



Welcome to this very special edition, DCREC podcast series. Sponsored by the Defined Contribution Real Estate Council, an organization passionate about providing American workers a financially secure retirement by investing in commercial real estate. And now, here is today's host, Todd Schnick.

Todd Schnick: Good morning, and welcome back to this very special edition DCREC Briefing. I am your host, Todd Schnick. So let's get right to it, going to be a very interesting conversation this morning. I am joined by Diane Smola and Jani Venter, both of AON Hewitt investment consultants. Ladies, welcome to the show.

Diane Smola: Thank you.

Jani Venter: Thank you, Todd.

Todd: We're going to have an implementation discussion around daily priced real estate, promises to be very intriguing, I would love for both of you to walk us quickly through your individual roles with AON. So Diane, why don't you lead us off?

Diane: Sure. I'm an associate partner in AON Hewitt Investment Consulting, and my role is client facing. So I lead both defined contribution and defined benefit relationship.

Todd: Jani, why don't tell us about your work?

Jani: So I'm also an associate partner and I work closely with Diane. My role is also client facing but I am also on the research side leading the research on the daily priced real estate vehicle that we will be discussing today.

Todd: Okay. Well, thank you both. So let's get going here. So Diane, why don't you lead us off. What was the catalyst for your clients to consider including private real estate in their target date fund?

Diane: Well, you know Todd, as part of our consulting relationships with clients, we're always looking to bring new investment ideas to the table. We've been long proponents of private real estate for defined benefit clients. So when the direct private real estate products were approved and bi-rated by our manager research team for defined contribution plans, it was really exciting. We educated our defined contributions on the merits and including the asset class and a multi-asset portfolio, namely that private real estate could support higher risk adjusted returns and increased diversification. So we targeted discussing this opportunity with clients you had custom target date funds or other white label funds.

And one of my clients immediately receptive to considering this addition to their custom target date fund.

Todd: So Diane, in these initial discussions with clients, what were the main considerations with including private real estate?

Diane: Yeah. You know, as I said, one of my clients are initially very receptive others were as well but some concerns that were raised were concerns with the original philosophies on the construction of their custom target date funds. One client in particular had their target date funds originally structured with simplicity in mind. They hired us to construct those custom target date funds using only options that were in their lineup as core standalone option. Adding the daily valued real estate fund which would not be made available as a core standalone option was a shift, and that originally stated loss of faith. So they expressed concerns about how to communicate that change to their plan participants. We went back and forth a number of times over many discussions and in the end the client agreed that the investment opportunity was just too compelling not to move forward with it. They found comfort in the fact that the daily valued real estate options could not be offered on a standalone basis giving the plans investment committee the freedom to both maintain that simplistic philosophy on building the custom target date funds from core while still enhancing them with a component that isn't appropriate or available on a standalone basis.

Todd: So Jani, would the considerations of including daily valued real estate vary by client type?

Jani: Yes, Todd, indeed they do. Since not all investments are appropriate for all clients. And as a fiduciary for our clients, we perform an in-depth analysis of each client to determine a customized solution that would address their specific real estate needs. So this also applies to how we recommend daily valued fund solutions that focus on providing clients with exposure to these private core real estate strategies.

So for example, we recommend the daily valued real estate funds forward to find contribution clients and their target date fund as Diane discussed. But we also recommended them for the DC and DB platform within AON's outsourced CIO or delegated platform. So the consideration for AON's outsourced CIO platform to include daily value private real estate focused on the potential benefits provided by the private real estate specifically, which includes diversification, income, inflation protection, and an improved risk return profile. Then we looked at the two client types on the outsourced CIO platform, defined benefit clients and defined contribution clients because they have different needs. On the defined benefit platform, clients can obtain exposure to private real estate through separately managed traditional core fund or with an accustomed daily valued co-mingled vehicle that's created by AON that provides blended exposure to daily valued private real estate funds and [inaudible 00:05:38]. So this is the solution that we typically recommend because it focuses on managing liquidity, reducing volatility, and improving the risk adjusted returns for investors. Now on the define contribution platform, daily valued real estate is included in our inflation, income, and growth objective base strategies. So the benefits of including private real estate definitely outweigh the cost and potential implementation challenges over the long term.

Todd: Okay. So Diane, how is the conversation with defined contribution clients different when compared to define benefit client conversations?

Diane: Sure, Todd. For defined contribution clients, liquidity and participant communications are the biggest issue. Daily valued private real estate portion of the multi-asset portfolio must be sufficient enough to realize the benefits of the investment are small enough to minimize any liquidity concerns.

Jani: So I can also add to that and in our opinion, defined benefit clients have absolutely historically benefitted from including private real estate in their portfolios. So the exposure to this less liquid asset classes with higher fees such as private real estate, they're definitely more common and more widely accepted in the defined benefit portfolios. We found that the major concerns in initial discussions with DC clients predominantly focus on fees and liquidity and then on the implementation. There is also a longer education timeline with DC clients but they definitely benefit from education on the structure liquidity and fees associated with these products as they grow more comfortable with including private real estate in their portfolios.

Todd: Alright. So Jani, why are you now comfortable with the real estate products available to defined contribution investors?

Jani: Well, Todd, there are a number of reasons. Firstly, the maturation of the daily valued funds over the last 11 years along with the shift in the DC plans towards the use of multi-asset portfolios has created an investment environment that is now well-positioned to actually successfully incorporate private real estate funds into the DC investment plan. Secondly, the new generation of daily valued real estate funds available in the market, especially those that have been rated by AON's research team address the legacy concerns of liquidity, valuation, and pricing frequency, and offer viable solutions to DC investors. And finally, investors can also select from a range of core and core plus risk profiles within the private allocation in these vehicle which allows for more tactical use of the funds within a larger portfolio context.

Todd: Alright. So Diane, once the client approved the allocation to real estate, what were the implementation considerations that had to be addressed? And I'm assuming they were designed in communications issues?

Diane: They definitely were designed in communication issues, Todd. So the first of which is consideration of the fit within their existing investment lineup. Does the inclusion of direct private real estate fit or not? The considerations can be as simple as whether or not the lineup already includes actively managed options or as complex as whether or not the client already has or needs to create multi-asset options. Participant communications is another area of concern. They are always a sensitive topic for committees whenever a change is made in the fund lineup. They are concerned about how participants will receive that change. Adding direct private real estate is a unique communications challenge due to its unique liquidity parameters and positioning as a component in a multi-asset fund rather than a standalone option. AON does not consult on participant communications but we've

observed that less is more approach in which the investment [inaudible 00:09:47] the change as described and the new specific multi-asset option allocations are provided tend to work the best. Another issue that stays in implementing direct private real estate is updating the very important investment policy statement for the plan sponsor.

Todd: Yeah. I imagined so. And I also assume there are operational issues as well, yes?

Diane: Absolutely. First consideration would be does the existing custodian have familiarity with the product and its operation? There's trading limits, expertise in rebalancing back to targets, given the liquidity limits associated with these products also. Do they have the ability to roll trades forward efficiently? Does the custodian already have this particular option with another plan for which they provide services so that we can reference their capabilities in this area?

Another is setting those appropriate allocation and rebalancing ranges. We talked about this earlier but the allocation to the direct private real estate has to be sufficient enough within that multi-asset portfolio to really realize the benefits but also small enough to minimize liquidity concerns. Now, what we found is special consideration has to be given to narrowing those rebalancing ranges in an attempt to minimize the need to transitory balancing over several trading days rather than on a single date. Daily allocation of participant activity is also a concern operationally. The letter of direction for the custodian has to specify how daily allocations will be made to the remaining components exclusive of the direct private real estate that are within that multi-asset portfolio on a daily basis pending the monthly rebalancing and [inaudible 00:11:49] to the direct private real estate allocation.

And then lastly, as you're getting ready to commit to these products, you have to commit a certain dollar amount and so one of the challenges is predicting the cash flow and the true commitment that the plan will be ready to make once they pass through what can be a long investment queue. So calculating that amount can be a challenge as I said, particularly with companies who have periodic incentive payments, multiple payroll cycles, both of which need to be anticipated along with market value changes between the date of the estimate and the day that the actual funding is anticipated

Todd: Alright. Well, thank you for that. Jani, why don't you wrap things up and walk us through what is actually driving the market's acceptance of daily priced real estate funds and why now?

Jani: So Todd, I'd be happy to do that. Fundamentally, it comes down to that the stable return profile and diversification benefits offered by private core real estate supports a strong investment rationale for including private real estate in defined contribution plan. With the evolution of these daily valued real estate funds and the DC market shift toward multi-asset platforms, DC plan providers now have the tools to provide participants exposure to the same private real estate characteristics that were only previously available to the plan. We believe that there is now a strong case for DC plan providers to evaluate the role of private real estate and the vehicles that offer exposure to the sector's characteristics and benefit.

Todd: Alright. Well, gosh, this has been a very interesting conversation. I'm grateful for both of you joining us on the show today. So we're bad out of time. Before I let you go, Diane, I'll ask you, should

people have any questions on any of these, where do they go to get answers and learn more about the important work that you're doing?

Diane: Sure. I think the best way, Todd, is to direct everyone to go right to our website which is AONhewitt.com/investmentconsulting.

Todd: Alright. Well, thank you for that. And also, AON Hewitt Investment Consulting is a registered investment advisor with the SCC who provides customized investment advisory solutions primarily to corporate defined benefit and defined contribution retirement plans. Prior to making any specific asset class recommendation to a client, AHIC will complete a comprehensive analysis of a client's portfolio, objectives, and risk tolerance to determine whether private real estate is a suitable option for their portfolio.

Alright. Well, that's all the time we have for today. Todd Schnick signing off from this very special edition DCREC Briefing. We look forward to seeing you next time.

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