An interview with:

John McClelland
Former Principal Investment Officer, Real Estate
Los Angeles County Employees Retirement Association

INVESTOR PERSPECTIVES ON DIVERSITY, EQUITY & INCLUSION

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NAREIM DIVERSITY, EQUITY & INCLUSION SURVEY INTERVIEW SERIES:

LOS ANGELES COUNTY EMPLOYEES RETIREMENT ASSOCIATION

NAREIM
The business of real estate investment management

About the Global Diversity, Equity & Inclusion Survey

NAREIM has tracked Diversity, Equity & Inclusion (DEI) since 2017 as part of its organizational benchmarking research. In 2020, we expanded our work and research to help the entire industry become more diverse.

The work will be long — but rewarding. According to the latest NAREIM Diversity & Inclusion Survey, just 15% of executive managers were women and 15% were nonwhite. However, diversity is not just about gender or ethnicity, although very important.

As John McClelland says in the accompanying interview, diversity is also about diversity of thought and the diversity of ideas within a team. Diversity is about having, and listening to, the different voices at the table to better prepare an investment firm for managing and executing upon situations, such as those we face today.

As NAREIM, in partnership with Ferguson Partners, ANREV, INREV, NCREIF, REALPAC, PREA and ULI prepare to invite real estate investment managers and the wider commercial real estate industry to participate in the Global DEI Survey this Fall, we asked institutional investors to talk about their perspectives on DEI and how they are working with investment managers to deliver lasting change for the industry. Enjoy the conversation.

Participant biographies

John McClelland recently concluded a 37-year career in institutional real estate investing. He spent 21 of those years directing real estate investment activity of the Los Angeles County Employees Retirement Association. With LACERA, John managed the approximately $5.5 billion real estate allocation in separate accounts and commingled funds investing in all major property types in the United States and globally. He also introduced a real estate debt investing program at the plan. In addition to his tenure with LACERA, John earlier worked with the investment management company, FIA Associates, the California State Teachers' Retirement System, and with the investment banking, consulting and management firm Chadwick, Saylor and Company. John holds an MBA from California State University, Sacramento and a B.S. degree from UCLA. He remains active in the industry including as an honorary member of PREA, where he served as chairman of the plan sponsor counsel and a member of the board; a member of the advisory board of Alliance Global Investors; and soon to be member of the board of Institutional Real Estate, Inc.

Suzanne West is a Senior Advisor to The CenterCap Group. She is also Founder and President of Epic Advisory LLC. West draws upon her 30 years of experience across the real estate industry to provide clients with capital raising and strategic consulting services. Previously, she was involved in the formation of Belay Investment Group which invests capital on behalf of the California State Teachers' Retirement System (CalSTRS) alongside emerging managers that she helped source and mentor. Prior to Belay, she was a Cofounder of Park Madison Partners (PMP), a New York-based real estate advisory and placement firm which she helped grow over her eight-year tenure. Suzanne received a B.S. in Finance from the University of Connecticut.

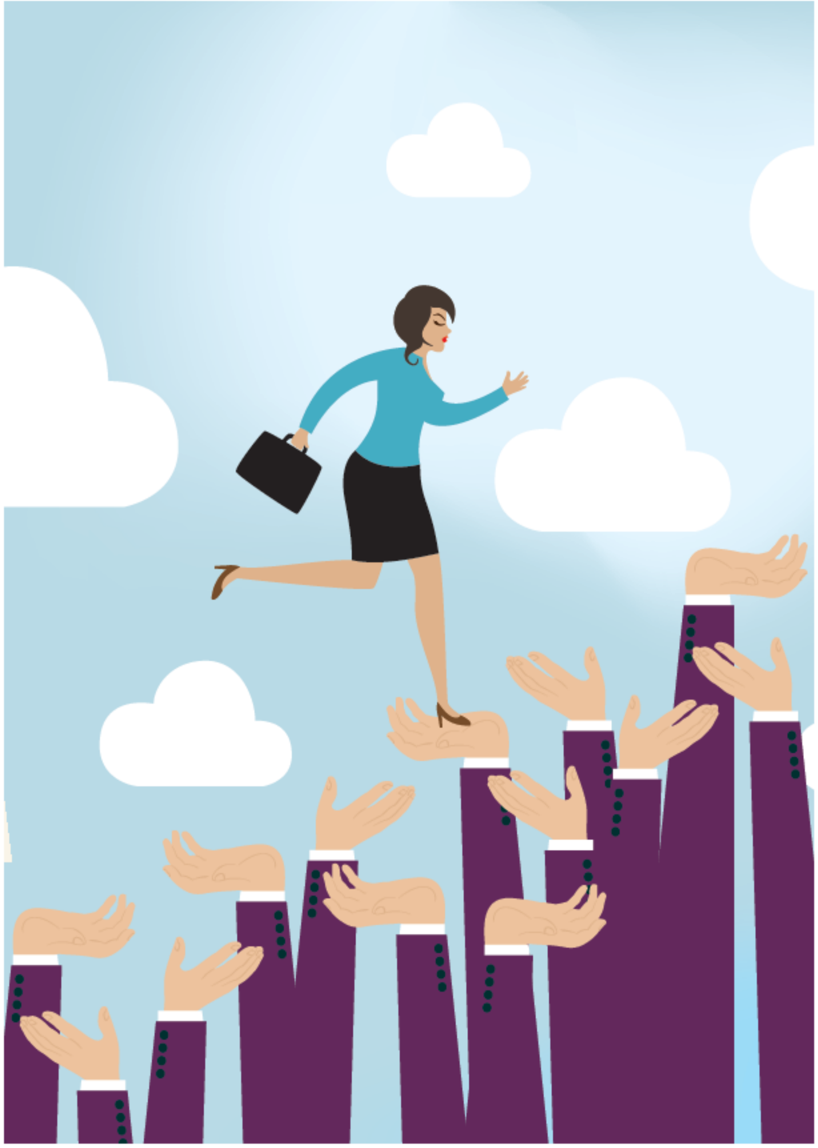
Diverse professionals should be seen and heard

Diversity, equity and inclusion is going to be a serious consideration in manager selection.

For John McClelland, diverse professionals bring valuable insights that could benefit the investment decision-making process. Over the course of two interviews, in January while Principal Investment Officer, Real Estate at LACERA, and in July after retirement, John spoke to NAREIM about LPs as a steward for change and the industry's slow and steady progress on DEI.

He wants to see junior professionals represented at due diligence and onsite meetings. Not only can juniors learn from firsthand experience at these meetings, but it also shows that the manager values these professionals and takes DEI seriously.

However, DEI shouldn't be about elevating the token diversity person at the expense of reverse discrimination — but about advancing the best people and building supportive networks.



> "Many [investors] are already asserting their expectations and collecting information from investment managers."

Key highlights:

- LPs will want not only statistics from investment managers, but also DEI policy and company reports on DEI efforts every year. There will be ongoing accountability and monitoring. LPs will want to see improvement over time in the diversity, equity and inclusion efforts of the firms.
- One of the big leaps in manager selection will be ability for LPs to have scorecards beyond their own universe of managers to be inclusive of other managers so that they can compare their current managers' score relative to others in the universe.
- In the work from home environment, LPs are asking to speak to analysts or junior team members in their underwriting of managers and GPs. This also benefits junior members in terms of their development opportunities to see senior level interaction and to speak with investors when called on.
- LPs are looking to see diversity in the composition of the investment committee.

Suzanne West: How can institutional investors as a steward of capital be a catalyst for change? As you now sit outside the seat of LACERA, what do you say to people who opine, "LPs have a responsibility because they can speak with their capital about where to push change in one direction or another?"

John McClelland: Institutional investors, particularly public plan sponsors, have a clear mandate of meeting return expectations in order to provide the promised benefits to the beneficiaries they serve. There are many ways to execute and implement that mission. Whether they should, and how much, and to what extent they want to integrate diversity, equity and inclusion into their decision-making, varies dramatically by institution.

When I was at LACERA, it was becoming increasingly important to the board, to the senior leadership, to my peers and to my team to be aware of and to try to make inroads into improving the DEI overall within the investment management community, including within our own organization.

LPs as a catalyst

Suzanne West: How can LPs do more for advancing diversity, equity and inclusion? Should they?

John McClelland: I think that investors can and will get more and more active. Many are already asserting their expectations and collecting information from investment managers. It's interesting that they're getting very little pushback in the United States. They re getting tremendous pushback from other parts of the world because employers are prohibited from asking some of the questions to identify the characteristics that are now being readily identified within DEI data collection efforts. It's easy to know how many women you have working in the firm, but it gets more difficult from there. How many minority employees are there? How do you want to categorize them as minority? A Japanese worker in the US is a minority, but if you're investing in Japan and you have a Japanese worker, he or she is not a minority.

There's going to be a lot of data collection. Then investors are going to ask themselves, "What do we do with this? What could we force and foist upon the investment management community?" At the moment, LPs are leaning towards encouragement. They won't fire or hire managers that are not diverse. However, I've seen "no" votes by individual members of a board in a public environment because the manager was not diverse.

There's going to be demand for not only statistics, but also DEI policy and company reports on DEI efforts every year. There will be ongoing accountability with data collection and monitoring to try to encourage DEI. LPs will want to see improvement over time in the diversity, equity and inclusion efforts of the firms.

Suzanne West: To come back to what you said, LPs are not going to fire or hire managers that are not diverse. How will it start to translate?

John McClelland: I think it will translate in, first and foremost, an encouragement to make an improvement, and then the development of some method of monitoring and measuring that improvement.

In that balance of investment decision-making is the question of do you, or don't you, invest with an organization. The diversity, equity and inclusion factors are going to be a consideration in the decision that, at least initially, is not going to dominate the decision. There may be a weighting situation; DEI might be 10% or 15% of weight where the fees might get 10%. Strategy and investment prowess is still going to be in the 30%-plus range, and processes and procedures is going to be more weighted. Diversity, equity and inclusion is going to be a serious consideration in manager selection.

When you get to the margins, the factor that tips the scale for a manager is perhaps a better DEI rating or score. Vehicle structure may matter. If you have a separate account, LPs might put a five-year clock on you and say, "If your DEI numbers don't improve to X over the next five years, we're going to start shopping for a different manager." That's different with funds because you're typically locked in for a period of time. Investors will take the position that they're not going to invest in your next fund unless you accomplish DEI goals.

Whether they stick to that or not depends on the market environment. A manager that is offering a heavily sought-after strategy, has a great performance record and is constrained by the amount of money they can accept, is obviously in a position to dictate more terms and pushback against filling forms or doing a survey every year.

Measuring diversity

Suzanne West: When you think about your fiduciary role as an investor, you think about the prudence of diversity in portfolio construction. Investors construct diversified asset portfolios positioned to withstand, or even capitalize on, changes in the

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market environment. How can we get the industry to move away from thinking about DEI as a social issue, but rather as a responsible investor issue? Looking forward, when investors strategize about repositioning an asset or fixing a broken asset, the more diverse perspectives that come to the table to solve those problems, the greater the likelihood for innovative solutions that maximize the value proposition.

Can you turn the argument around and say, "It's actually being more responsible as a fiduciary" to include diversity, equity and inclusion as part of the investment process rather than something that goes against your fiduciary responsibility? Unless we move away from thinking about it as a social issue, we're going to have a hard time getting people to embrace it as a smart approach to being a fiduciary, making fiduciary decisions.

John McClelland: I think that's correct, Suzanne. At LACERA, I had a number of people of different ages and different ethnic backgrounds working on my team. When we were looking at an apartment investment opportunity not long ago, the first instinct one of my younger teammates had was to jump on the Internet and do a virtual tour of the property, as though they were a tenant or prospective tenant. Would they want to lease there? Just underwriting the virtual presence and footprint of the opportunity was something we would never have even thought of doing even 10 years ago. To them, it's the first thing that came to mind.

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And the other thing I'd point out, just to date myself and my ethnicity, is old white guys like me would never have dreamed of going to rent an apartment without walking through it themselves. And yet virtual leasing now happens all the time across the assets in our portfolio; our partners are making tremendous use of that technology and that capability. I think that's a terrific example of how the diversity of thought and opinion brings value to the equation.

Suzanne West: There aren't a lot of studies focused purely on the private real estate sector, but it does seem that there's more and more evidence that higher diversity among teams correlates to better performance and outcomes. Studies have shown this to be the case whether at the board level or with the senior management. Diverse professionals don't necessarily have to be on the investment committee, making decisions. They don't have to sit in the ownership chair, but ownership should incorporate and respect those voices. And so, how can we get a better outcome with our managers in the industry to more fully subscribe to it and embrace it?

John McClelland: I believe you had a couple of questions buried in there, Suzanne. One of them is whether diversity, equity and inclusion considerations replace or otherwise substitute for other underwriting considerations. I would say absolutely not, but they're additive. It's almost impossible for the addition of this information in that viewpoint to be a negative to the whole consideration. I think the industry is moving, perhaps slowly, but nonetheless moving in the direction you're suggesting, which is that investment managers with more diversity, equity and inclusion will be better positioned to help us meet that goal of producing the promised benefit. So it's not a social thing. I think that that line of thinking is increasingly showing up in boardrooms and in trustees around the country.

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The other thing I would mention is I love the concept of being able to measure the results. I think there are numerous studies that try to compare results with and without a more diverse decision-making process. I think that a more diverse process leads to better results, but not much of that data seems to be available in real estate. I would premise that's because, as we know, real estate is not homogenous. Each piece of real estate is different and has its own separate factors, any number of which can dramatically impact performance. To isolate the variable about the DEI inclusion in decision-making is extraordinarily difficult.

Addressing ESG

Suzanne West: Does LACERA as a public plan address diversity, equity and inclusion?

John McClelland: They absolutely do. Before I retired in March, a presentation was made to our board of investments in early December [2020] about the most current thinking on diversity, inclusion and the expansion of that into a program that internally we referred to as TIDE, which is Towards Inclusion, Diversity and Equity. It's a public document that your readers could access if desired.

LACERA also developed manager scorecards. Manager scorecards are put together every quarter by staff for all of the asset classes, including real estate. It attempts to measure numerous metrics, one of which is performance. Before I retired, we had been working on the manager scorecard for a couple of years.

It's a little easier in the public markets, but we expanded it to include private equity and private real estate. We expected over time to be able to quantitatively look at our scorecard evaluation and see how things were changing. And hopefully the team can draw some interesting conclusions about the relationship between the different categories within the score, and whether there's a relationship between the ESG score and the performance, for example. I don't know how statistically significant that might end up becoming, but I think it's an advancement in the right direction. I don't think LACERA is unique in the public pension environment for focusing on this. But I do think that we were perhaps expanding it a little bit more than a lot of our peers were.

Suzanne West: Did your managers know that LACERA had a scorecard and that you were keeping score internally and recording your observations?

John McClelland: Not only did they know, they got to see the scorecard. LACERA developed their own scorecard, their own categories and their own rating system, but it only let them rate the managers that were currently in their universe of managers on their balance sheets. The effectiveness of that will become known, evolve and probably improve over time. One of the big leaps has to be the ability to have scorecards beyond your own universe of managers to be inclusive of other managers so that you can compare your current managers' score relative to others in the universe. This would help with selection. All of the categories that are integrated into the scorecard are very much involved in the diligence and evaluation of managers.

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LACERA also had a due diligence questionnaire that we went through every year with our managers, as opposed to just when we were deciding whether to allocate money. The access to LACERA's board information and board meetings has improved significantly since we moved all meetings to virtual via Zoom. The link was posted publicly and the public could link in, listen and make public comments.

The public comment that we were hearing was increasingly related to ESG-related concerns and matters. It's a significant topic of interest with the board. This matters on every investment brought to the board. There was a discussion about ESG and the implications for each specific investment and the diversity, equity and inclusion practices of each specific GP and manager. There was a separate page on each one of those.

Does ESG make or break the decision? No. It's just a factor.

Suzanne West: When you received questions about ESG components during board meetings, were these considered a risk factor that the board wanted you to incorporate as it relates to social considerations or environmental or organizational vulnerability?

> **Does ESG make or break the decision? No. It's just a factor.**

John McClelland: The preponderance of commentary that we got was related to a social consideration of a specific investment. Frequently comments came from union representatives representing employees who were not happy with how a private equity manager was handling something. In years past, we had comments from the public about union organization efforts at hotel properties. They were unhappy about how hotel management was reacting to organizing efforts and wanted the investors to intercede on the union's behalf.

Let me just close the loop on one thing. "Wannabe" managers, as I call them, would be remiss to not take advantage of the educational

opportunity that they have to learn about LACERA from broadcasted board meetings. What are the central issues being discussed? What are the concerns and motivations of the members? What's the current strategy as well as the potential shifts? LACERA's CIO is impressed when groups come in and references the board's concerns and the programs the investment staff have initiated in the context of their business proposition. It shows a thoughtful approach that incorporates the pension fund's objectives in the context of their investment strategy. I would encourage people to do that.

LACERA is certainly not at the forefront of the public sector with that level of transparency. People are able to listen live to these meetings, but there is no archive of recordings. Many systems such as CalPERS and CalSTRS already have that capability. I think it's inevitable LACERA will get there.

Elevating junior professionals

Suzanne West: Employee satisfaction discussions today are being driven by the employees. If an organization wants to keep a solid talent pool in place with minimal turnover, the best way to do that is to make sure employees feel relevant and that they have a voice as well as opportunity for growth. Today's younger workforce feels more empowered as demonstrated by a willingness to move on if they don't see their objectives being met or if they no longer feel as though the culture is a fit. How does one, as an outsider looking in, assess employee satisfaction or whether a firm has a healthy inclusive culture?

John McClelland: By probing and going in a little deeper, we get a better sense of the overall culture. LPs are asking more questions in interviews and their underwriting process to not just check the box, but to ask about policy and how it really gets implemented. Are the employees required to acknowledge their understanding of it?

An unintended benefit of our Zoom world in this work from home environment, is that we're afforded the opportunity to see and talk to more participants in our underwriting of managers and GPs than we might otherwise have. The only group we usually got to interact with is the one getting on airplanes or the ones the manager wanted to show us if we had an onsite visit. In the virtual environment, we asked to speak to analysts or junior team members. There was no good reason for that request to be denied.

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Suzanne West: There is unfortunately a fear among the investment management community or the wannabe investment managers that they need to be very polished or scripted when they come in to meet with an investor. The stakes are really high.

I'm always pushing for more representation at meetings. With many clients I've gotten pushback where the comeback has been, "I don't want to put that person in front of an investor because they're not experienced in presenting to investors." My perspective is the investors will understand and appreciate it because it's authentic. Managers should showcase their bench, even those without the presentation experience, as the investor is trying to more fully assess how the team approaches the investment process and how collaborative the process really is.

John McClelland: I wanted to make two observations. One has to do with the magnitude of the importance that a manager or GP places on that meeting with the potential LP; that they got a meeting, that we might be an interested investor, is a big deal. The idea that the younger, junior people might participate at that stage of the process could be terrifying because it's such a high-risk environment. The virtual opportunity to have more people involved is terrific in terms of their development opportunities so that they could, even if they're not in the game, be on the sideline watching the game so that they can see this interaction. I will say from my standpoint, I find it increasingly difficult to get the senior people to pause long enough to let any junior people contribute.

I was notorious for telling senior people when I'm prepping them for a discussion: "I want to hear other people talk. I will, during this meeting, look to one of your colleagues and ask them a question, and I want them to answer it. I don't want you to."

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Putting intent into action

Suzanne West: I frequently hear people say that they just don't see a lot of diversity across the applicant pools when posting positions. That to me just means you need to broaden your search efforts. Think outside the box. Granted, if you're hiring a senior person, there's probably not a lot of senior black women that came up through the ranks and have 20 years of experience in acquisitions. However, for entry to mid-level professional hires, you should be able to attract a diversified pool of talented candidates from which to select the most qualified person.

John McClelland: We tend to see women in HR and finance and marketing. I always try to encourage them to go into the deal underwriting and acquisitions side, because I see that, more frequently than not, as the avenue for the upper echelon.

One of the things I look for is the composition of the investment committee, the group that's stamping approval on deals. How many members are women? I'm encouraged that women are increasingly being appointed to the investment committee. That's an exciting change in our industry.

I have been encouraged when seeing groups that have internal efforts to expand and support diversity, equity and inclusion within their own organization. Often there is a women's network and it has the support and mentorship of senior women in the organization. Some organizations have multiple different groups to support multiple different segments of diversity, equity and inclusion. I think that's a growing trend that will pay dividends going forward.

Suzanne West: John, your message to managers is very clear and I believe would resonate with many of your peers: We're not asking you to check the box. We're not asking you to make a change overnight. What we're asking you is to demonstrate a thoughtful approach to improving your potential for better performance and attracting the best talent to bolster your organization. We are seeking partners not just allocators of our capital so invest the time to understand what is important to us and present yourself accordingly.

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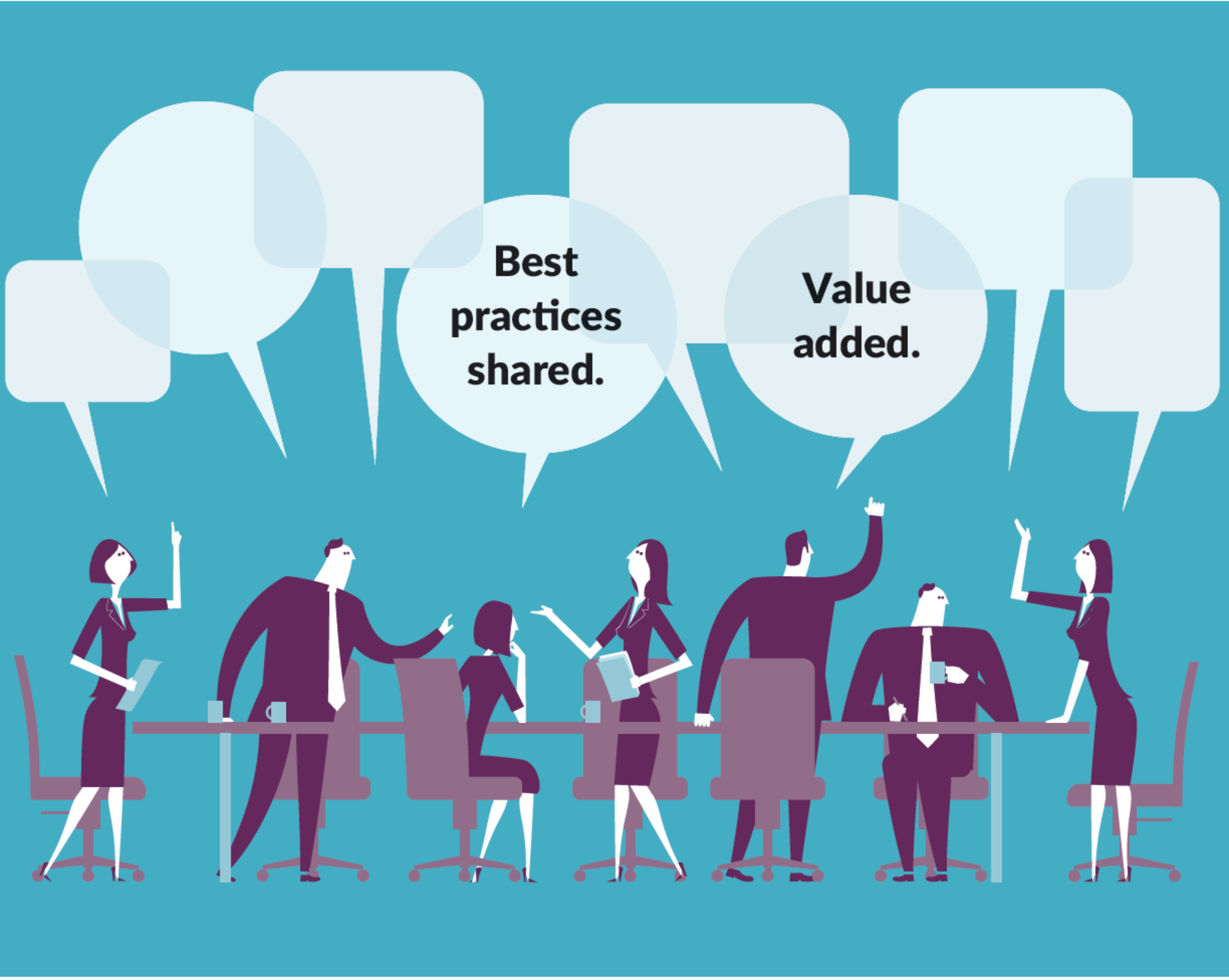

ABOUT NAREIM

NAREIM is the industry association dedicated to the business of real estate investment management. Founded in 1990, NAREIM today represents real estate investment management firms with combined assets under management of more than $2 trillion. For 30 years, NAREIM has been the home of real estate investment management business strategy benchmarking and best practices, where investment managers learn and share intelligence on business and organizational practices and performance.

For more information, contact **Zoe Hughes,** CEO, NAREIM at zhughes@nareim.org or visit www.nareim.org.