

# Real Assets Credit Search

IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

**Presented to the IPERS  
Investment Board**

**By Pat Reinhardt, SIO - Alternatives**

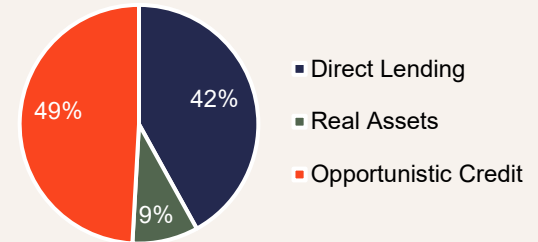
**March 25, 2022**



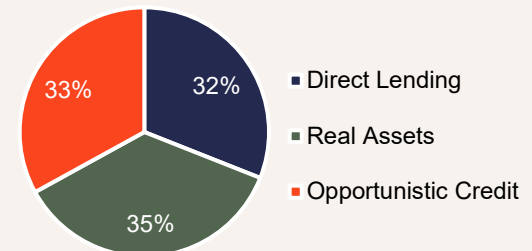
# IPERS Private Credit Portfolio

- The Investment Board increased the Private Credit target allocation from 3% to 8% in September 2020.
- IPERS is targeting relatively equal weights to Direct Lending, Opportunistic Credit and Real Assets Credit strategies.
- With the conclusion of the Opportunistic Credit search in 2021, the Private Credit portfolio was made up primarily of Direct Lending and Opportunistic Credit strategies, with two Real Assets Credit strategies receiving approval during the prior search.
- The Real Assets Private Credit Search commenced in the second half of 2021 to complete the overall portfolio construction of the Private Credit portfolio.

## Current Allocation<sup>1</sup>



## Target Allocation<sup>2</sup>



<sup>1</sup> Based on approved commitments to Private Credit managers to date.

<sup>2</sup> Based on existing and approved commitments and inclusive of private real asset credit recommendations.

# IPERS Private Real Assets Credit Search

- A total of 90 respondents submitted responses to the Private Real Assets Credit search.
- 65 respondents met the minimum requirements:
  - Registered investment adviser under the Investment Advisers Act of 1940.
  - At least three years of experience managing the proposed product as of June 30, 2021.
  - At least \$250 million in AUM by the proposed product as of June 30, 2021.
- Virtual due diligence meetings were conducted with 13 managers.
- Eight opportunities are being recommended for investment across all manager submissions.
- Three managers are being recommended for bench consideration.

RFP Process					
	Total Respondents	Met MRs	Semi-Finalists	Finalists	Recommended Allocations <sup>1</sup>
Core Real Estate Debt	31	23	3	2	\$250M
Opportunistic Real Estate Debt	25	16	4	2	\$300M
Infrastructure Debt	14	10	3	1	\$100M
Leasing Strategy	6	5	2	2	\$200M
Other Real Assets Credit	14	11	2	1	\$100M
Total	90	65	14	8	\$950M

90 managers submitted in response to the search. 8 were recommended to the Pension for \$950M of total investments.

<sup>1</sup> Potential allocations. Actual recommendations subject to negotiations and included as a range.

# Core Real Estate Debt Submissions

- Of 31 submissions in the core real estate debt group, 23 managers met minimum requirements.
- In the first round of evaluations, 23 managers were assessed and scored across the following five dimensions: organization (10%), product (30%), process (20%), performance (20%) and terms (20%).
- Three managers were selected for virtual on-sites and interviewed by IPERS staff and Wilshire.
- Two managers – **Heitman Credit and Principal** – are being formally recommended to the IPERS Investment Board. Please refer to the Investment Summaries in the Appendix.

## Evaluation of Core Real Estate Debt Submissions



# Opportunistic Real Estate Debt Submissions

- Of 25 submissions in the opportunistic real estate debt group, 16 managers met minimum requirements.
- In the first round of evaluations, 16 managers were assessed and scored across the following five dimensions: organization (10%), product (30%), process (20%), performance (20%) and terms (20%).
- Four managers were selected for virtual on-sites and interviewed by IPERS staff and Wilshire.
- Two managers – **Kayne Anderson and Oaktree Capital Management** – are being formally recommended to the IPERS Investment Board. Please refer to the Investment Summaries in the Appendix.
- Two managers – Sound Mark Partners and Calmwater – are recommended to be reserved as bench managers. Please refer to the Investment Summaries in the Appendix.

## Evaluation of Opportunistic Real Estate Debt Submissions



# Infrastructure Debt Submissions

- Of 14 submissions in the infrastructure debt group, ten managers met minimum requirements.
- In the first round of evaluations, ten managers were assessed and scored across the following five dimensions: organization (10%), product (30%), process (20%), performance (20%) and terms (20%).
- Three managers were selected for a virtual on-site. Two were interviewed by IPERS staff and Wilshire.
- One manager – **IFM Investors** – is being formally recommended to the IPERS Investment Board. Please refer to the Investment Summary in the Appendix.

## Evaluation of Infrastructure Debt Submissions



# Leasing Strategy Submissions

- Of six submissions in the leasing strategy group, five managers met minimum requirements.
- In the first round of evaluations, five managers were assessed and scored across the following five dimensions: organization (10%), product (30%), process (20%), performance (20%) and terms (20%).
- Two managers were selected for a virtual on-site and interviewed by IPERS staff and Wilshire.
- Two managers – Oak Street and JP Morgan Asset Management (Global Transportation Income Fund) – are being formally recommended to the IPERS Investment Board. Please refer to the Investment Summaries in the Appendix.

## Evaluation of Leasing Strategy Submissions



# Other Real Asset Credit Submissions

- Of 14 submissions in the other real assets credit group, 11 managers met minimum requirements.
- In the first round of evaluations, 11 managers were assessed and scored across the following five dimensions: organization (10%), product (30%), process (20%), performance (20%) and terms (20%).
- Two managers were selected for a virtual on-site and interviewed by IPERS staff and Wilshire.
- One manager – **Raven Capital Management** – is being formally recommended to the IPERS Investment Board. Please refer to the Investment Summary in the Appendix.
- One manager – AgAmerica – is recommended to be reserved as a bench manager. Please refer to the Investment Summary in the Appendix.

## Evaluation of Other Real Asset Credit Submissions





# Total Real Assets – Potential Portfolio Construction

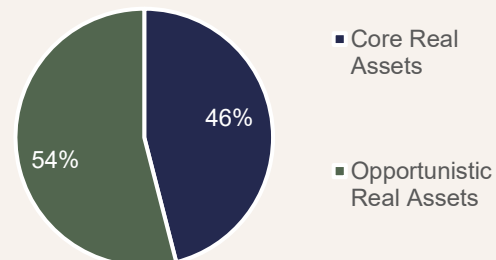
	Allocation Range (\$)		Midpoint Allocation <sup>3</sup> (%)
	Low	High	
Core Real Assets Credit			
PGIM Global Real Estate Debt <sup>1</sup>	\$200	\$300	19.2%
Heitman CREDIT	\$100	\$200	11.5%
Principal	\$50	\$150	7.7%
IFM Investors	\$50	\$150	7.7%
Sub-total	\$400	\$800	46.2%
Opportunistic Real Assets Credit			
Kayne Anderson, KARED IV	\$100	\$200	11.5%
Oaktree, RE Debt Fund II	\$100	\$200	11.5%
ITE Management	\$50	\$150	7.7%
HPS Investment Partners	\$50	\$150	7.7%
JP Morgan, GTIF	\$50	\$150	7.7%
Oak Street, NL Property Fund	\$50	\$150	7.7%
Sub-total <sup>2</sup>	\$400	\$1000	53.8%
Total Real Assets Credit Portfolio	\$1,300	100%	100%

<sup>1</sup> PGIM Global Real Estate Debt is currently being invested.

<sup>2</sup> Raven Asset Based Credit Fund II will be included in the Direct Lending Portfolio

<sup>3</sup> These allocation percentages are subject to change depending on final mandate sizes

## Current Recommended Allocation



- The core segment of real asset credit portfolio is focused on lower risk, income-generating strategies that are primarily senior in nature. The allocation provides a stable, baseline return with a primary focus on real estate credit and an allocation to infrastructure lending with a similar return profile but providing diversification benefits.
- The opportunistic segment of the real asset credit portfolio includes marginally higher returning real estate credit, energy lending, and leasing strategies. The recommended real estate credit exposure in this segment is complementary to the core allocations given the allowance for different structures and an ability to execute on more opportunistic approaches. The addition of leasing strategies offers further diversification, incremental return upside, and an emphasis on downside protection through exposure to counterparties with high credit quality.

# Representative Fee Structures

Real Asset Credit Search Categories <sup>1</sup>	Fee Information by Category		
	AMF	Carry	Preferred Return
<i>Core Real Estate Debt</i>			
	55bps to 150bps	0% to 20%	0% to 8%
<i>Opportunistic Real Estate Debt</i>			
	65bps to 175bps	10% to 20%	4% to 8%
<i>Infrastructure Debt</i>			
	50bps to 150bps	0% to 20%	0% to 8%
<i>Leasing Strategy</i>			
	90bps to 150bps	10% to 20%	6% to 7%
<i>Other Real Assets Credit</i>			
	85bps to 200bps	10% to 20%	0% to 8%

<sup>1</sup>Based on viable investment opportunities for each of the sub-strategies.

# Hiring Recommendations

Staff requests the Investment Board approve the following recommendations:

	Sub-Strategy Allocation Range (\$)	
	Low	High
<i>Core Real Estate Debt</i>		
Heitman CREDIT		
Principal		
<b>Sub-total</b>	<b>\$150</b>	<b>\$350</b>
<i>Opportunistic Real Estate Debt</i>		
Kayne Anderson, KARED IV		
Oaktree, RE Debt Fund II		
Sound Mark <sup>1</sup> (Bench Manager)		
Calmwater <sup>1</sup> (Bench Manager)		
<b>Sub-total</b>	<b>\$200</b>	<b>\$400</b>
<i>Infrastructure Debt</i>		
IFM Investors		
<b>Sub-total</b>	<b>\$50</b>	<b>\$150</b>
<i>Leasing Strategies</i>		
Oak Street		
JP Morgan, GTIF		
<b>Sub-total</b>	<b>\$100</b>	<b>\$300</b>
<i>Other Real Assets Credit</i>		
Raven Capital Management		
AgAmerica Lending <sup>1</sup> (Bench Manager)		
<b>Sub-total</b>	<b>\$50</b>	<b>\$150</b>
<b>Total Real Assets Credit Portfolio</b>	<b>\$550</b>	<b>\$1,350</b>

All recommendations are contingent on completion of operational due diligence and final contract negotiations.

This recommendation called for the pension fund to increase its credit allocation by \$550M to \$1.35B, an increasingly common recommendation from equity to debt.

<sup>1</sup>Being recommended as a bench manager

# Appendix

## Investment Summaries – Recommended Mandates

# HEITMAN CORE REAL ESTATE DEBT INCOME TRUST

**Investment Strategy** – The Heitman CREDIT Fund is an open-ended commercial real estate debt strategy primarily focused on senior secured bridge and development loans (93%); however, the Fund retains the ability to opportunistically invest in subordinated debt (7%). The portfolio seeks stability through diversification across both geography and sector. The current portfolio is allocated as follows: Apartment (33%), Office (32%), Specialty (17%), Industrial (11%), and Retail (7%). Loans are expected to be 3-5 years in duration on average and originated at LTVs of 65-80% at the asset-level. The Fund will utilize fund-level leverage of no more than 45% of collateral property value and is targeting a leveraged net IRR of 6.5-8.5% with the majority of returns generated through current income.

**Portfolio Positioning** – Heitman will serve as a core real estate debt holding within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Experienced and highly aligned senior leadership group with 37 Partners owning 100% of the Heitman management company
- Top-tier global platform dedicated exclusively to real estate with significant platform resources including in-house asset management, construction, acquisitions, loan administration, and research capabilities
- Strong risk-return profile with emphasis on senior loans and consistent current income
- Institutional, thorough investment process

## Concerns / Mitigations

- Exposure to sectors experiencing near-term headwinds including office and retail
  - Diversified nature of portfolio and focus on downside protection through senior structures mitigate risk

This search was conducted in 2021, i.e., a very different environment. It pitched up to 80% LTV loans with 6.5-8.5% leveraged net IRRs. Relative value feels very different today.

# PRINCIPAL REAL ESTATE DEBT FUND SERIES

**Investment Strategy** – Principal Real Estate Open-Ended Debt Fund will invest in a diversified portfolio of higher yielding private debt investments primarily in the U.S. The portfolio is expected to include subordinated debt investments such as mezzanine and B-notes, senior mortgages such as bridge loans and participating construction permanent loans, and completed spec projects. Underlying collateral may consist of office, medical office, single family rental, retail, and industrial among others. The strategy is expected to generate a 6.5-8.5% net IRR.

**Portfolio Positioning** – Principal, through an open-ended fund structure that is being contemplated, will serve as a core real estate debt holding within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Firm tenure and reputation in the real estate sector
- Substantial platform resources aiding in all aspects of real estate investment process
- Large, dedicated operations team
- Deep and consistent track record in the real estate debt market

## Concerns / Mitigations

- New, open-ended fund structure from previous three closed-end funds
  - Proven, repeatable investment process
  - Successful implementation of strategy in earlier fund series
- Alignment of the Firm with the success of the strategy, given the AUM of strategy relative to the Firm's real estate assets
  - Dedicated product team is deep, tenured, and supported by the vertically integrated resources of the platform
  - Successful implementation of closed-end fund series

# KAYNE ANDERSON REAL ESTATE DEBT IV (KARED IV)

**Investment Strategy** – KARED IV will focus on commercial real estate debt and securities sourced directly on a primary basis (direct relationships with borrowers), through the investment in Freddie Mac-related structured products (40-60%), and through the direct origination of junior debt positions secured by assets predominantly in niche real estate sectors such as multifamily housing, student housing, medical office, seniors housing, and self-storage. KARED IV is expected to target a 10-12% net IRR.

**Portfolio Positioning** – Kayne Anderson will serve as an opportunistic real estate debt holding within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Freddie Mac “Select Sponsor”
- Niche sector expertise
- Significant underwriting and operating resources
- Reputation and credibility
- Information advantage in niche sectors as an equity and debt investor

## Concerns / Mitigations

- Minority ownership with AIMS Petershill
  - No control over day-to-day management of the business
- KARED IV fundraising – Firm is closing in on their hard target fund size of \$1.6B
  - Manager has extended their final close to accommodate IPERS’ commitment within the target fund size
- Freddie Mac investment pools
  - Strong underwriting process has been successfully demonstrated in previous funds

# OAKTREE REAL ESTATE DEBT FUND III (SMA)

**Investment Strategy** – Oaktree’s real estate debt strategy focuses on a flexible real estate debt mandate that will pursue (i) private loan origination, (ii) regulatory-driven opportunities, (iii) real estate structured credit, and (iv) real estate-related corporate debt. There are limited guidelines surrounding portfolio construction, as Oaktree will pursue the most attractive opportunities across its four strategy verticals from a risk-adjusted return perspective. The strategy is expected to target a 12-14% net levered IRR.

**Portfolio Positioning** – Oaktree will serve as an opportunistic real estate debt holding within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Deep and experienced investment team
- Global platform resources and research capabilities
- Well-reputed Firm with strong fundraising ability
- Dedicated in-house asset management team
- Opportunistic and flexible allocation among multiple investment themes

## Concerns / Mitigations

- Ownership dynamics given Brookfield’s majority third-party ownership
  - Strategy will benefit from Brookfield’s platform capabilities and expertise within real assets



# IFM INVESTORS U.S. INFRASTRUCTURE DEBT FUND

**Investment Strategy** – The Fund will focus on U.S. sub-investment grade infrastructure debt. The strategy will focus on assets with monopolistic characteristics, low demand risk, and financial safeguards. Investments will have covenant packages, contracted revenue streams, a comprehensive security package, and the potential for significant equity cushion. The strategy's unlevered sleeve will target 6-8% net returns, while the levered sleeve will utilize a maximum 1:1 fund level leverage and target 10-12% net returns.

**Portfolio Positioning** – IFM's portfolio will serve as an infrastructure debt holding within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Institutional firm with considerable platform resources
- Experienced infrastructure investors with 20-plus year track record, spanning over 290 transactions globally
- Attractive risk-adjusted return profile
- Advantaged underwriting insight given the Firm's history as an owner-operator of infrastructure assets

## Concerns / Mitigations

- Short term track-record for Product
  - Highly reputable firm in the infrastructure space
  - Successful longer-term track record for similar strategies
  - Consistent, defensive performance through COVID time-frame
- Less than ideal ownership structure, as the Firm is owned by 23 Australian pension funds
  - IFM Investors operates as a separate business entity with its own independent board of directors
  - Investment team maintains control over key decisions and day to day management

# OAK STREET REAL ESTATE CAPITAL NET LEASE PROPERTY FUND

**Investment Strategy** – The Net Lease Property Fund will focus on single-tenant, free-standing properties triple net (NNN) or double net (NN) leased to investment grade rated tenants with a target of 20+ years of lease term (minimum of 17 years) and 6-6.99% capitalization rates. Fund will primarily target single tenant office, industrial and retail properties with an emphasis on properties that are mission-critical and tenants that operate in recession-resistant businesses. The strategy targets a 7% annualized current cash return net of fees and an overall 10% net IRR.

**Portfolio Positioning** – Oak Street will serve as a leasing strategy within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Deep and successful track record in triple net lease strategy
- Attractive risk-return profile through long-term NNN leases secured by hard assets of investment-grade quality tenants
- Strong tenant credit underwriting and proactive approach to sourcing through data-driven inputs and active conversations with corporates
- Investment discipline in strategy execution

## Concerns / Mitigations

- **Ownership by Blue Owl**
  - Team retains full control of investment and day-to-day decisions and carry retained within Oak Street
- **Potential key person risk with Marc Zahr**
  - Firm has an established, data driven investment process
  - Significant industry experience for other Investment Committee members
- **New product at Firm**
  - Strategy highly similar to the flagship strategy, where Oak Street has demonstrated consistently attractive performance

This strategy is likely in a very different relative value position now, with cap rates up substantially.

# J.P. MORGAN GLOBAL TRANSPORTATION INCOME FUND

**Investment Strategy** – The Fund will target an 8-10% net yield and a net IRR of 10-12% by owning, operating, financing, and leasing a broad spectrum of transportation assets that are utilized in the global transportation market and are key to the supply chain for large-scale companies. Specifically, the Fund will look to directly or indirectly finance large-scale, capital intensive assets ranging from approximately \$50 to \$500 million in value within the aircraft, maritime, heavy logistics, vehicle fleet, and energy logistics sectors (including “next generation” ESG-focused assets). The Fund seeks to take advantage of long-term transportation demands and drive value within the Fund through current income generated from asset operations and long-tenured (5 to 15 years on average) lease payments from high credit quality counterparties.

**Portfolio Positioning** – J.P. Morgan will serve as a leasing strategy within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Senior team’s sector expertise and access to extensive JPMAM platform resources
- Differentiated strategy with a specific sector focus relative to more generalist core-plus infrastructure strategies
- Attractive risk/return profile with high-quality credit counterparties and an attractive, consistent cash yield that has remained resilient through COVID-19

## Concerns / Mitigations

- Large, multi-strategy organization with GTIF representing a small portion of the Firm’s significant AUM
  - Team remains aligned and motivated to demonstrate continued success
- Short-term headwinds from supply chain and transportation disruption due to COVID-19
  - Performance has been resilient through COVID-19
- Limited track-record relative to peers
  - Strong returns to date and approach differentiated from other infrastructure and leasing strategies
  - 16 consecutive quarters of 2.0% plus cash yields through 4Q21

# RAVEN ASSET-BASED CREDIT FUND II

**Investment Strategy** – The Fund originates and funds asset-based senior-secured loans targeting non-sponsor backed borrowers across five asset types in which the team has significant expertise: receivables/intellectual property, specialty finance, real estate, transportation, and infrastructure. Loans are heavily customized and structured to mitigate risk of principal impairment whereby the Firm operates as the lead/sole lender to control price and structure. The Fund will look to make investments of \$10 – \$50 million in the lower middle-market. The positions will be 100% senior-secured overcollateralized by fungible assets at LTVs between 40%-60% with full covenant packages in place. Furthermore, loans originated by Raven will have short duration profiles of 1-3 years which facilitates recycling of capital. The strategy is expected to target an 8-10% net levered IRR.

**Portfolio Positioning** – Raven will serve as a Direct Lending strategy within the Private Credit portfolio.

## Investment Merits

- Singular focus on heavily structured non-sponsor backed transactions in asset-based industries
- Fund size appropriate to strategy and market opportunity with limited competition
- Experienced, senior-led team with ample workout and restructuring experience

## Concerns / Mitigations

- Potential key person risk surrounding founder
  - Established, capable team surrounding Josh Green
  - Lead PM for Product is a capable and experienced investor
- Potential conflict with flagship Opportunity Fund
  - Difference in return profile between strategies mitigates risk of overlap
- Reinvestment risk given short duration loans
  - Opportunistic, all-weather strategy allows for loans to multiple different market segments
  - Demonstrated sourcing capabilities
  - Heavily customized and structured loans

# Appendix

## Investment Summaries – Bench Managers

# SOUND MARK PARTNERS

**Investment Strategy** – Sound Mark’s strategy targets subordinated commercial real estate debt within innovation districts. Sound Mark defines innovation districts as areas with above-average demographics that drive long-term growth, typically located near a university. The strategy targets 60-85% LTVs and 9-14% interest rates on loans.

**Portfolio Positioning** – Sound Mark would serve as an opportunistic real estate debt holding within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Single strategy firm at an ideal lifecycle stage
- Women & diverse-owned firm
- Differentiated strategy focused on smaller transactions

## Concerns / Mitigations

- Potential key-person risk surrounding Jenna Gerstenlauer
- Smaller team

# CALMWATER REAL ESTATE CREDIT FUND IV, LP

**Investment Strategy** – The strategy is focused on senior secured commercial real estate bridge lending in lower middle market opportunities across the U.S. The Fund will target investments where capital is being used for acquisition, refinancing, recapitalization, repositioning, and/or lease-up. Seed investments in the portfolio are diversified across Multifamily (30%), Residential (29%), Industrial (28%), Retail (6%), Hospitality (5%), and Land (3%). Opportunities are expected to be primarily sourced through direct/repeat relationships - 86% historically - built through Calmwater's tenure in the real estate space. The portfolio is targeting a levered net IRR of 10-12% with a weighted average LTV of 67%.

**Portfolio Positioning** – Calmwater would serve as an opportunistic real estate debt holding within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Single-strategy focused firm at an attractive lifecycle stage
- Less competition in the lower middle market with loan sizes from \$7-65 million
- Highly diversified portfolio across both sector and geography
- Experienced and stable investment team
- Attractive risk adjusted returns for senior secured, short duration, and conservative LTVs

## Concerns / Mitigations

- Limited platform resources given this is a single-strategy firm
- Small investment team relative to peers

# AGAMERICA LENDING, LLC

**Investment Strategy** – AgAmerica Lending Fund is an open-end, commingled vehicle focused on originating, purchasing, and holding loans secured by agricultural property in the United States. Target investments include whole mortgage loans, bridge financing, performing or sub-performing loan portfolio purchases, A- and B-tranche participations, and issued securitizations. Typical underlying loans are \$500k to \$25m in size, senior secured by first position mortgages and deeds of trust, and conservatively underwritten with LTVs around 50%.

**Portfolio Positioning** – AgAmerica would serve as an “other” real asset credit strategy within the Real Assets Credit sub-portfolio of the Private Credit portfolio.

## Investment Merits

- Growing single-strategy firm in a favorable lifecycle stage
- Experienced senior team with relevant industry and agriculture experience
- Differentiated agricultural property focus
- Conservative underwriting (50% LTVs)
- Operating within a less-competed and fragmented market segment
- Sourcing advantage through partnerships with Farm Credit, AgriAccess, UBS Private Wealth, and direct-to-consumer efforts.

## Concerns / Mitigations

- Historically retail-oriented investor base
- Relatively high fees relative to broader real asset credit universe
- Lack of clarity around capacity and ability to deploy larger ticket sizes within market segment



## IOWA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

