

COMMONWEALTH OF PENNSYLVANIA  
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

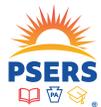
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Private Real Estate Policy

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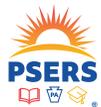


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### Revision History

Private Real Estate Policy Established	March 6, 2020
Policy Revised	March 5, 2021
Policy Revised	March 15, 2022



## **I. SCOPE**

The Private Real Estate Policy (“Policy”) applies to investments in the Private Real Estate asset class (the “Portfolio”) within the Pennsylvania Public School Employees’ Retirement System (“PSERS”) Defined Benefit Fund (the “Fund”).

## **II. PURPOSE**

This Policy provides a broad strategic investment framework for managing investments in the Portfolio. The Non-Traditional Investments Due Diligence Policy provides the key components of the underwriting (due diligence) process.

## **III. ROLES AND RESPONSIBILITIES**

Roles and Responsibilities related to this Policy are identified within PSERS’ Investment Policy Statement (“IPS”).

## **IV. INVESTMENT PHILOSOPHY**

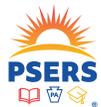
PSERS seeks to diversify its assets by providing exposure to private investments as part of the overall investable universe. Additionally, when compared to other investable opportunities, private investments are intended to provide exposure to higher potential returns, stronger investor rights and protections, and better alignment of interests.

The Portfolio seeks to provide current income, appreciation, a potential hedge against inflation, and serves as a diversifier to the overall portfolio. The Portfolio also provides access to investment opportunities not available in the publicly traded real estate markets.

This Portfolio targets risk-adjusted returns in excess of its benchmark, net of fees, over a full market cycle. The benchmark is identified within the IPS.

To maintain diversification within the Portfolio, PSERS pursues a global investment strategy that incorporates various investment strategies, sectors, and investment vehicles across the risk spectrum pursuant to the strategic asset allocation set forth in the IPS.

Investments shall be diversified across fund size, sector, strategy, geography, and vintage year. This will be implemented through primary and secondary investments in closed-end funds, open-end funds, co-investments, secondaries, separate accounts, joint ventures, partnerships, limited liability companies, operating companies, and direct investments.



## V. ALLOCATION

Allocation is a critical driver for the long-term success of PSERS. Given the long-term nature of this Portfolio, commitment pacing and manager selection have heightened importance as tools to manage the allocation.

Long-term asset allocation targets have been developed with the assistance of PSERS' Investment Consultants and are detailed in the IPS.

The Portfolio can be segmented by strategy as outlined below:

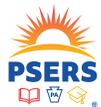
<b>Core</b>	<ul style="list-style-type: none"> <li>• Stabilized, income-producing properties typically located in primary markets</li> <li>• Returns primarily driven by current income, with modest appreciation</li> <li>• Higher levels of occupancy</li> <li>• Lower levels of leverage (up to 50%)</li> </ul>
<b>Value-Add</b>	<ul style="list-style-type: none"> <li>• Properties in need of renovation or repositioning</li> <li>• Returns split between current income and appreciation</li> <li>• Lower levels of occupancy</li> <li>• Moderate levels of leverage (typically 50% to 75%)</li> </ul>
<b>Opportunistic</b>	<ul style="list-style-type: none"> <li>• <b>Ground up development, distressed situations, or properties requiring major repositioning</b></li> <li>• <b>Returns primarily driven by appreciation, with modest levels of current income</b></li> <li>• <b>Varying levels of occupancy</b></li> <li>• <b>Higher levels of leverage (up to 85%)</b></li> </ul>
<b>Agriculture</b>	<ul style="list-style-type: none"> <li>• <b>High-quality agricultural land assets in primary farming regions</b></li> <li>• <b>Returns primarily driven by current income, with modest appreciation</b></li> <li>• <b>Strategies may include permanent and annual crops</b></li> <li>• <b>Leverage up to 75%</b></li> </ul>

## VI. PERMISSIBLE INSTRUMENTS

### A. Investment Types

This Policy authorizes commitments to investment vehicles, including, but not limited to, funds, partnerships, co-investments, secondaries, separate accounts, joint ventures, limited liability companies, private REITs and operating companies (collectively "Investments").

Investments may be considered throughout the entire capital structure. Notwithstanding Direct Investments (as defined in Section VI.C.), PSERS will only consider investment structures that seek to provide limited liability to PSERS, limiting PSERS' potential losses to the amount committed plus reasonable, normal investment expenses.



All investment structures must be reviewed by PSERS' legal counsel and provide the necessary legal protections acceptable to the Investment Office, PSERS' Office of Chief Counsel and the Office of Executive Director. Said structure should be commensurate with a given investment's objectives and risks.

## **B. Co-Investments and Secondary Investments**

Co-Investments: As of the date of this Policy, co-investments are only permitted to be entered into alongside existing External Managers in the Fund, except for co-investment opportunities located in Pennsylvania (PA Co-Investment Program). Co-investment opportunities located in Pennsylvania from existing External Manager relationships where PSERS and/or the assigned Investment Consultant is a limited partner will be handled in accordance with the Non-Traditional Investments Due Diligence Policy. However, a co-investment may still be held in the PSERS' portfolio if the fund that offered co-investment was sold as a part of a secondary sale.

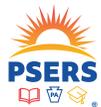
Secondary Investments: In a secondary transaction, an existing limited partner sells its limited partnership interest to a third-party buyer. PSERS is permitted to acquire additional/and or new limited partnership interests ("Secondary Investments") in funds managed by an existing External Manager.

The maximum cumulative allocation for co-investments and secondary Investments is \$500 million. The total investment in any single co-investment or secondary investment is limited to \$75 million.

## **C. Direct Investments**

The ownership structure of separate accounts, joint ventures, partnerships, limited liability companies, and real estate operating companies (collectively "Direct Investments") provides greater flexibility and control of the assets as compared to other Private Real Estate investment structures. A third-party asset manager shall be selected to assist in the acquisition, operations, monitoring, and disposition of each Direct Investment. Contracts for third-party asset and property managers should include a termination option, and the term of the contracts should consider the projected hold period of the investment. IOP will evaluate third-party asset and property managers at regular intervals during the life of the contract.

IOP shall review and authorize annual operating and capital budgets for all Direct Investments. Annual capital budgets in excess of \$25 million shall require Board approval.



The use of debt to finance asset purchases has the potential to enhance the investor's return on equity but also has the potential to magnify losses. Direct Investments in real estate are typically partially financed with debt. As described in the Private Real Estate strategies above, a specific strategy may utilize more or less leverage than another strategy.

Direct Investments will generally be appraised annually and in accordance with industry standard methodologies. The annual appraisal may be completed by the asset manager, a third-party appraisal firm, or some combination thereof. In certain scenarios (recent acquisition, planned disposition, long-term ground lease, asset in pre-development stage, etc.), an appraisal may be waived with approval from the Deputy CIO – Non-Traditional Investments. If an appraisal is waived, the investment will be held at the prior period valuation and adjusted for capitalized costs incurred during the period.

## **VII. PERFORMANCE OBJECTIVES**

The long-term objective for the Portfolio is to outperform its policy benchmark as set forth in the IPS, on a net-of-fees basis, over long-term time horizons through prudent investment commitment pacing, diversification, and External Manager selection.

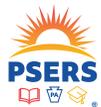
## **VIII. RISK MANAGEMENT**

Private investments do not easily lend themselves to traditional quantitative measures of risk, such as standard deviation and benchmark Tracking Error. Rather, risk is managed through a combination of quantitative and qualitative techniques. The following sections identify certain significant risks of Private investments and their methods of control.

### **A. Liquidity Risk**

Private investments typically have extended holding periods. Early divestment, if feasible, may result in a sale at a significant discount to fair market value. Therefore, these investments are deemed to be illiquid.

PSERS' overall liquidity risk is managed by the Board during the Strategic Asset Allocation process. Liquidity risk in this Portfolio is managed via the annual pacing plan. This plan seeks to achieve the target allocation by balancing anticipated contributions and distributions from existing investments with future capital deployment. The annual pacing plan may be adjusted intra-year to reflect updated expectations around contributions, distributions, and/or future capital deployment activity.



Open-end funds generally offer quarterly liquidity in their fund documents; however, requests for redemptions go into a queue and are not always honored on a quarterly basis. Redemptions only take place when there is available cash flow. Investment Managers are typically not required to sell assets to meet redemption requests.

## **B. Blind Pool Risk**

Capital commitments are typically made into closed-end funds. Most, and in some instances all, of the investments to be made by the Investment Manager within a closed-end limited partnership structure are unknown at the time PSERS commits to invest in the partnership. When PSERS invests into blind pools, due diligence is focused on evaluating numerous aspects of the investment opportunity including, but not limited to: 1) Investment Manager track record, 2) firm capabilities, and 3) market opportunities.

## **C. Vintage Year Risk**

A vintage year refers to the earlier of a fund's first cash flow date or the first investment made by a fund. Irregular annual capital commitments should be minimized as it may lead to over- or under-concentration of investments in certain vintage years.

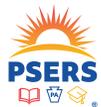
Vintage year risk is managed via the annual pacing plan, as more fully described in the Liquidity Risk section.

## **D. Geographic and Sector Concentration**

Over-concentration to any particular geography or sector can expose the portfolio to unintended macro-level risks. As such, IOP strives to diversify the investments across geographies and sectors. Geographic and sector concentration risk are considered during the due diligence process (see Non-Traditional Investments Due Diligence Policy).

## **E. Currency Risk**

Investments may be denominated in foreign currencies. Significant movements in foreign currency values, relative to the U.S. Dollar ("USD"), may impact a portfolio's reported returns, which are denominated in USD. Currency risk is often impractical to hedge at the investment level; however, it can be managed by IOP in accordance with the Currency Hedging Policy.



## **F. Manager Risk**

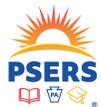
External Manager exposure risk typically manifests within Private assets in the following ways: (a) the size of PSERS' commitment to a specific partnership or fund investment; (b) open-ended, or evergreen structures where IOP have discretion to increase or decrease allocation and (c) PSERS' exposure to any one External Manager or firm. These risks are controlled as follows:

- a. Partnership or fund investment exposure is controlled by limiting the commitment size to a specific investment partnership. The maximum commitment to a partnership is limited to the lesser of 30% of an expected fund size or 1.0% of the Total Fund Economic Exposure, as defined in the Leverage Policy, unless otherwise approved by the Board.
- b. The allocation to a single active External Manager mandate in an open-ended structure is limited to 1.0% of the Total Fund's Economic Exposure, as defined in the Leverage Policy. The CIO shall have discretion on the timing of reducing any External Manager portfolio exceeding the limit. However, the CIO is not permitted to allocate additional exposure to those portfolios currently above the limit unless otherwise approved by the Board.
- c. Within the Portfolio, PSERS' maximum total exposure (defined as net asset value plus unfunded commitments) to all partnerships and other investment vehicles sponsored by a particular External Manager or firm, within the asset class, is limited to 3.0% of the Total Fund's Economic Exposure, as defined in the Leverage Policy, unless otherwise approved by the Board.

## **G. Leverage Risk**

External Managers may finance a portion of their asset purchases with debt. Leverage constraints are typically identified in the governing documents at the underlying investment- and fund-levels. The use of debt to finance asset purchases has the potential to enhance the asset's return on equity but also has the potential to magnify losses. PSERS seeks to invest with External Managers that have demonstrated the prudent use of leverage. Monitoring leverage risk includes scrutiny over External Managers' usage of subscription facilities.

Leverage Risk on Direct Investments are discussed in section VI. C. above.



## **H. Valuation Risk**

Private assets are typically illiquid and are not traded frequently, or in many cases not traded at all. As a result of a lack of observable inputs of trading activity, a reliable market price of such investments may not be available, and consequently a fair value of these assets cannot be determined by readily observable inputs. In such cases, assets may be valued by the External Manager, third-party appraisers or some combination thereof. PSERS strives for External Managers that have a formal Valuation Policy.

Valuation Risk on Direct Investments are discussed in section VI. C. above.

## **I. Counterparty Risk**

The use of prime brokers, leverage providers, servicers, custodians, derivatives, and other third-party service providers introduces counterparty risk in the Portfolio. If counterparties are not able to meet their obligations, losses may occur. IOP, in conjunction with the Investment Consultant, will review this risk through operational due diligence reviews of the Private Investment Managers.

## **J. Legal Risk**

Private investments have unique characteristics which require legal expertise. All investment structures must be reviewed by PSERS' legal counsel and provide the necessary legal protections acceptable to the Investment Office, PSERS' Office of Chief Counsel, and the Office of Executive Director. Structures should be commensurate with a given investment's objectives and risks.

## **IX. MONITORING AND REPORTING**

See Monitoring and Reporting section of the IPS.