



MEMORANDUM

DATE: February 20, 2024
TO: California State Teachers' Retirement System
FROM: RCLCO Fund Advisors (RFA) – Taylor Mammen, Ben Maslan, Sriyas Pande, and Amber Hughes
SUBJECT: Semi-Annual Open Session Report; As of September 30, 2023

INTRODUCTION

RFA's semi-annual report is as of Q3 2023. Goals and objectives that the semi-annual report evaluates include: a real estate allocation target of 15%; a net return that exceeds the NCREIF NFI-ODCE Index, a hedge against inflation and stable cash flow generation, an allocation based on property stage (stable and value creation) to maintain an appropriate risk profile; and an appropriate level of leverage, with a loan to value (LTV) limit of 50% for the controlled portfolio and 65% for the non-controlled portfolio.

PORTFOLIO HIGHLIGHTS

- ▶ The real estate portfolio has outperformed both its target return benchmark and inflation over all measurable time periods over the last decade. The portfolio has generated a 10-year net TWR of 8.6%, outperforming the ODCE benchmark return of 7.2% by 140 basis points, and a 5-year net TWR of 7.0%, outperforming the ODCE benchmark return of 4.7% by 230 basis points. Over shorter time periods, the portfolio generated a 3-year net TWR of 7.8% and 1-year net TWR of -9.7%, outperforming the ODCE by 320 and 160 basis points, respectively.
- ▶ The real estate portfolio had a NAV of \$49.1B as of Q3 2023, which is in line with the target allocation of 15%. The portfolio is compliant with the targeted allocation by investment strategy and is within the permitted leverage limits for the control and non-control portfolios of 50% and 65%, respectively.
- ▶ The allocation to traditional office properties has decreased over the past year and is in line with the benchmark. The portfolio continues to be underweight industrial and multifamily properties by 12% and 11%, respectively.

MARKET HIGHLIGHTS

- ▶ Private real estate returns were negative in Q4 for the fifth consecutive quarter as NFI-ODCE and NPI posted quarterly returns of -4.8% and -3.0%, respectively. Full year 2023 total returns were -12.0% for ODCE and -7.9% for NPI, the lowest returns since the GFC. Further negative appreciation is likely as appraisal values move closer to transaction values.
- ▶ Real estate transaction volumes decreased 25% QoQ to \$70B in Q4 with declines in most property types. Annual transaction volume totaled \$350B in 2023, less than half of 2022's \$740B and the lowest annual total since 2012.
- ▶ Real estate debt will likely remain scarce and expensive as banks maintain tight lending standards. Institutional dry powder fell 15% in 2023, reflective of the cautious mood among investors. CRE distress and loan delinquencies rose considerably over the year, adding downside risk to the market outlook.