



Mendocino County Employees' Retirement Association Real Estate Manager Structure

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Guiding Principles of Investment Structure

- **Active management offers the potential to add value over the index and can be complementary to passive management.**
 - Excess returns are more difficult to achieve in efficient markets such as large cap U.S. equity and U.S. fixed income
 - Potential for excess returns are compelling in small/mid cap US equity, non-US equity, emerging equity and non-US small cap equity
- **Well-diversified market-neutral exposure with no unintended biases**
 - Avoid overlapping mandates
 - May wish to purposefully add bias to small/mid cap U.S. equity and emerging markets equity for potential return enhancement



Guiding Principles of Investment Structure (cont'd)

- **Callan's overriding philosophy is to keep the structure as simple as possible**
- **Allocations to managers should be meaningful for the Plan**
- **The appropriate number of managers must balance style and relationship diversification with lower fees and more manageable monitoring**
- **Two primary influences on the appropriate number of managers**
 - Size of the allocation relative to the total Plan
 - The higher the allocation, the greater the desired manager diversification
- **Active versus passive**
 - Fewer managers may be suitable when the portfolio is managed passively.



Real Estate: A Definition

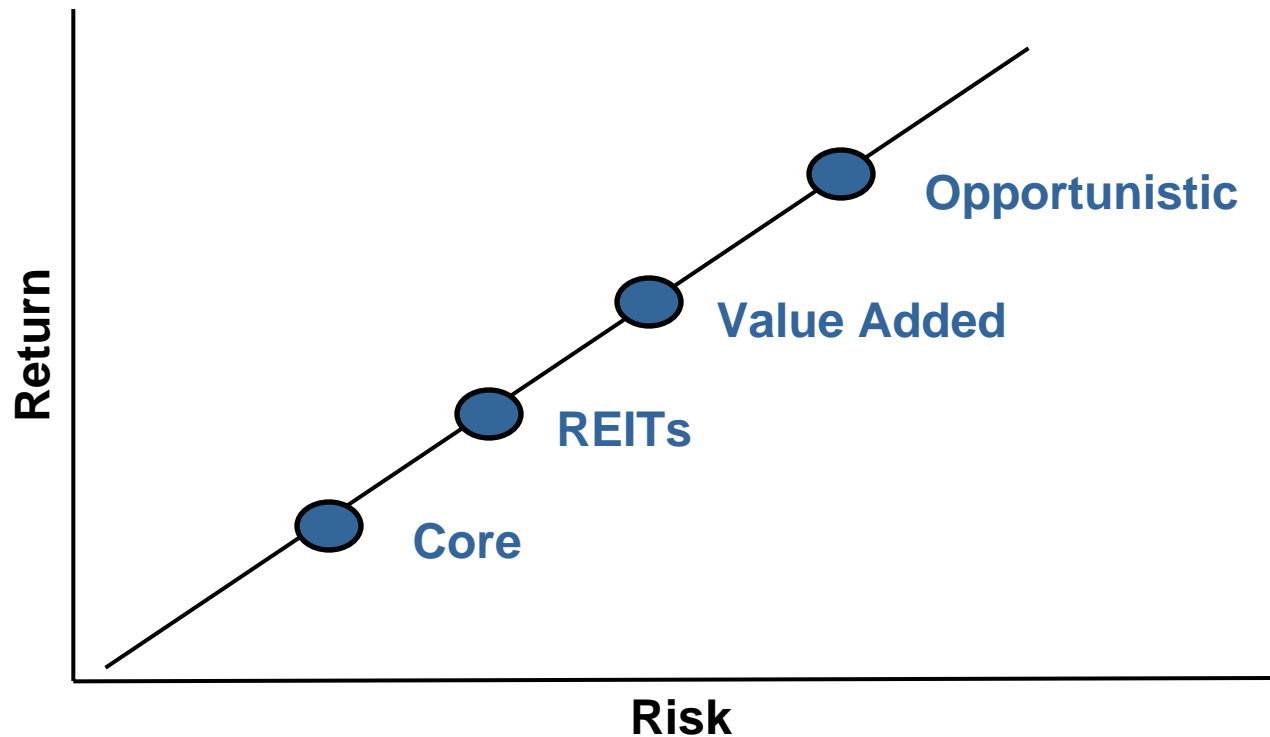
	Privately Traded	Publicly Traded
Equity	<p>Equity ownership in commercial real estate</p> <p>Includes: office, industrial, retail, multifamily and other specialty property types</p>	<p>Real Estate Securities</p> <p>Includes: REITs, Real Estate Operating Companies, Real Estate Development Companies, among others</p>
Debt	<p>Mortgage Loans</p> <p>Includes: Senior mortgages, mezzanine debt, among others</p>	<p>Mortgage-Backed Securities</p> <p>Includes: CMBS and CDOs (Typically held in bond portfolios)</p>

All strategies exist domestically and internationally



Implementation - Real Estate Strategies

Conceptual Return and Risk Associated with Different Investment Strategies





“Core” Real Estate Strategies

- **Most conservative equity real estate approach and most prevalent in institutional portfolios**
- **Existing properties with quality construction and design features, quality tenants and staggered lease schedules**
- **At least 80% leased upon purchase**
- **Predictable income and cash flows**
- **Located in economically diversified metropolitan areas**
- **Investment structures using all cash or limited leverage (less than 40%)**
- ***Two-thirds of the anticipated total return will be from income.***



“Value Added” Real Estate Strategies

- **Seeks a competitive income return with potential for capital appreciation**
- **Acquires properties and incorporates re-leasing, repositioning, and re-development strategies**
- **Once value has been created, the property is targeted for sale**
- **The strategy is typically accessed via closed-end commingled funds, but separate accounts and open-end funds are utilized, as well**
- **Leverage ranges from 40% to 75%**
- ***Anticipated one half of the total return will be from income and one half from appreciation.***



“Opportunistic” Real Estate Strategies

- **Return targets are higher than core and value added**
- **Leverage used to enhance returns (65%+)**
- **Incorporate various investment strategies**
- **Almost always accessed via closed-end commingled funds or co-investment opportunities with those funds**
- **Terms and fees similar to those of private equity funds**
- **Examples include: Global, International, Distressed Real Estate Portfolios, Mezzanine Debt, Convertible & Preferred Equity Investments, Commercial Development**
- ***Anticipated more than two-thirds of the total return will be derived from capital appreciation.***



Public Real Estate Securities

- **REITs = Real Estate Investment Trusts**
- **Publicly-traded real estate companies**
- **Daily liquidity**
- **Returns are highly correlated with the returns of small/mid cap value equities**
- **Access to property types not attainable in most separate accounts or commingled funds (e.g., Regional Malls, CBD Office, and Hotels)**
- **Enhanced diversification**
- **Increased volatility**
- **Lower fees**
- **Exposure to REITs through equity portfolios (Russell Indices and S&P 500).**



Global Real Estate Securities

- **Share the same characteristics of domestic REITs, but with added transparency hurdle**
- **Include real estate operating and development companies**
- **Major Asian country participants include Australia, Hong Kong, Japan, Singapore, and New Zealand**
- **North American representation is made up of the United States and Canada**
- **Major European country participants include France, Sweden, Netherlands, UK and Germany**
- **REIT legislation continues to spread globally**
- **Historical diversification and correlation benefits.**



Global vs. Domestic REITs

- **Global REITs offer an expanded opportunity set to diverging economic, country, company, market and life cycle exposures**
- **The Global REIT universe is expanding and legislation has recently been introduced or is under consideration in many new countries**
- **Global REITs provide low-cost exposure to international real estate**
- **Capital in-flows to global REITs have increased the size and quality of the global REIT universe**



Current MCERA Real Estate Structure

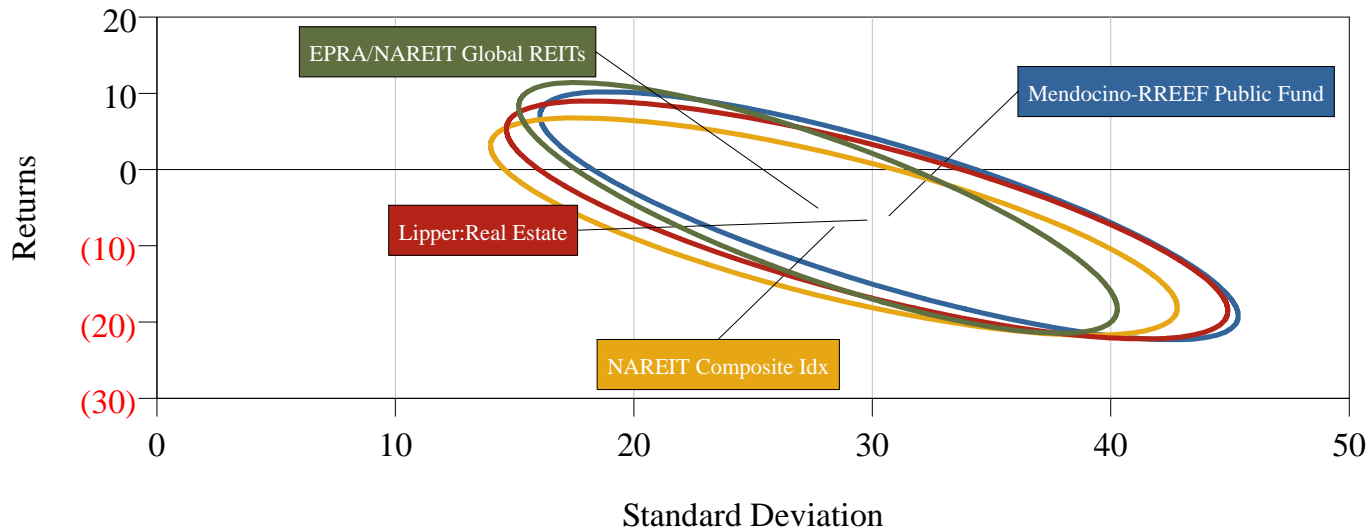
Style	Allocation (%, Real Estate Assets)	Allocation (%, Total Assets)	Allocation (\$, mm)
Public			
REITs	43.1%	3.5%	9.88
RREEF Public Fund	43.1%	3.5%	9.88
Private			
Core Open-Ended Real Estate	56.9%	4.6%	13.06
RREEF America II Fund	56.9%	4.6%	13.06
Total	100.0%	8.0%	22.94

- **Mendocino currently has exposure to both a REIT fund and a core open-end fund.**
- **The core open-end fund has a modestly greater allocation than the REIT fund.**



MCERA Historical Public Real Estate Performance

Rolling 12 Quarter Scatter Chart
for 2 3/4 Years Ended June 30, 2010

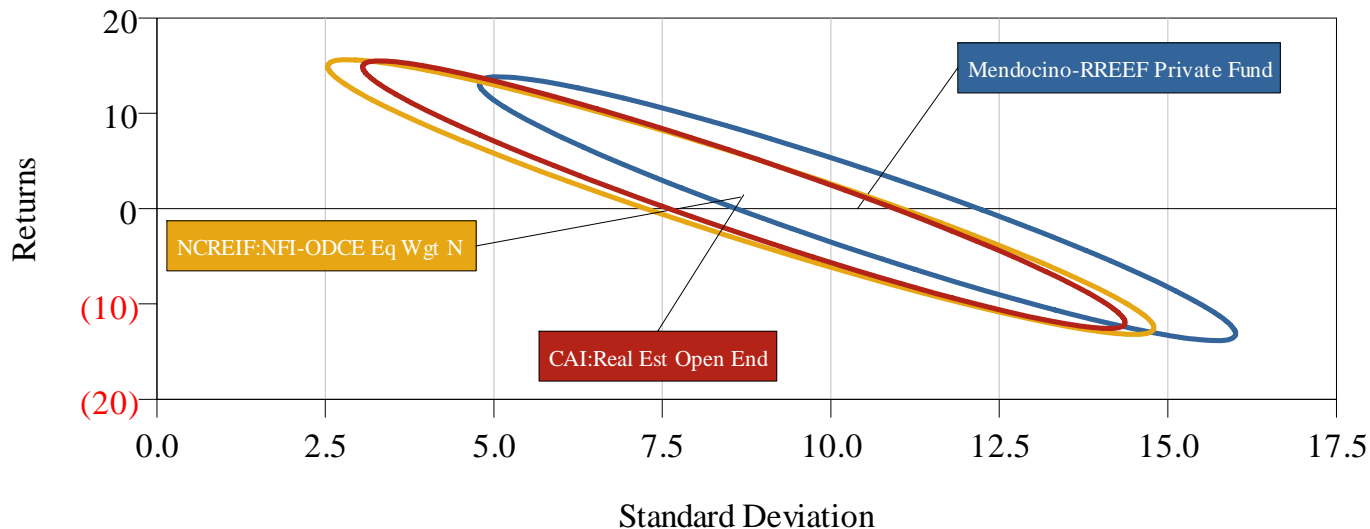


- **The RREEF Public Real Estate Fund has provided slightly higher returns at slightly more risk than both the NAREIT index and the Lipper Real Estate group.**
- **Global REITs have historically provided modestly more return at somewhat less risk.**



MCERA Historical Private Real Estate Performance

Rolling 12 Quarter Scatter Chart
for 2 3/4 Years Ended June 30, 2010

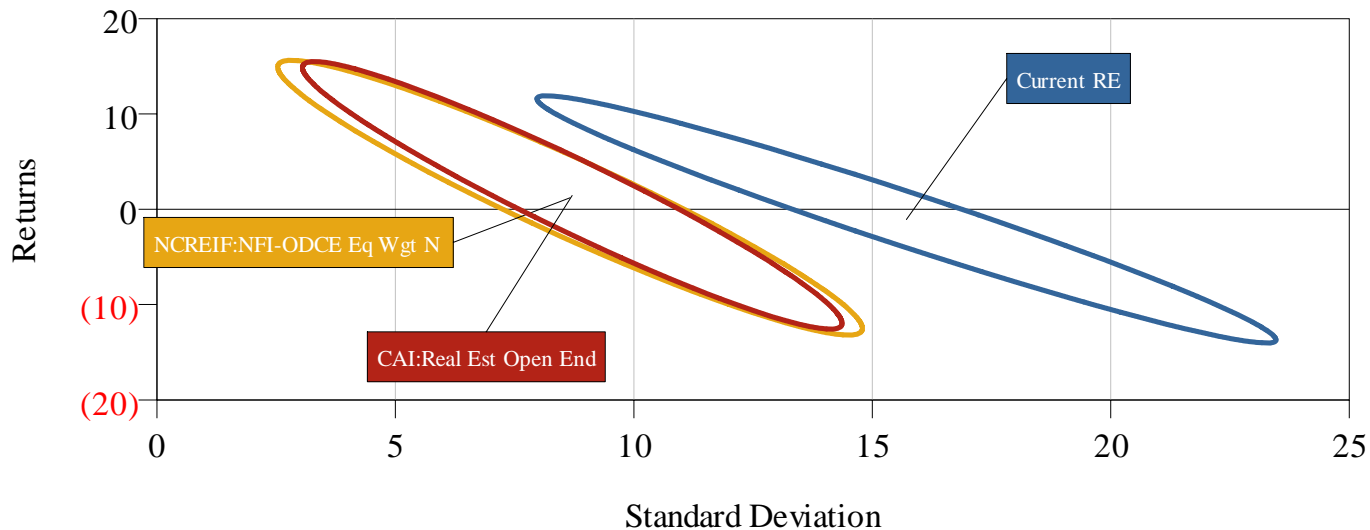


- **The RREEF America II Fund has provided similar returns at somewhat more risk than both the NCREIF ODCE index and the Callan Open End Real Estate Style group.**



MCERA Historical Total Real Estate Performance

Rolling 12 Quarter Scatter Chart
for 2 3/4 Years Ended June 30, 2010



- REITs are generally viewed as a supplement to private real estate consequently the overall real estate portfolio should be measured against a private real estate benchmark.
- The MCERA portfolio has achieved similar returns but at measurable higher levels of risk.



Current and Alternative Real Estate Structures

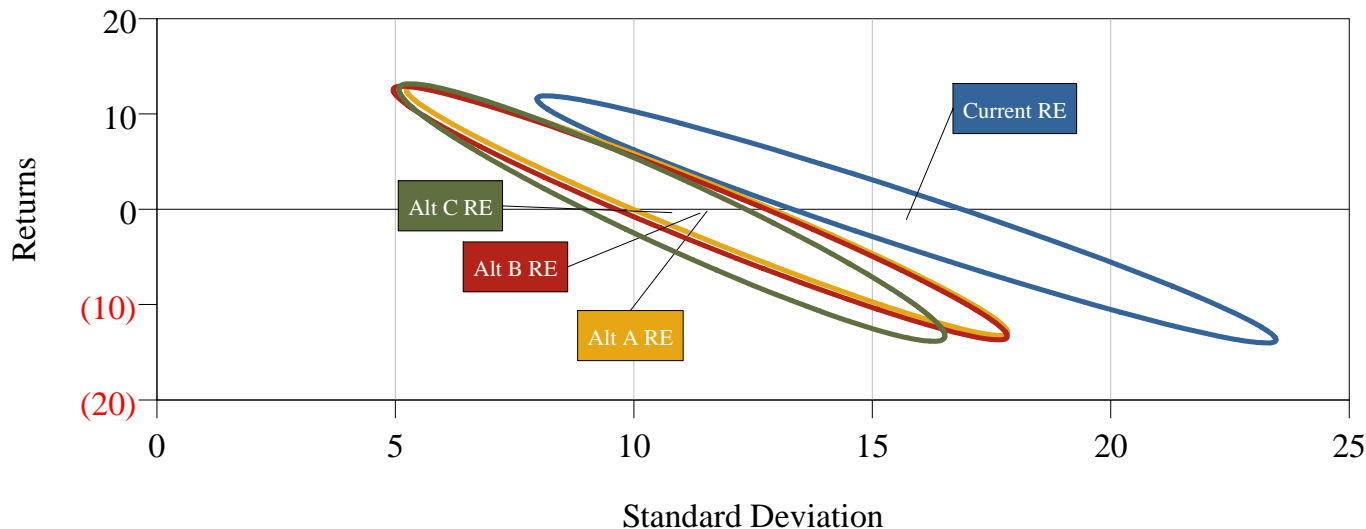
Style	Current	Alternative A	Alternative B	Alternative C
Public				
REITs	43.1%	20.0%	20.0%	20.0%
RREEF	43.1%	20.0%	20.0%	0.0%
Global REITs	0.0%	0.0%	0.0%	20.0%
Private				
Core Open-Ended Real Estate	56.9%	80.0%	80.0%	80.0%
RREEF	56.9%	80.0%	55.0%	55.0%
New Fund	0.0%	0.0%	25.0%	25.0%
Total	100.0%	100.0%	100.0%	100.0%

- **Allocation A reduces the allocation to REITs to 20% to maintain their benefits but limit the overall portfolio volatility.**
- **Allocation B also has a 20% allocation to REITS but diversifies the existing RREEF core open-end fund.**
- **Allocation C maintains the private market diversification and introduces public market diversification through global REITs.**



Current and Alternative Real Estate Structures

Rolling 12 Quarter Scatter Chart
for 2 3/4 Years Ended June 30, 2010



- The reduction in the REIT allocation reduces the volatilities of alternatives A, B and C.
- The proxy for an additional open-end fund is the Callan Open-End Real Estate Style Group.
- Although alternatives B and C do not appear to reduce return volatility much, they do diversify business and strategy risk and expand the opportunity set.