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MEMORANDUM

TO: Investment Advisory Committee – Employees Retirement System of Texas
FROM: Meketa Investment Group ("Meketa")
DATE: January 19, 2021
RE: Addendum to Private Real Estate Portfolio Annual Tactical Plan for Fiscal Year 2021

Background

In April 2020, Meketa, in collaboration with Staff, prepared and delivered to the Investment Advisory Committee the Private Real Estate Portfolio Annual Tactical Plan for Fiscal 2021. The plan was drafted at the very onset of the COVID-19 pandemic and accompanying global economic crisis. Stay-at-home orders were in place, public markets had experienced a material contraction, and private market transaction activity had come to a grinding halt. The FY 2021 Plan thus took a conservative approach to estimating new investment activity for the coming year, in deference to the material uncertainty around the potential duration of the shutdown and its effects on demand for real estate assets. At that time, the private real estate weight was at its target weight of 9% but now stands at approximately 7.9%. The original FY 2021 Plan targeted $300 million in new private real estate commitments in FY 2021, split evenly between core and non-core investments with an upper range of $600 million.

Tactical Plan Update

Today, while we collectively continue to struggle with COVID-19, we have witnessed a remarkable rebound in public markets generally, a continued decline in federal treasury rates, and roughly nine months of rent collection and pricing data that support some insight into the impacts on real estate and capital markets.

Clearly, COVID -19 has accelerated secular changes already impacting parts of the real estate market pre-pandemic, resulting in an impressive dispersion of returns by property type over the course of calendar year 2020. Industrial, residential, data center and life science real estate proved resilient during COVID-19 conditions, while retail and hospitality notably suffered. The longer-term fate of office remains murky, although contractual rent collections during work-from-home conditions have remained healthy, a testament to the longer-term nature of office leases with credit tenants. Residential rental properties in institutional hands delivered positive cash flow, with collections down in single digits.

Staff remained diligent and attentive to market conditions, managing to identify suitable investment opportunities throughout the year. The TX ERS Real Estate Program currently comprises 7.9% of the total portfolio against a long-term target of 9.0%. In consideration of both these factors, Meketa recommends amending the FY 2021 Plan to accommodate moderately increased commitment activity, as highlighted in the tables below.

FY 2021 Tactical Plan – Original		
Category	**Number of Investments**	**New Commitments in Millions (Range)**
Core	0-2	$150 ($0-$300)
Non-Core	3-6	$150 ($0-$300)
TOTAL	**3-8**	**$300 ($200-$600)**

FY 2021 Tactical Plan – Proposed Amendment		
Category	**Number of Investments**	**New Commitments in Millions (Range)**
Core	2-4	$250 ($200-$400)
Non-Core	4-6	$250 ($200-$400)
TOTAL	**6-10**	**$500 ($400-$800)**

To date in FY 2021, TX ERS has approved three non-core commitments totaling $175 million. Currently identified pipeline opportunities include four core investments representing $325 million and two additional non-core investments representing $150 million. Successful underwriting of these opportunities would see TX ERS committing a total of $650 million in FY 2021 to real estate, evenly split between core and non-core investments. More opportunities could present themselves before the fiscal year ends as the market and economy continue to recover.

Given the under allocation to real estate within the TX ERS program and Staff's identification of appropriate investment opportunities amidst turbulent market conditions, Meketa supports an increased level of investment activity for the remainder of FY 2021.