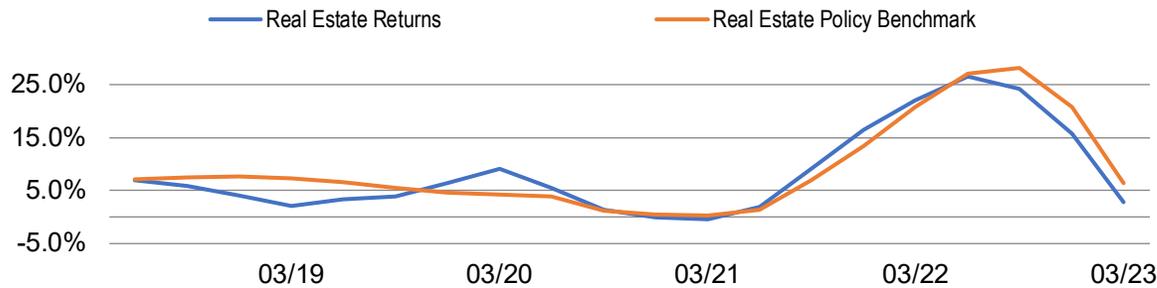
Property Type (\$ Billion)



Total Return

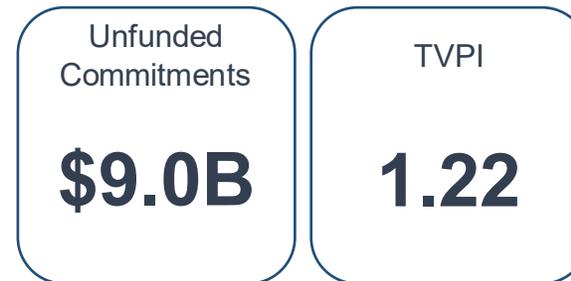


Rolling 1-Year Net Returns vs Policy Benchmark*



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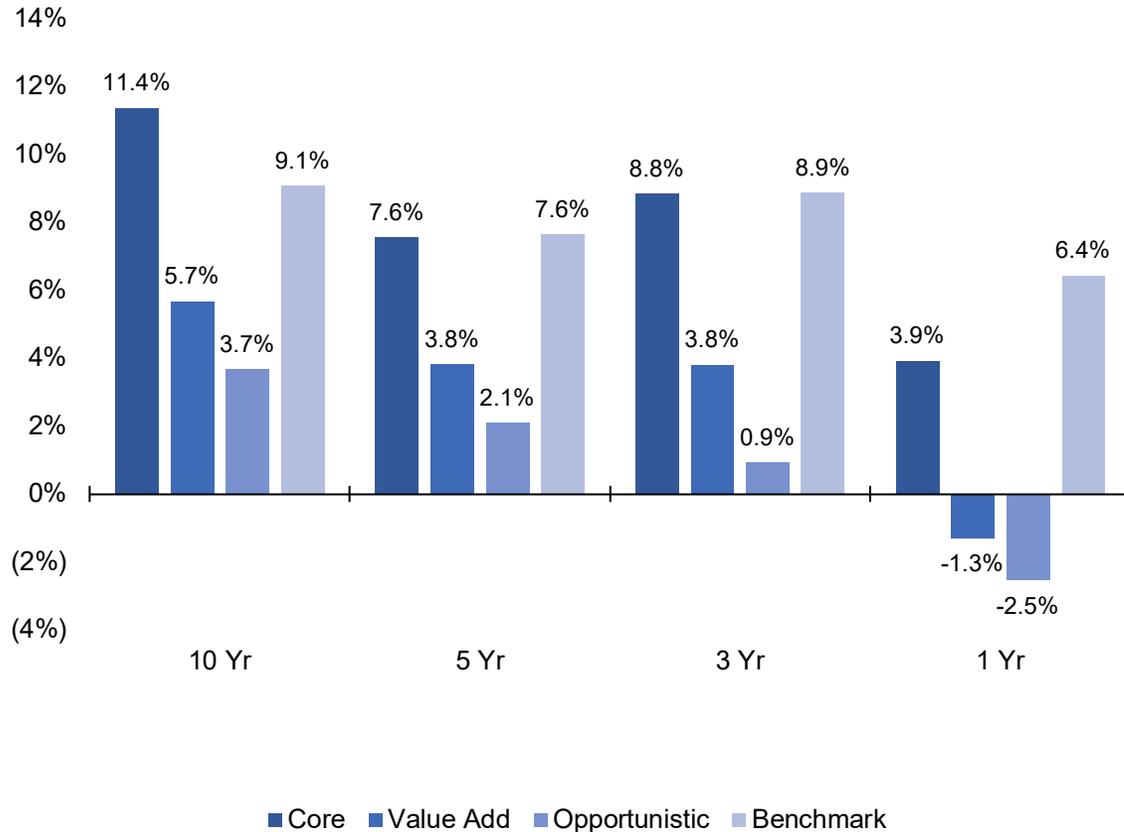
Key Metrics



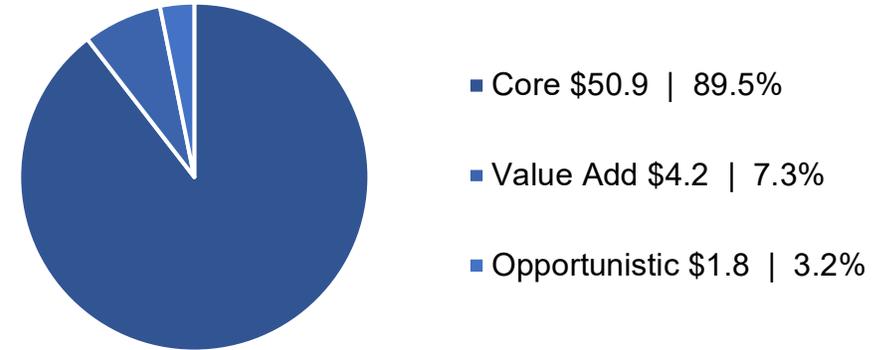


Performance and Allocation Analysis | Real Estate

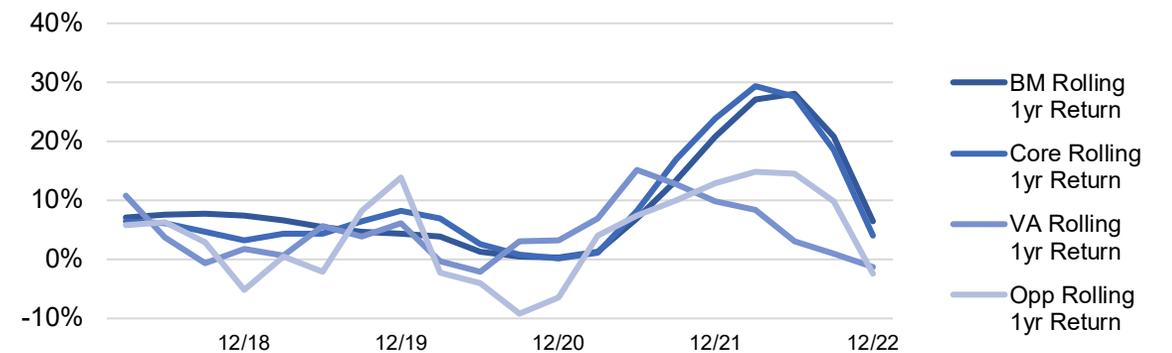
Total Return



Exposure by Risk (\$ Billion)



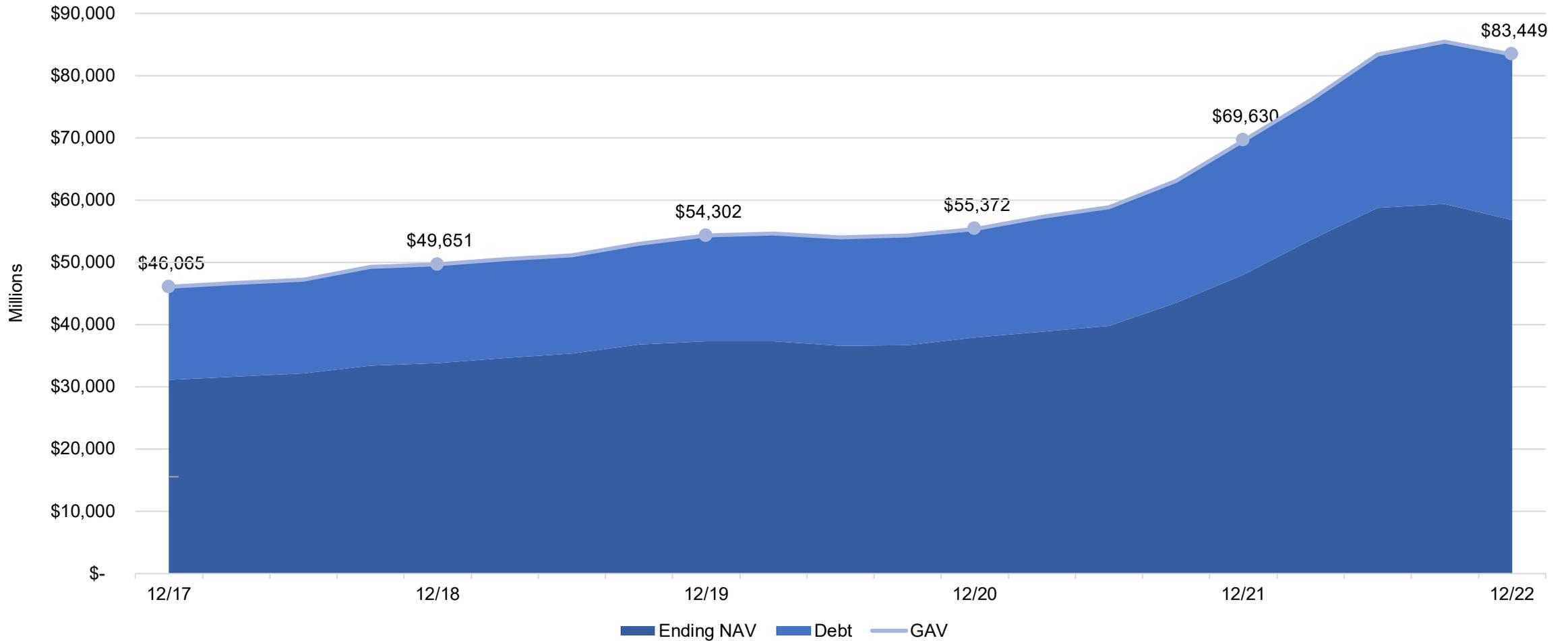
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*As of 12/31/22

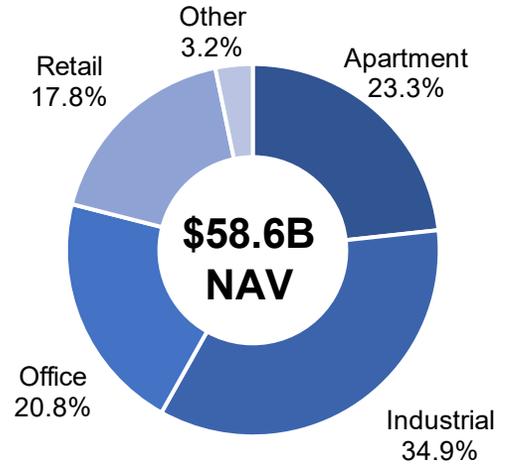
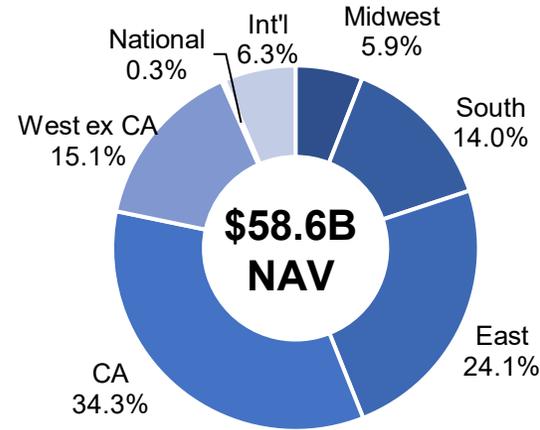
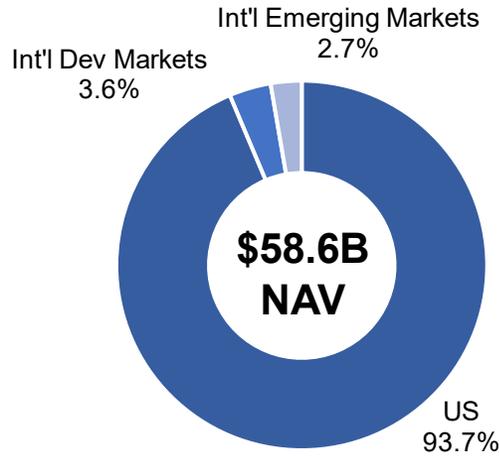


GAV & NAV | Real Estate

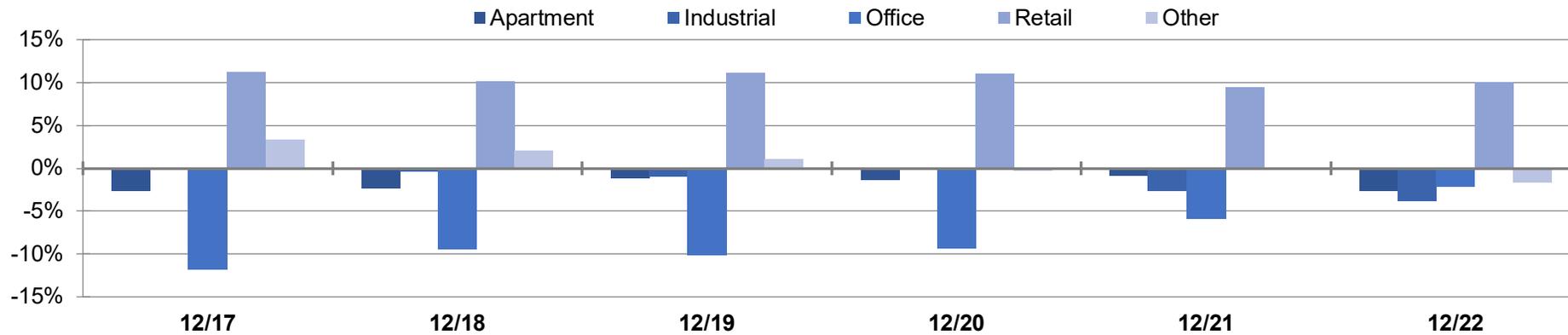




Exposures | Real Estate



Difference versus Property Type Benchmarks*



*Based on GAV

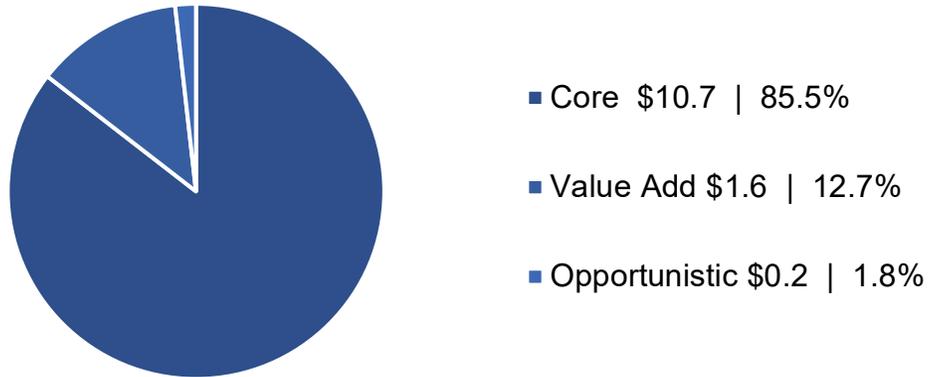
Portfolio Analysis

Infrastructure

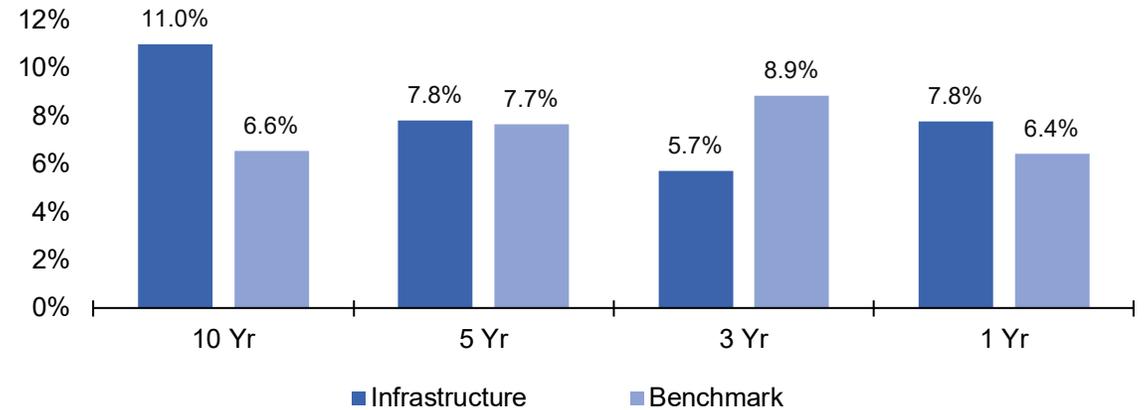


Portfolio Performance | Infrastructure

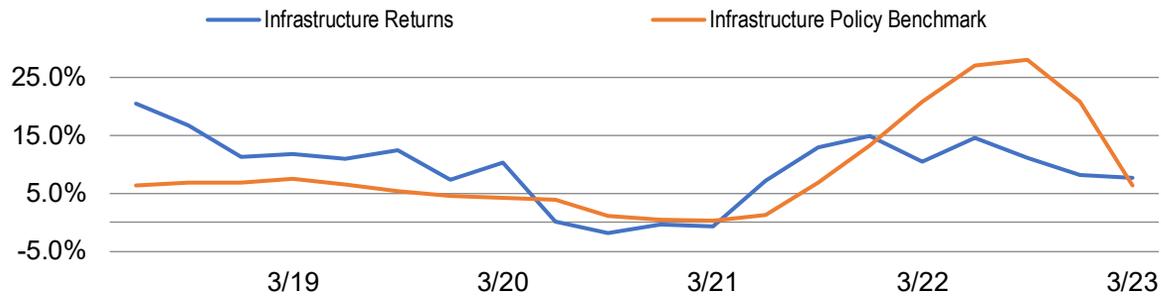
Risk Type (\$ Billion)



Total Return

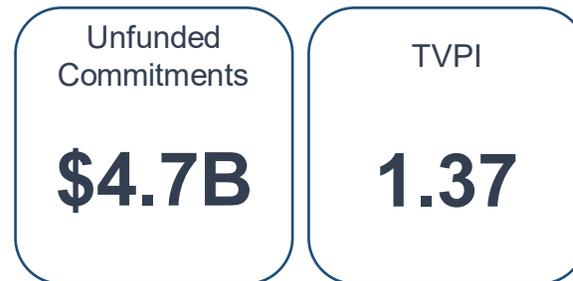


Rolling 1-Year Net Returns vs Policy Benchmark*



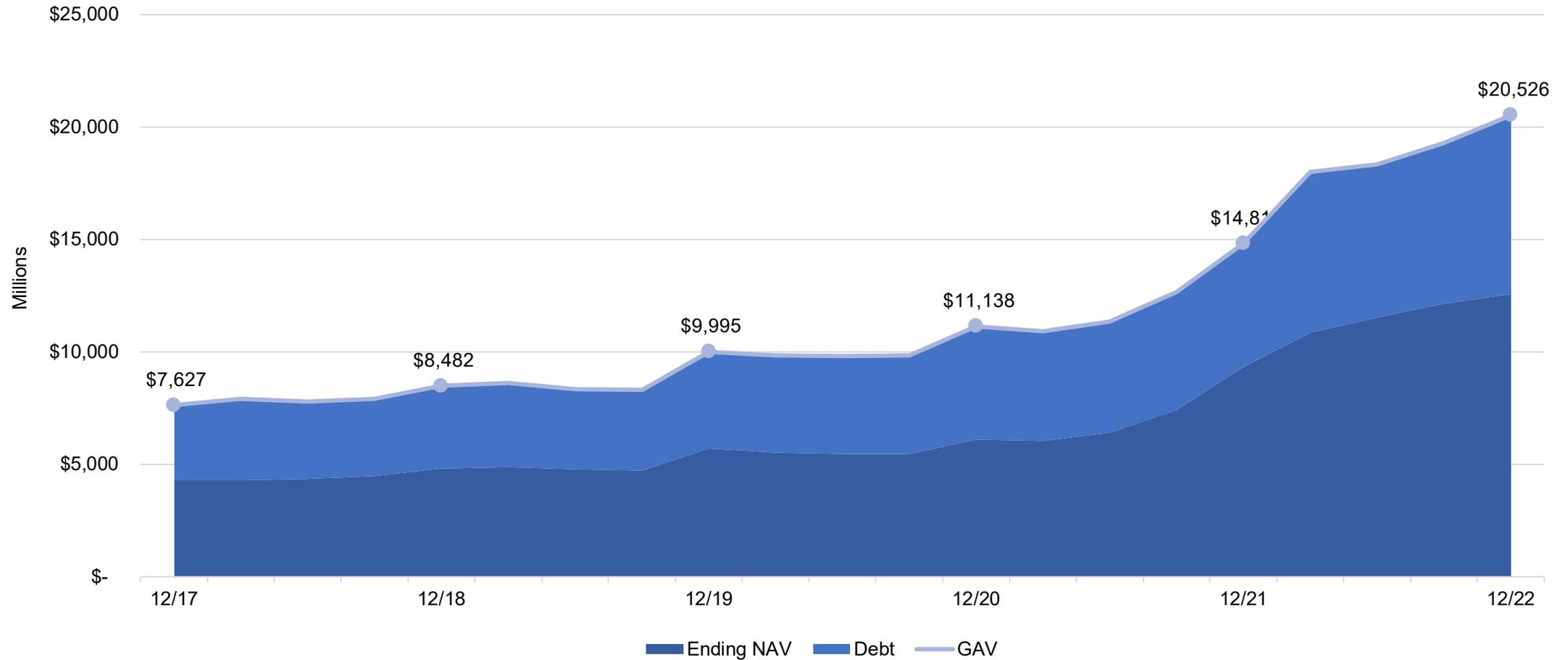
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Key Metrics



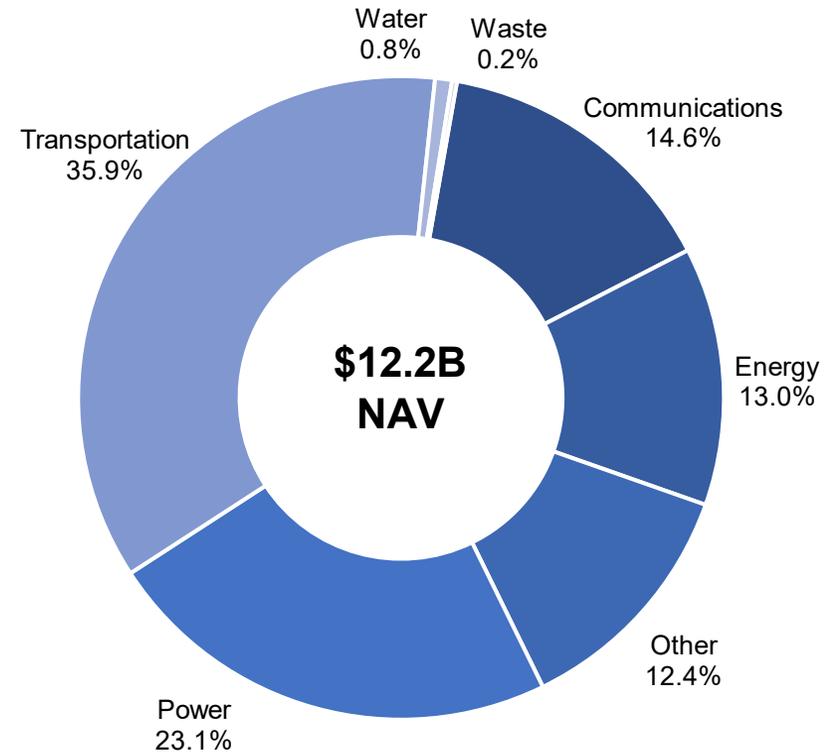
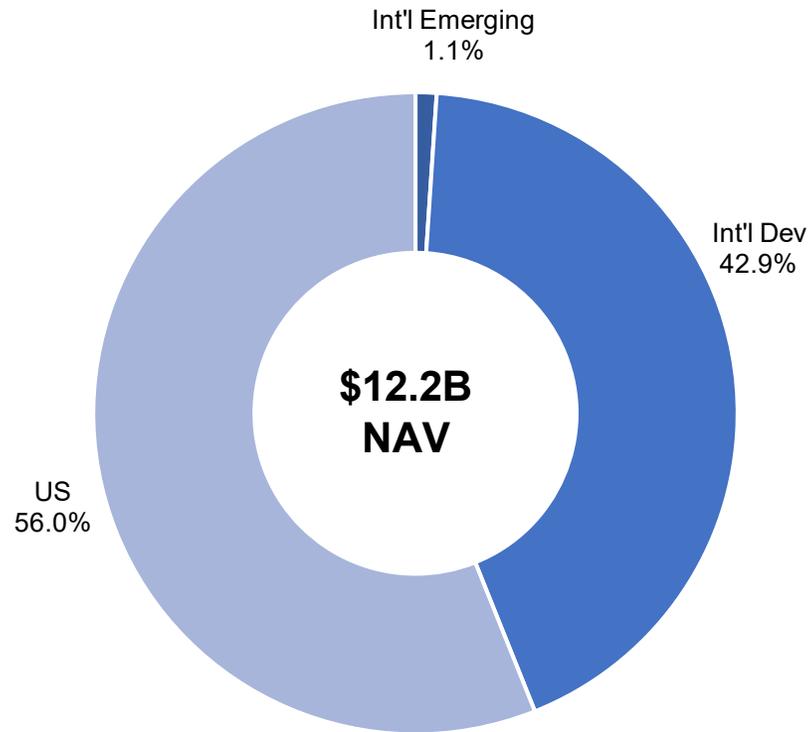


GAV & NAV | Infrastructure





Geography & Asset Type* | Infrastructure



*As of 12/31/22



Evaluation and Initiatives

- Program comprised of high-quality, essential assets in defined target markets with stable cash flows has held up through business cycles. Portfolio delivered 8.6% over 10-Yr period
- Conservative leverage characteristics facilitate stability
- Expansion of relationships with best-in-class infrastructure managers
- Continue resource planning to effectively manage a growing portfolio
- Review system requirements to support expanded portfolio management needs and growing portfolio complexity
- Continue to align with Total Fund objectives and Real Assets' standardization of reporting, evaluation of climate risk tools, Energy Optimization for Real Estate and third party assessments (i.e. GRESB)



Key Initiatives | Integration of Governance and Sustainability

Sustainable Investment Activities	Description / Status
Global Real Estate Sustainability Benchmark (GRESB)	<ul style="list-style-type: none"> 87% of the portfolio submitted into GRESB Assessment in 2022
Energy Optimization (EO) Initiative for Real Estate	<ul style="list-style-type: none"> Ongoing identification of accretive EO opportunities, reducing carbon intensity and generating cost savings over time
Climate Risk & Energy Transition Research	<ul style="list-style-type: none"> Climate risk assessment completed for the domestic Real Estate portfolio in collaboration with Total Fund research Energy Transition Review for Infrastructure included an evaluation of potential risks and opportunities
National Council of Real Estate Investment Fiduciaries (NCREIF) Pension Real Estate Association (PREA) Reporting Standards	<ul style="list-style-type: none"> CalPERS represented on NCREIF PREA’s Reporting Standards Council Contributed to the development of “ESG Principles of Reporting for Private Real Estate”

Key Initiatives | Responsible Contractor Program (RCP) Policy

Purpose

- The RCP Policy supports fair market wages and benefits based on local conditions for workers employed by contractors and subcontractors, subject to fiduciary principles*
- Applies when the Real Assets program makes investments in the service, maintenance, development, and improvement of CalPERS' domestic Real Estate and Infrastructure assets

Scope

- U.S. Real Estate and Infrastructure assets where CalPERS holds > 50% interest
- Contracts of \geq \$100k
- Managers provide an annual RCP compliance and certification report

Successes

- Track record of consistent manager compliance (at or near 100% since the Policy was enhanced and revised in 2015)
- Established bidding and notification process, leading to over \$980 million paid to certifying responsible contractors FY22

Challenges

- Ongoing training and administration along with portfolio growth
- Time and resource intensive process, particularly for new investment managers learning how to implement the Policy

*Responsible Contractor Policy Update November 14, 2022 [Agenda Item 6d - Attachment 1 \(ca.gov\)](#)



Key Initiatives | Sustainable Investment Practice Guidelines*

- ESG considerations are integrated into Real Assets’ processes around selection, contracting, and monitoring
- Where CalPERS has governance, managers utilize an ESG Matrix during due diligence to ensure that ESG related risks and opportunities are systematically considered.
- Examples of ESG factors include the following:

Environmental

Climate risk

Resilience of surrounding infrastructure

Energy Efficiency & Emissions

Resource use (including water)

Social

RCP Policy Compliance

Safety & Wellness

Community relations

Accessibility

Governance

Alignment of Interest

Control Rights

Transparency/reporting

*<https://www.calpers.ca.gov/docs/real-assets-sustainable-investment-guidelines.pdf>