



# Real Estate Strategy Semi-Annual Report (Open Session)

Prepared for California State Teachers'  
Retirement System

As of Q3 2024

**RFA**  
RCLCO FUND ADVISORS

The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.

February 14, 2025



## CONTENTS

Goals and Objectives.....	3
Performance.....	4
Appendix: Key Market Trends.....	12
Disclaimers.....	18

## REPORT PREPARED BY:

Taylor Mammen, Chief Executive Officer

Ben Maslan, Managing Director

Erik Ctvrtlik, Senior Associate

Ethan Michalowski, Associate



The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.

# CalSTRS Q3 2024 Open Session Report

## Goals and Objectives

The objective of this semi-annual report is to provide the Committee with an evaluation of the real estate portfolio's alignment with CalSTRS' established goals and policies and the investment opportunities presented by property and capital markets.

To accomplish the above objective, we reviewed the CalSTRS portfolio, policies and limitations, previous recommendations and activities, as well as current and forecasted economic, capital market, and property market conditions.

Current and long-term portfolio goals and objectives that the semi-annual report evaluates include:

- ▶ A real estate allocation target of 15% +/-5%;
- ▶ Target net return that exceeds the NCREIF NFI-ODCE Index;
- ▶ Provide stable income, a hedge against inflation, and improved diversification to the overall CalSTRS Investment Portfolio;
- ▶ Allocation based on property stage – stable and value creation (lease-up/reposition and construction) – to maintain an appropriate risk profile; and
- ▶ An appropriate level of leverage, with a loan-to-value (LTV) limit of 50% for the control portfolio and 65% for the non-control portfolio.

# Performance

## As of Q3 2024

- ▶ The real estate portfolio has outperformed its target return benchmark over the last decade and outperformed inflation over the 10-year time horizon. The portfolio has generated a 10-year net TWR of 6.4%, outperforming the ODCE benchmark return by ~120 basis points. The portfolio has outperformed the ODCE benchmark over the last five years by ~130 basis points, delivering a net TWR of 3.4%.
- ▶ The portfolio has generated net TWRs of -8.7% and -0.3% over the 1- and 3-year time horizons. The portfolio underperformed the ODCE benchmark return of -8.0% over the past year by ~70 basis points, while outperforming the 3-year ODCE benchmark return of -1.0% by ~70 basis points. Given the legacy investment's small percentage of portfolio GAV, the 1- and 3-year performance is relatively unchanged when excluding legacy investments.<sup>1</sup>

### Portfolio Performance<sup>2,3</sup> Net Time Weighted Returns

	Including Legacy				Excluding Legacy			
	1 Yr	3 Yr	5 Yr	10 Yr	1 Yr	3 Yr	5 Yr	10 Yr
Core	-8.6%	-0.5%	2.9%	6.4%	-8.6%	-0.5%	2.9%	6.4%
Value Add	-13.4%	-4.0%	1.7%	7.2%	-13.4%	-4.0%	1.7%	7.4%
Opportunistic	-7.0%	2.1%	5.6%	6.5%	-7.1%	2.5%	6.7%	9.2%
<b>Total</b>	<b>-8.7%</b>	<b>-0.3%</b>	<b>3.4%</b>	<b>6.4%</b>	<b>-8.7%</b>	<b>-0.3%</b>	<b>3.5%</b>	<b>7.1%</b>
Target Return (ODCE)	<b>-8.0%</b>	<b>-1.0%</b>	<b>2.1%</b>	<b>5.2%</b>	<b>-8.0%</b>	<b>-1.0%</b>	<b>2.1%</b>	<b>5.2%</b>
Inflation (CPI)	2.4%	4.8%	4.2%	2.9%	2.4%	4.8%	4.2%	2.9%

<sup>1</sup>Legacy refers to historical investments made by CalSTRS, when operating under previous investment strategies and guidelines. These investments no longer align with current strategic objectives.

<sup>2</sup>The Core portfolio has a net target return benchmarked to the ODCE, while the Value Add and Opportunistic portfolios have net target returns of 50 basis points and 300 basis points over the ODCE, respectively.

<sup>3</sup>Interest expense from CalSTRS' Master Credit Facilities Program was misclassified in prior reporting from 2020 to 2023, and historical returns have been adjusted accordingly. This misclassification resulted in reported Real Estate Returns 23-53 bps above actual returns.

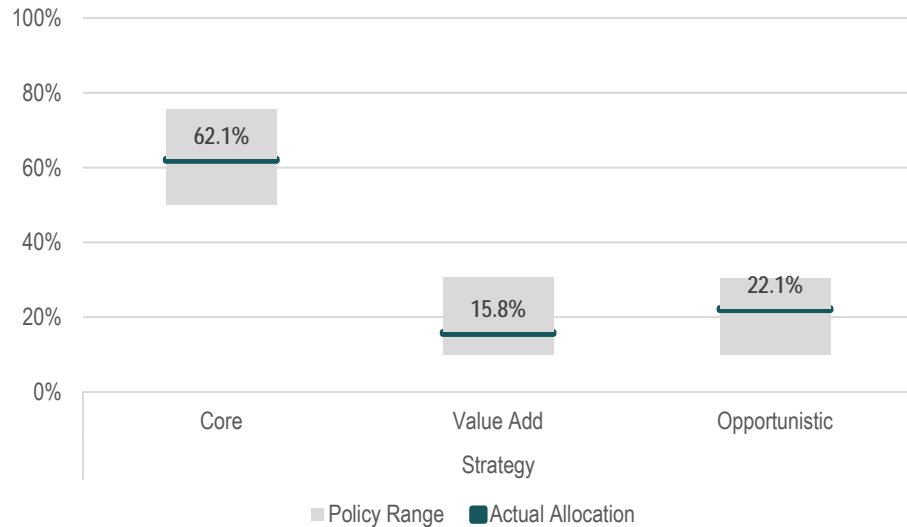
Source: State Street, PrivateEdge, NCREIF, FRED

# Funding Status and Compliance

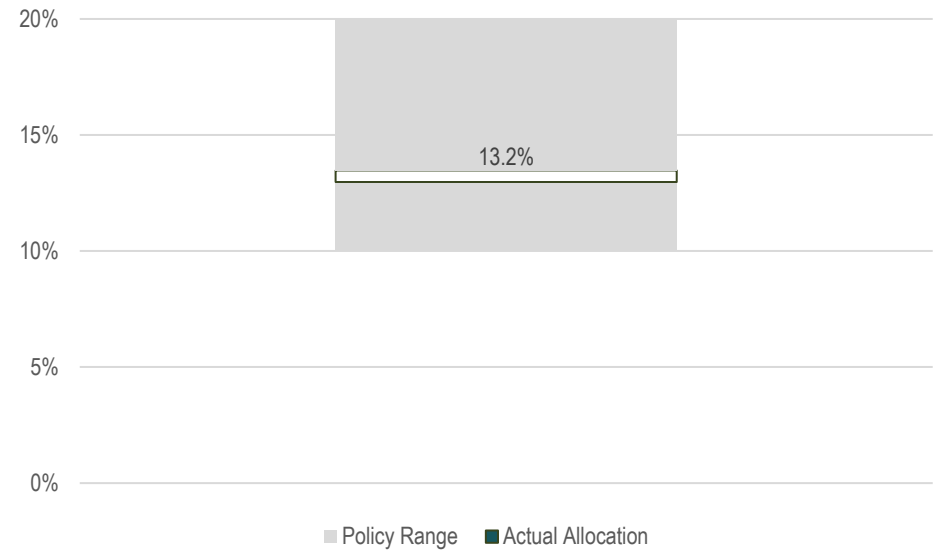
## As of Q3 2024

- ▶ The portfolio had a net asset value (NAV) of ~\$46.5B as of Q3 2024, equating to 13.2% of the total fund, which is below the target allocation of 15%, but within the permitted range of +/- 5%.
- ▶ The portfolio is compliant with the targeted allocation by investment strategy and is within the permitted leverage limits for the control and non-control<sup>1</sup> portfolios of 50% and 65%, respectively.

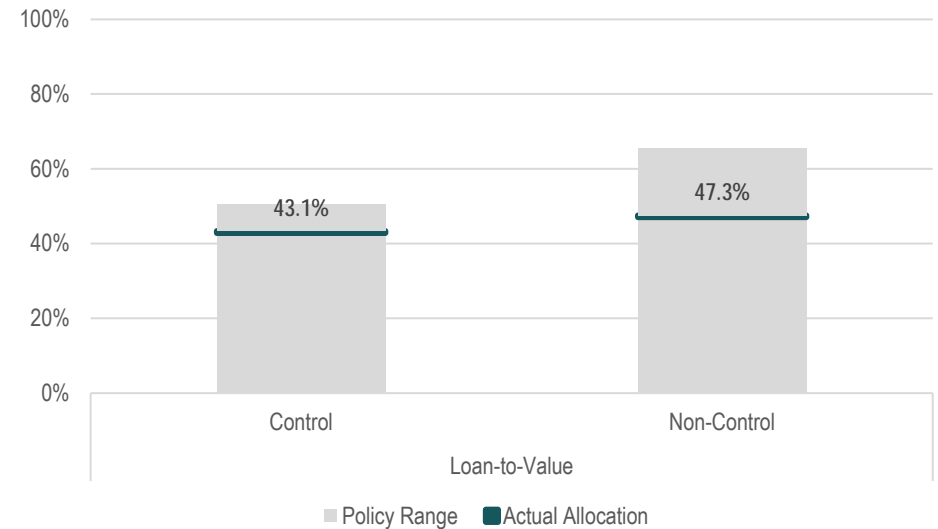
Compliance - Strategy<sup>1,2</sup>



Compliance - Allocation



Compliance - Leverage



The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.

<sup>1</sup>Control portfolios are those which CalSTRS maintains control over acquisitions, dispositions, and/or financing or has high liquidity in normal market conditions. In non-control portfolios, CalSTRS does not retain such discretion.

<sup>2</sup>Percentages do not account for the portion of Legacy assets. Public REITs included with Core.

Source: State Street

# Current Portfolio Summary

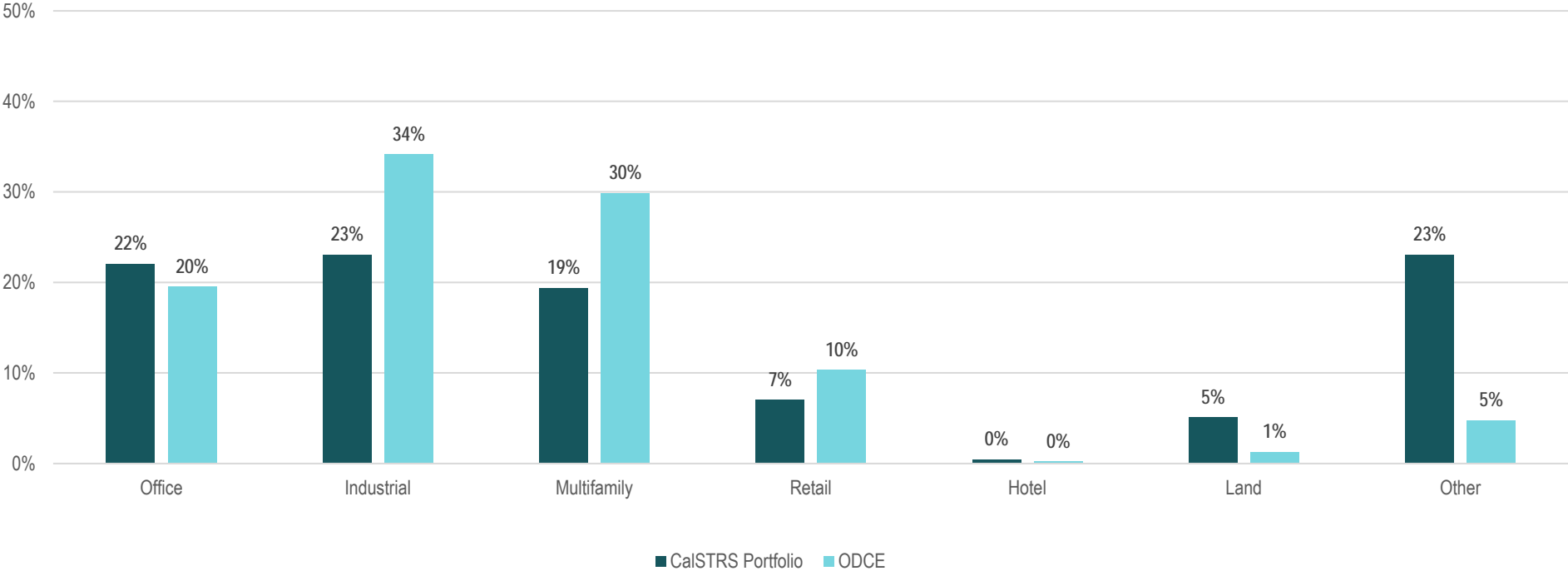
- ▶ The portfolio had a net asset value (NAV) of ~\$46.5B as of Q3 2024, equating to 13.2% of the total fund, below the target allocation of 15% but within the permitted range.
- ▶ Approximately 85% of the portfolio is invested in the United States.
- ▶ The portfolio continues to be underweight industrial and multifamily by 11% and 10%, respectively. The allocation to office properties (including life science properties) decreased by 261 basis points over the past six months and remains 2.5% overweight relative to the benchmark. This decrease in allocation is due to a combination of commitments by CalSTRS outside of the office sector, continued devaluation of office properties across the portfolio, and the sale of office assts. Excluding life science office properties, the weighting to office is in line with the benchmark.
- ▶ Total real estate debt was \$36.8B as of Q3 2024, an increase of nearly \$1.8B since Q1 2024. The LTV of the portfolio increased by 134 basis points from ~43% in Q1 2024 to ~44% in Q3 2024.
- ▶ The LTV of the control<sup>1</sup> portfolio increased ~2% from 41% to 43% in Q3 2024, while the non-control LTV decreased 74 basis points to 47%. Broadly, leverage increased largely due to industry-wide valuation markdowns but is expected to normalize over time. Per the investment policy statement, the LTV is within the compliance limit of 50% and 65%, respectively.
- ▶ The allocation by risk profile is 62% Core, 16% Value Add, and 22% Opportunistic, excluding Legacy investments (which comprise less than 1% of the NAV).

# Portfolio Diversification

## Property Type vs. ODCE

- ▶ The real estate portfolio remains overweight to office investments relative to the benchmark when including life science properties. Excluding life science properties, the office allocation is in line with the benchmark.
- ▶ The portfolio continues to be underweight to industrial and multifamily by 11% and 10%, respectively.
- ▶ The portfolio has a 10% allocation to real estate debt investments, which is the largest overweight allocation in the “other” category, given ODCE funds have no allocation to real estate debt investments.

Total Portfolio - Property Type Diversification<sup>1</sup>



*Note: ODCE and CalSTRS' weights based on gross real estate value.*

*<sup>1</sup>“Other” property type category is made up of the following property types in descending order by percentage: Debt, Mixed Use, Manufactured Housing, Senior Living, Self Storage, Hospitality, Healthcare, Diversified, Infrastructure, Private Equity Real Estate, REITs, and Securities.*

*Source: State Street, CalSTRS*



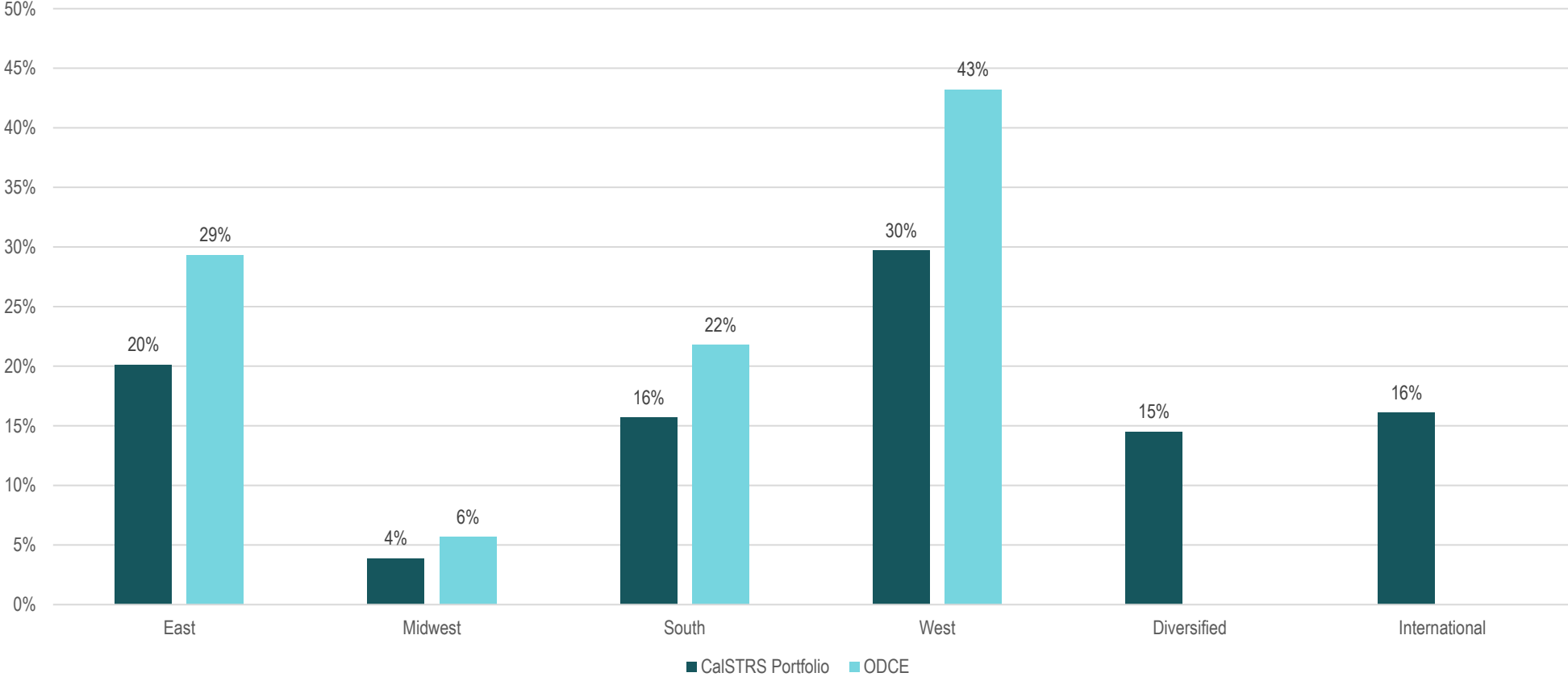
The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.

# Portfolio Diversification

## Geographic Allocation vs. ODCE

- ▶ Approximately 84% of the portfolio is invested in the United States. The benchmark has no International allocation.
- ▶ Excluding International and Diversified, the West geography is the only region outside of +/-10% of the benchmark regional weights.
- ▶ Approximately 31% of the portfolio is invested in diversified vehicles or outside of the United States.<sup>1</sup>

Total Portfolio - Geographic Diversification



Note: ODCE and CalSTRS' weights based on gross real estate value.

<sup>1</sup> "Diversified" geographic category represents the following locations, in descending order by percentage, Diversified, US Diversified, Global, Other, and Various.

Source: State Street, CalSTRS



The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.

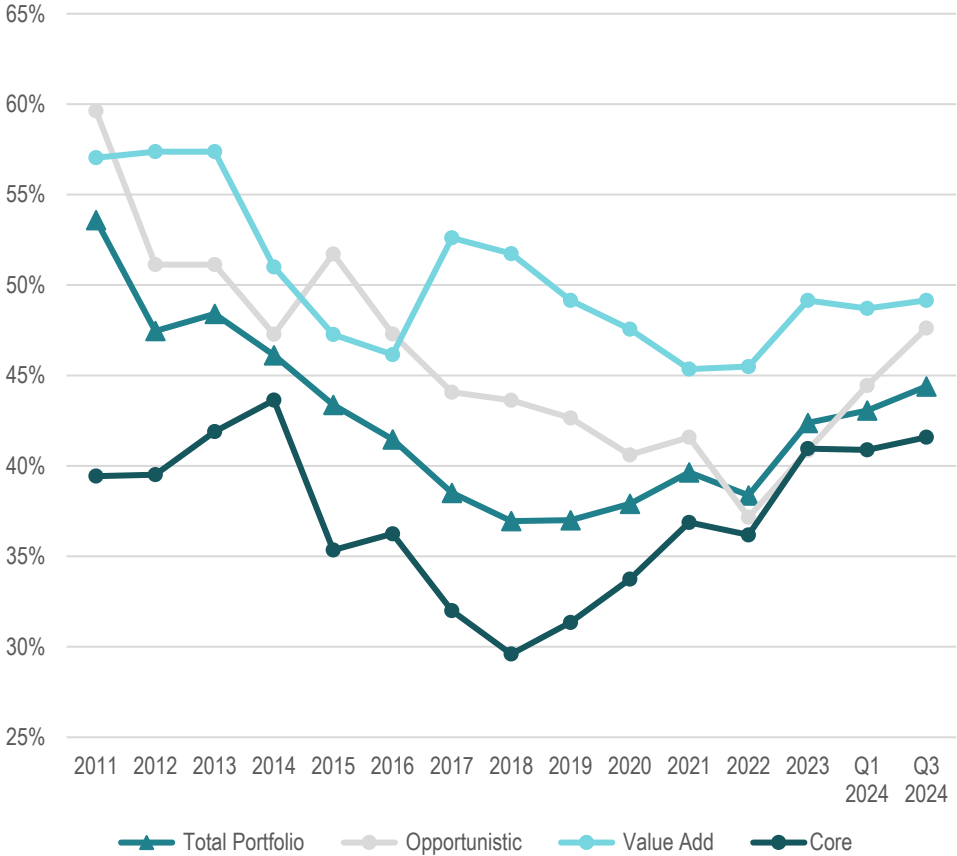


# Total Portfolio Leverage

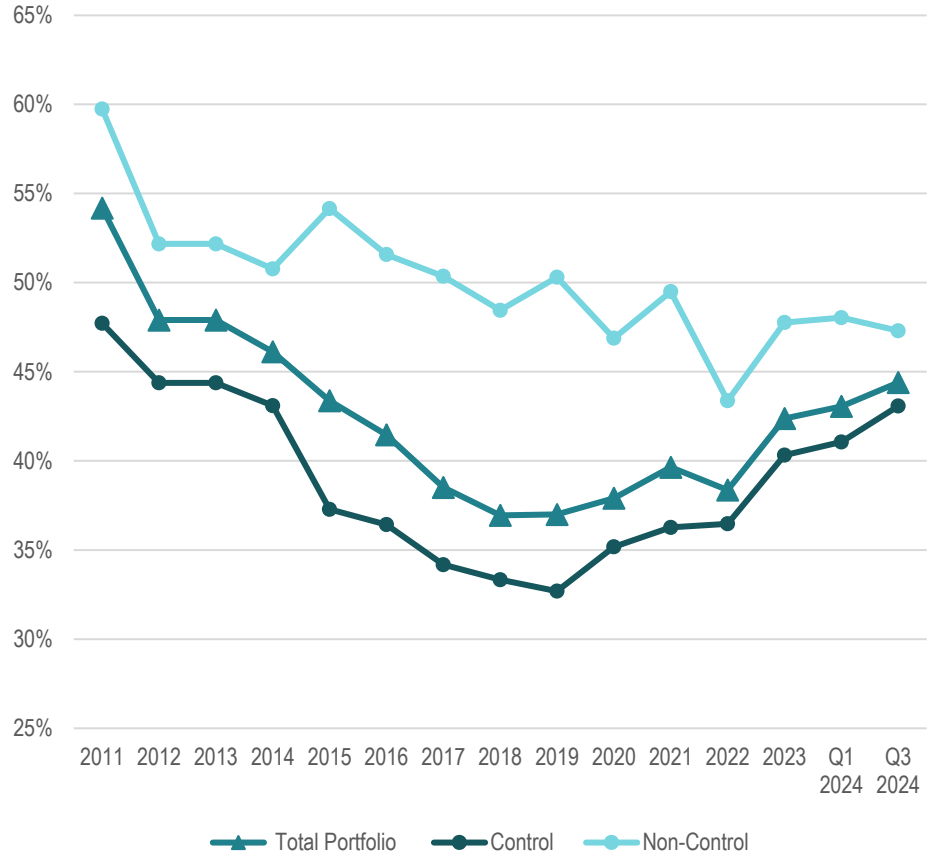
## By Risk Profile and Control

- ▶ CalSTRS' real estate debt was \$36.8B as of Q3 2024, an increase of nearly \$1.8B since Q1 2024. The LTV of the portfolio increased by 134 basis points from ~43% in Q1 2024 to ~44% in Q3 2024.
- ▶ The LTV of the control<sup>1</sup> portfolio increased by ~2% from ~41% to ~43% in Q3 2024, while the non-control LTV decreased by around 74 basis points to 47%.

Portfolio Leverage – By Risk Profile



Portfolio Leverage – By Control



The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.

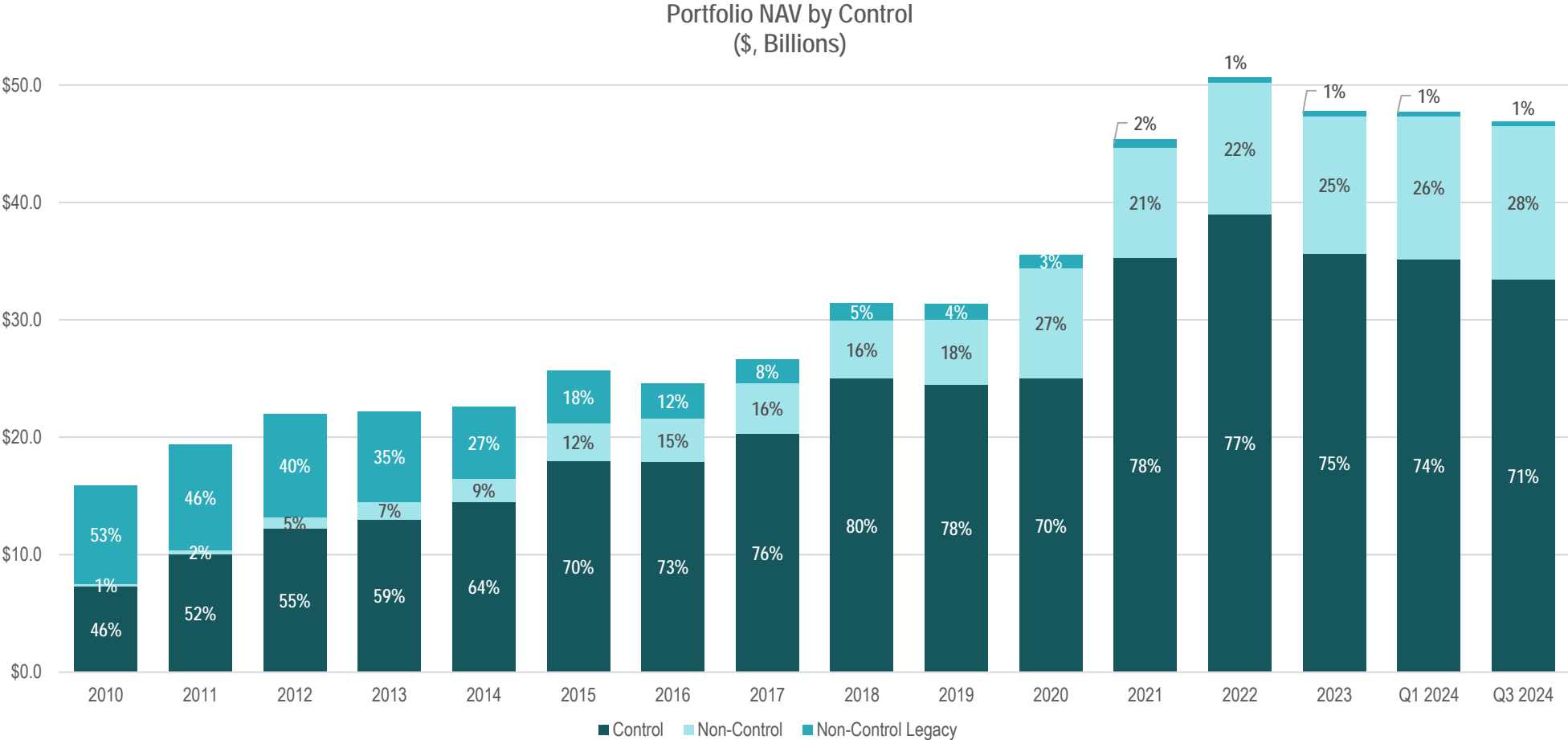
<sup>1</sup> Control investments are those which CalSTRS maintains discretion over acquisitions, dispositions, and financing, or has high liquidity in normal market conditions.

Source: CalSTRS, State Street

# Real Estate Portfolio Growth

## Portfolio NAV by Control

- ▶ CalSTRS' real estate portfolio NAV has decreased by \$0.9B in the past six months to \$46.5B (as of Q3 2024), largely a factor of industry-wide valuation markdowns. The control<sup>1</sup> portfolio is 71% of the NAV as of Q3 2024.
- ▶ Legacy investments represent less than \$0.4B of the NAV, or just under 1% of the portfolio.



<sup>1</sup>Control investments are those which CalSTRS maintains discretion over acquisitions, dispositions, and financing, or has high liquidity in normal market conditions.

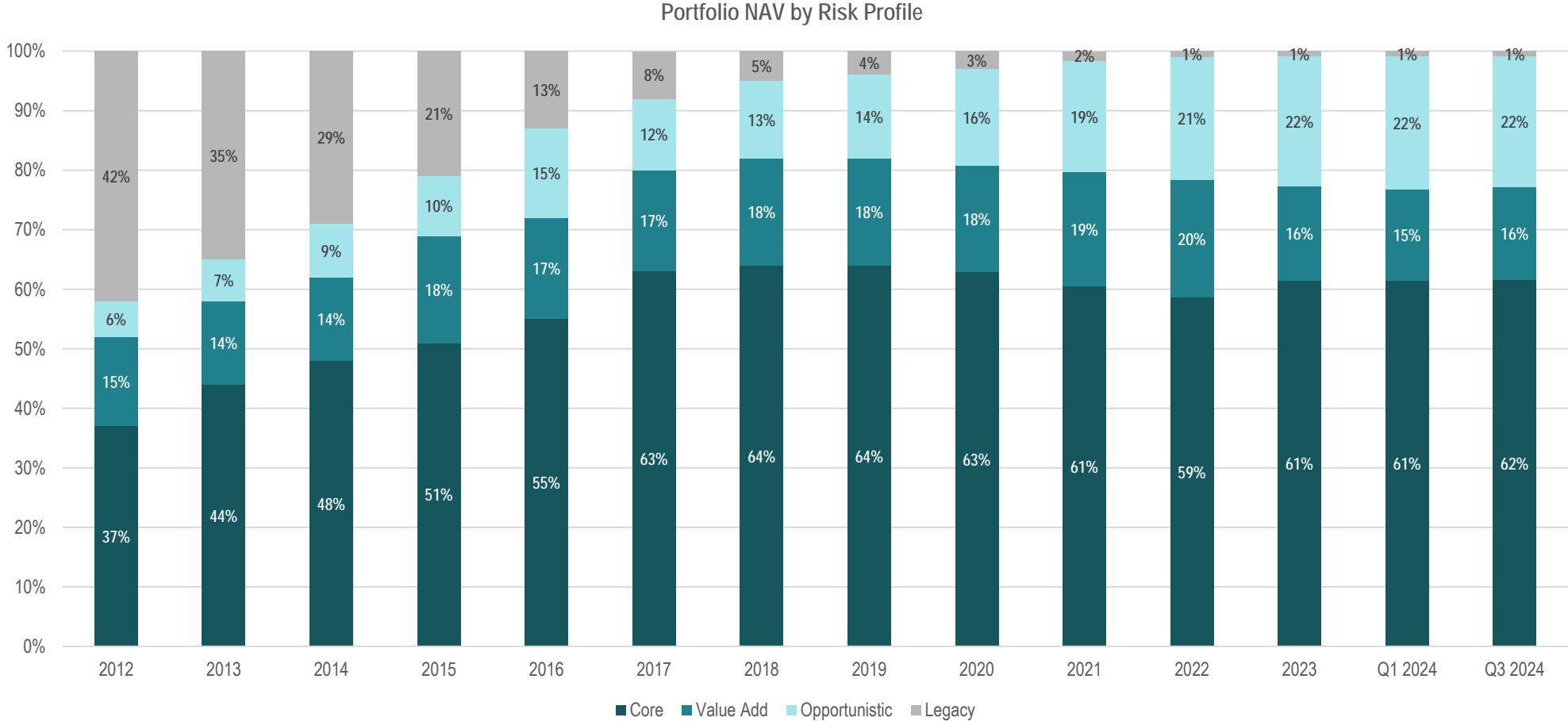
Note: Weights based on percentage of CalSTRS' net asset value. REITs included in Core.

Source: CalSTRS, State Street

# Portfolio Allocation

## By Risk Profile

- ▶ Allocations by risk profile have remained relatively constant over the last six months.
- ▶ The allocation to Opportunistic investments has decreased by 0.4%, while Core and Value-Add allocations both increased by 0.2% since Q1 2024.



The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.

*Weights based on percentage of CalSTRS' net asset value. REITs included in Core. Source: CalSTRS, State Street*

## APPENDIX: KEY MARKET TRENDS

---

# U.S. Real Estate Summary

## As of Q4 2024

- ▶ Real estate fundamentals are expected to recover in 2025 after facing pressures from oversupply in recent years.
  - » Industrial demand slowed in 2024 but rent growth should average ~4% annually through 2028.
  - » Apartment rent growth should trend up from flat to 2-3% through 2028 as excess supply tapers.
  - » Neighborhood retail rent growth is projected average 2-3% over the next 4 years as new supply is minimal.
  - » Office rents are projected to fall 0-1% annually, and vacancies will approach 20% by 2028.
  - » Specialty property types such as data centers and senior housing should see above-inflation rent growth.
- ▶ Real estate capital markets will likely improve in 2025, building on a recovery in 2H 2024. CMBS issuance increased to over \$100B for 2024 as rates moderated. Institutions continue to be constrained by little capital being returned.
- ▶ Real estate valuations will likely begin recovering in 2025. Preliminary appreciation returns for the NFI-ODCE index turned positive in 2024 Q4 for the first time in over two years.
- ▶ Prices have mostly reset at 20-40% below peak, while NPI appraised values are down 19% since peak (35% for office).
  - » Prices are below replacement cost in most sectors, creating buying opportunities, but sellers are reluctant to transact on better quality properties. Widespread foreclosures/distress selling is unlikely, except for office and regional malls.
  - » Senior and mezzanine debt and rescue capital continues to be attractive.
  - » Development opportunities will be very limited until rents catch up with costs, with a few exceptions (e.g., data centers, build-to-rent single-family).
- ▶ Sunbelt markets will likely continue to attract younger residents, driving strong real estate demand for years to come. Supply responses may restrain rent growth in Sunbelt markets, but development/build-to-core opportunities will be attractive.
- ▶ Weak office markets in Gateway cities will create ongoing problems with revenue and CBD vitality, although we believe that urban residential markets within diversified economies will continue to thrive (e.g., Los Angeles and New York).

# Property Markets Snapshot and Outlook

## As of Q4 2024

### Multifamily

- Vacancy increased over the last year and is expected to remain above the long-term average despite declining through 2027.
- Rent growth was slow over the last year but is forecast to rebound above the long-term average through 2027.

### Office

- Office vacancy climbed over the past year, reaching a record high of 15.5%. Further deterioration is predicted through 2027.
- Rent growth was slightly positive the past year but will likely remain low for the next three.

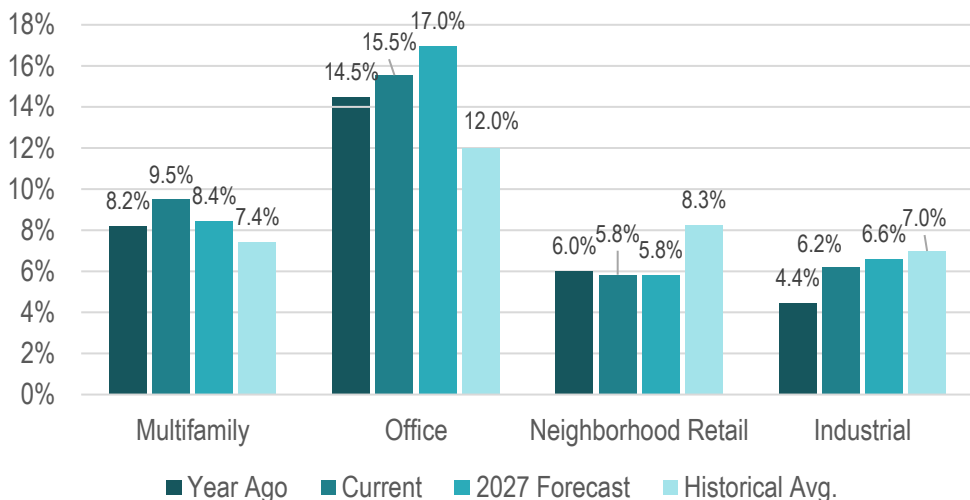
### Retail

- Neighborhood retail vacancy fell slightly over the past year. The current and forecast vacancy rates are well below the long-term average.
- Rents rose by 3.6% over the last year, and stable growth is forecast to persist, despite moderation.

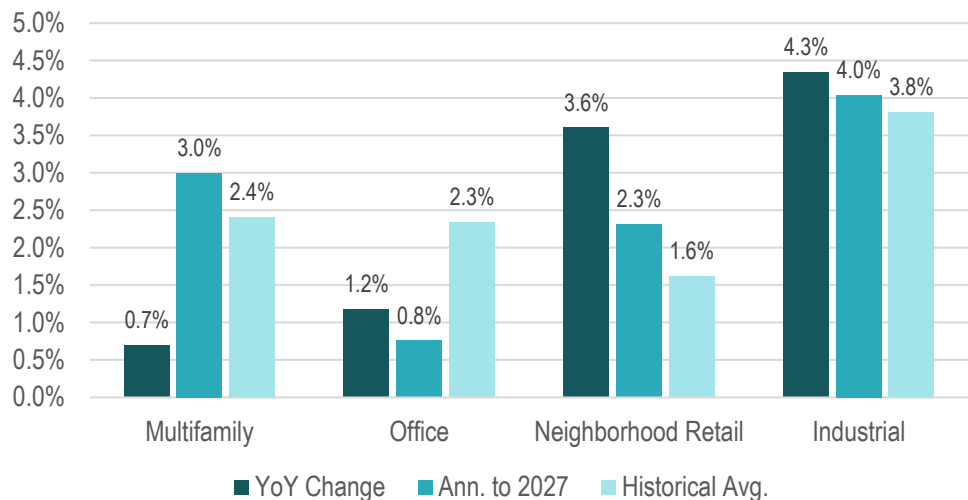
### Industrial

- Industrial vacancy rose over the past year but remained below the long-term average. Vacancy is expected to rise to near the long-term average through 2027.
- Rent growth led all property types over the past year and will likely do so over the next few years.

US Vacancy Rates

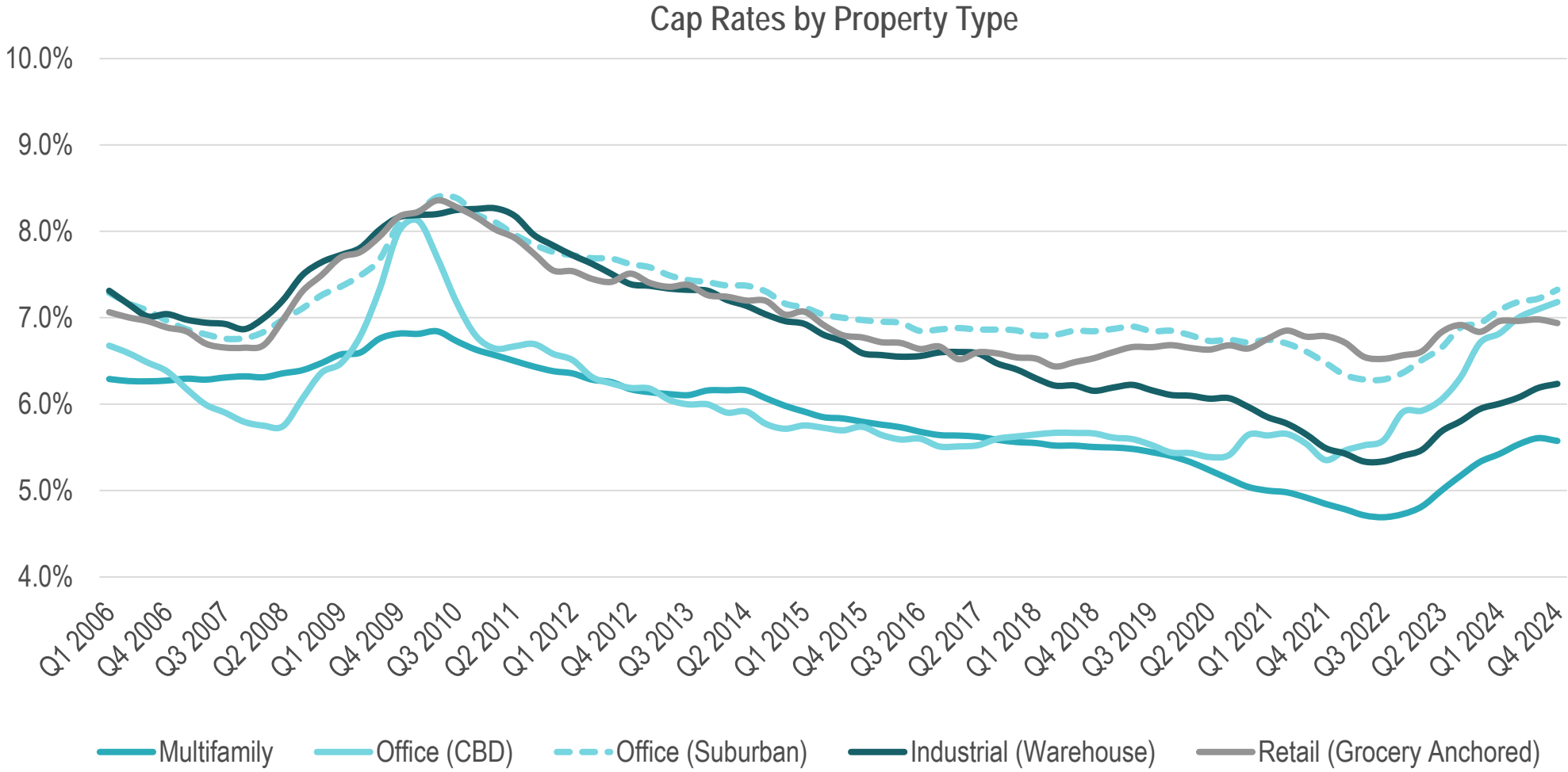


US Rent Growth



# Office Cap Rates Continued to Expand while Multifamily and Grocery Anchored Retail Rates Fell Slightly

Industrial Cap Rates Also Rose Slightly in Q4



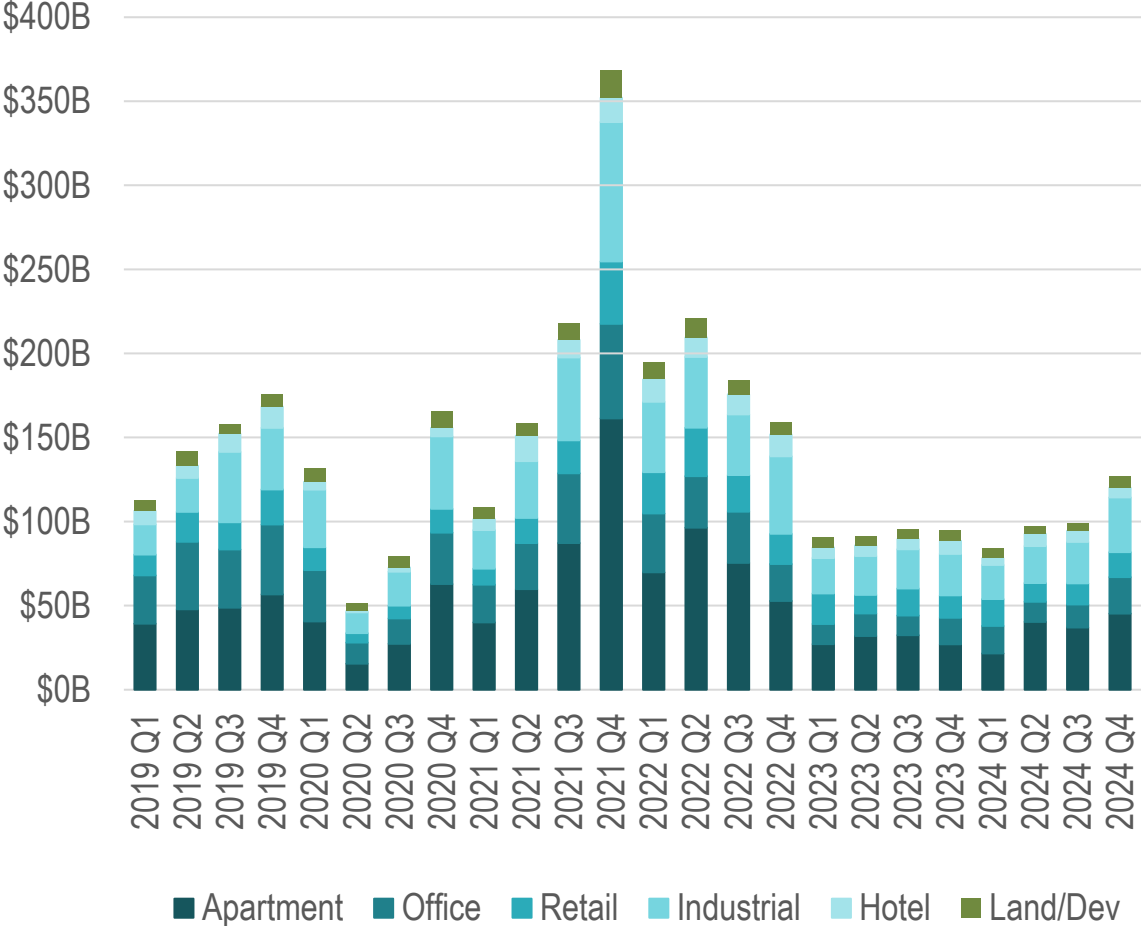
The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.

Source: MSCI

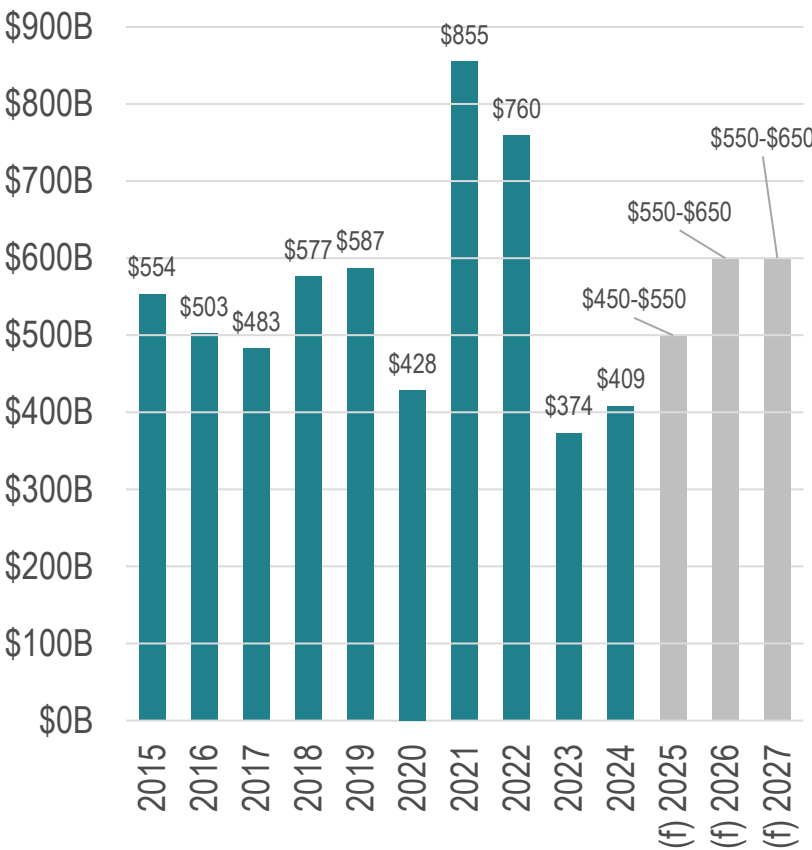
# Transaction Volume Climbed to \$127B in Q4

Investment Activity Is Expected to Continue Rising in 2025-26 as Markets Adjust to Repricing

Quarterly Transaction Volume



Annual Transaction Volume



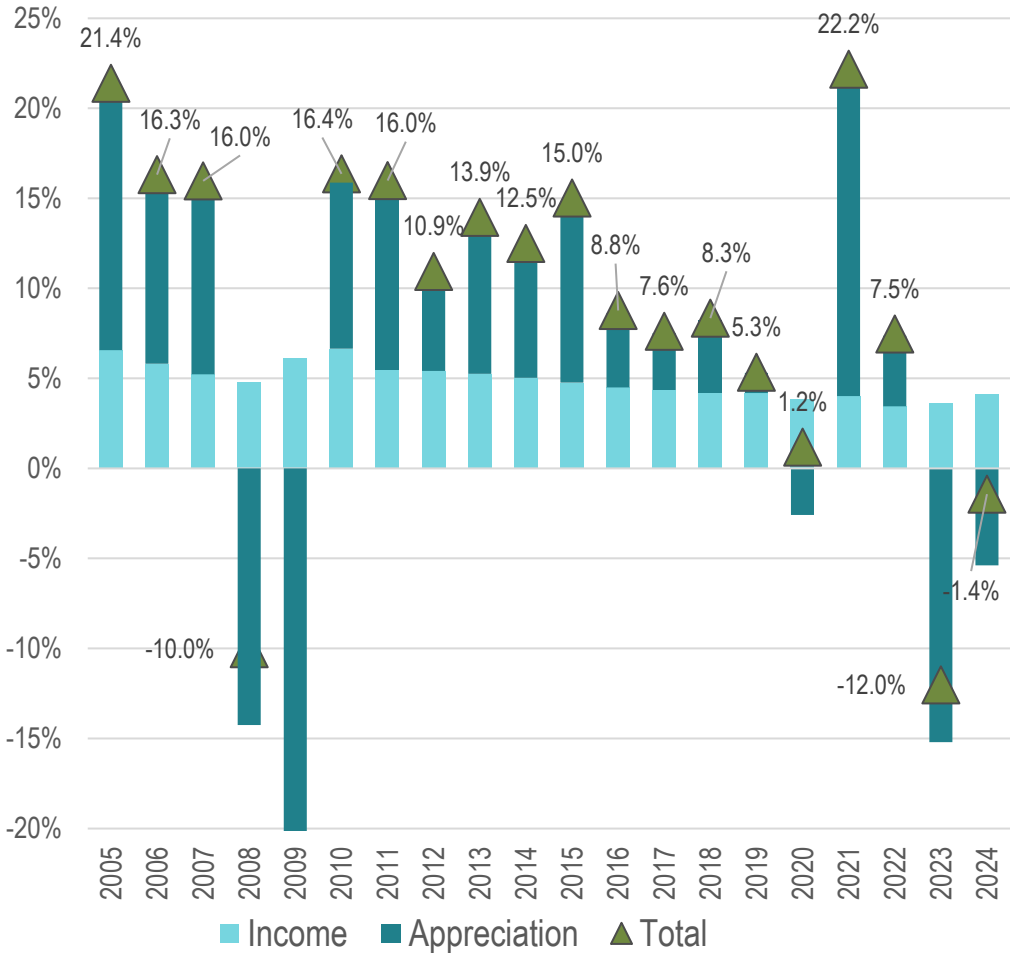
The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.



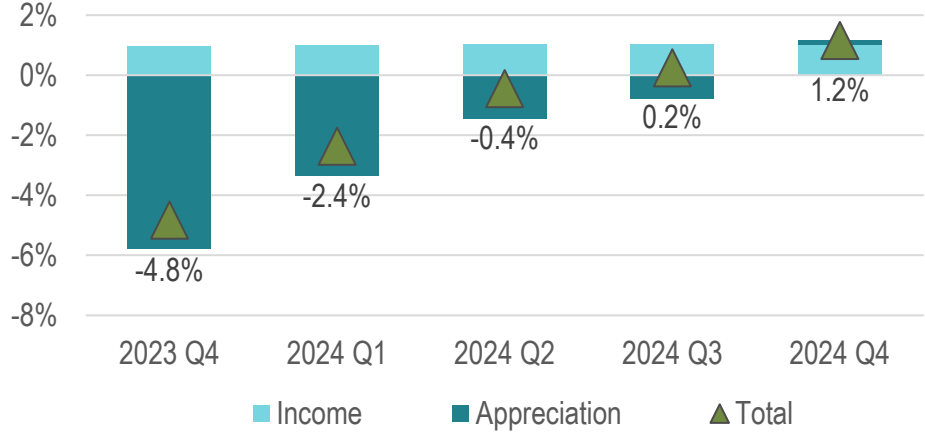
# Trailing 4Q ODCE Returns Improved Considerably in 2024

Most Property Type Returns Were Positive Over the Last Year; Only Office Remained Negative

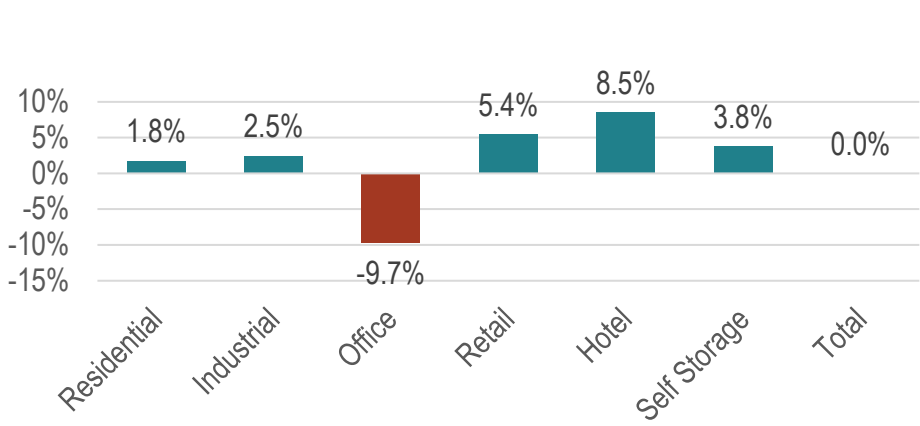
Annual ODCE Returns



Quarterly ODCE Returns



Rolling 4Q ODCE Return by Property Type



The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.

Note: Annual and quarterly returns are gross levered; property type returns are gross unlevered at ownership share. Source: NCREIF

# Disclaimers

## Critical Assumptions

Our analysis depends on the correctness and completeness of data available as of the date of this memo. The future performance of the global, national, and local economy and real estate market, and other factors similarly outside our control may vary. Given the fluid and dynamic nature of the economy and real estate markets, as well as the uncertainty surrounding particularly the near-term future, it is critical to monitor the economy and markets continuously. Stable and moderate growth patterns are historically not sustainable over extended periods of time; the economy is cyclical; and real estate markets are typically highly sensitive to business cycles. Further, it is very difficult to predict when an economic and real estate upturn will end.

Our analysis cannot predict unusual economic shocks on the national and/or local economy, potential benefits from major "booms" that may occur, or the residual impact on the real estate market and the competitive environment of such a shock or boom. Also, it is important to note that it is difficult to predict changing consumer and market psychology.

As such, we recommend the close monitoring of the economy and the marketplace, and updating this analysis as appropriate.

## General Limiting Conditions

Reasonable efforts have been made to ensure that the data contained in this study reflect accurate and timely information and are believed to be reliable and comprehensive. This study is based on estimates, assumptions, and other information developed by RCLCO Fund Advisors from its independent research effort and general knowledge of the industry. No responsibility is assumed for inaccuracies in reporting by any data source used in preparing or presenting this study. This memo is based on information that to our knowledge was current as of the date of this memo, and RCLCO Fund Advisors has not undertaken any update of its research effort since such date.



*Cover Images: North at Totem Lake Apartments,  
Kirkland, WA*

*Table of Contents Image: North at Totem Lake  
Apartments, Kirkland, WA*

**RFA**

**RCLCO FUND ADVISORS**

The information contained in this report is confidential, may be legally privileged, and is intended only for the use of California State Teachers' Retirement System.