Verus

PERSPECTIVES THAT DRIVE ENTERPRISE SUCCESS

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Topics of Interest

Private Real Estate in Taft Hartley Portfolios

Introduction

Taft-Hartley pension funds in the United States often make allocations to private real estate with the dual objectives of generating robust returns and supporting union workers by investing in "labor-friendly" real estate strategies.

There is occasionally a misconception that investing in labor-friendly real estate strategies involves sacrificing performance. In this Topic of Interest, we examine core real estate manager performance over time using the North American Building Trades Report Card[1] to identify whether a performance difference does, in fact, exist.

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[1]Real Estate Manager Report card. NABTU. (2022, July 25). Retrieved March 14, 2023, from https://nabtu.org/nabtu-real-estate-manager-report-card/

Setting the stage

— The North American Building Trades Union (NABTU) Real Estate Manager Report Card strives to assign a grade to real estate strategies based on the language contained in the manager's Responsible Contractor Policy (RCP) and the implementation of the policy.

— A variety of characteristics are evaluated, including but not limited to:

- What aspects of the project are covered by the RCP,
- Whether the real estate manager notifies local trades of the upcoming project,
- Whether a past record of labor disputes exists, and
- Whether employee work hours are reported.

— We have divided all core real estate strategies that have completed this survey into two categories:

- The half of the product universe with the highest grades, and
- The half of the product universe with the lowest grades.

— The average scores of each of the two categories are used for this analysis. While the grades do not necessarily conclude that a manager/product is recommended or not, it provides a means of evaluating the robustness of their engagement with various labor organizations and their willingness to enforce the provisions within their policies regarding organized labor.

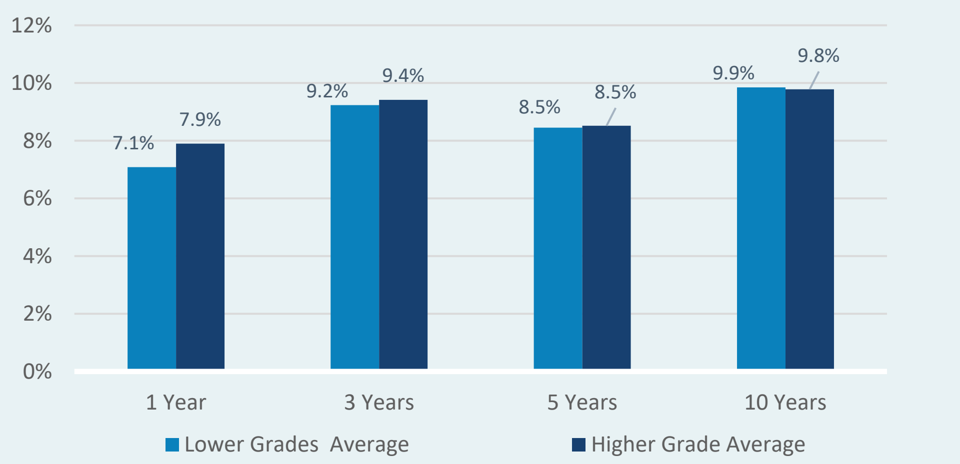
Highest grades vs. lowest grades

Below we illustrate the results of the analysis. First, **we find no material difference in performance between the core real estate strategies** with the highest grades and those with the lowest grades.

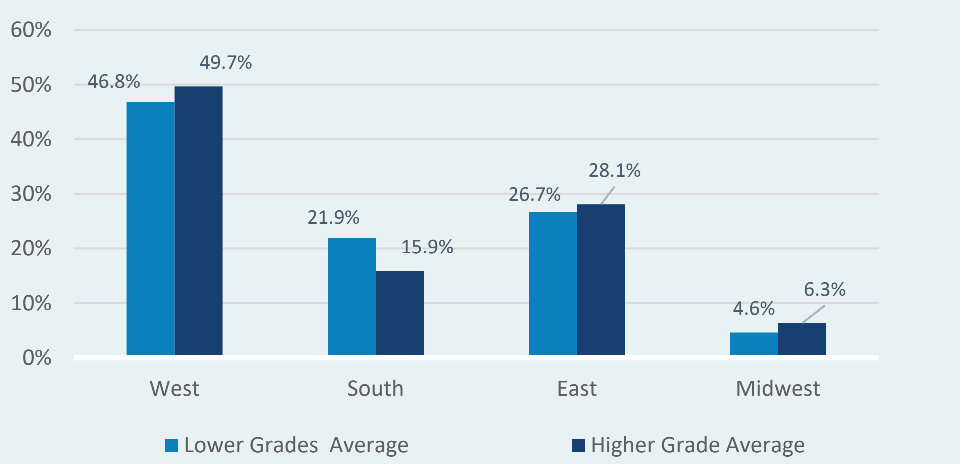
The performance of each set of strategies is displayed below, along with sector and geographic exposure. The similarities of exposures across groups suggests to us that exposure type did not play a major role in performance outcomes.

We found no material difference in performance, despite lower graded strategies having a larger allocation to the southern region.

PERFORMANCE BY REPORT CARD



EXPOSURE BY REGION



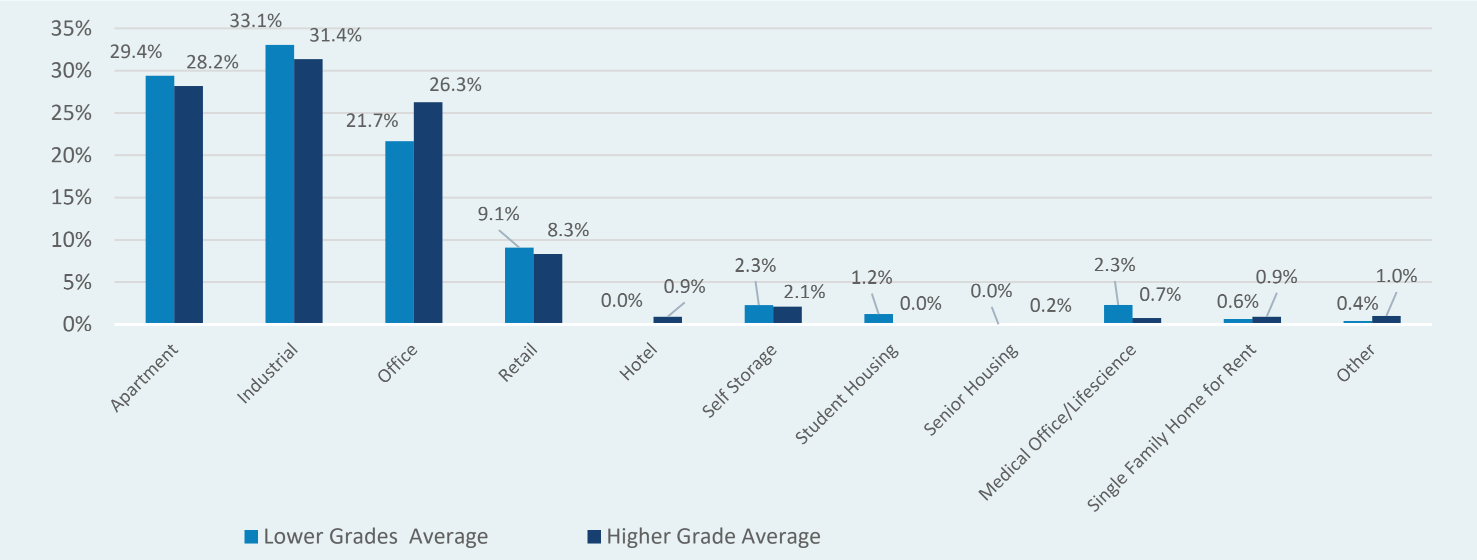
Source: North America's Building Trades Unions, Verus, as of year-end 2022. The highest-rated real estate managers are compared to the lowest-rated real estate managers.

Highest grades vs. lowest grades (cont'd)

In fact, higher graded real estate strategies produced equivalent performance despite holding greater investments in office real estate (office has been one of the worst-performing real estate sectors as of late).

Higher office allocations of these strategies make sense, given the union concentration in major cities with large office buildings and the many union jobs created by ongoing tenant-improvement processes.

EXPOSURE BY PROPERTY TYPE



We found no material difference in performance, despite higher graded strategies having a larger allocation to the office sector.

Source: North America's Building Trades Unions, Verus, as of year-end 2022. The highest-rated real estate managers are compared to the lowest-rated real estate managers.

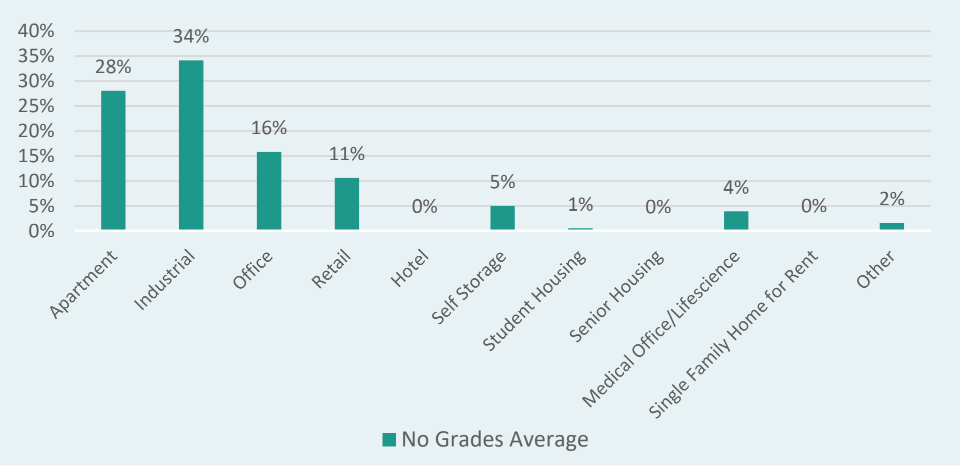
NABTU non-inclusive reports

The NABTU report card is not all-inclusive: there are several core real estate funds not rated on the report card.

The non-graded strategies have outperformed over all trailing time periods. Much of this can be attributed to the sector and geographic allocation and recent covid-driven performance dispersion in those characteristics. The office sector has underperformed the broader NCREIF Property Index significantly. Non-grade strategies have lower exposure to the office sector, which have been poor performers, and higher exposures to alternative property types, which have been strong performing sectors.

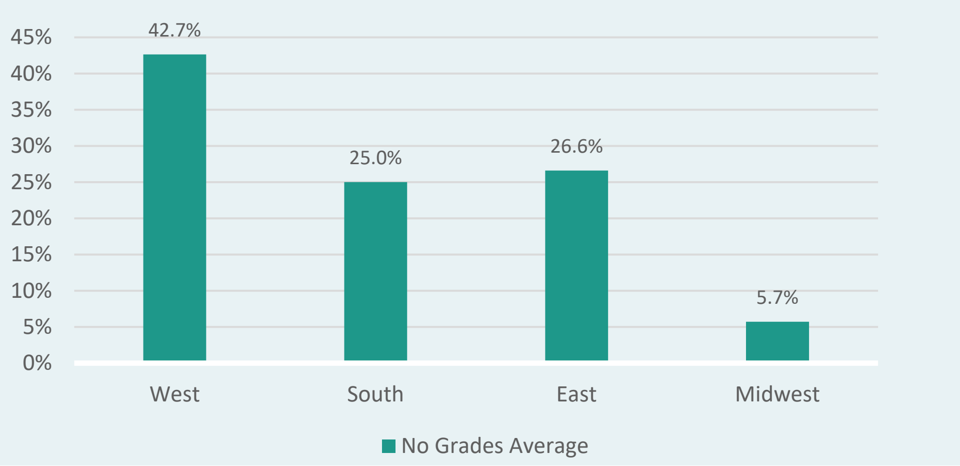
Additionally, these non-graded strategies held far greater investments in Southern U.S. real estate – a region experiencing tremendous population growth and real estate valuation increases. The South region has outperformed the broader NCREIF Property Index in recent years as well. The tailwind created from greater exposure in the South has been less impactful than the office sector allocations, but when combined explain the recent performance differences.

EXPOSURE BY PROPERTY TYPE



Source: North America's Building Trades Unions, Verus, as of year-end 2022

EXPOSURE BY REGION



Source: North America's Building Trades Unions, Verus, as of year-end 2022

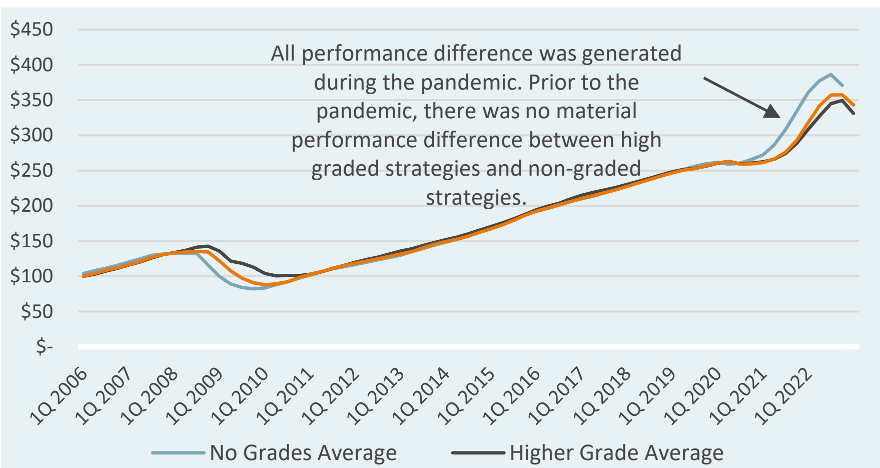
Performance

The locations and property types in which managers invest are important, as these decisions are the main drivers of return. However, the data suggests that a bias towards real estate managers that are seen as friendlier to labor does not hurt performance over the long run.

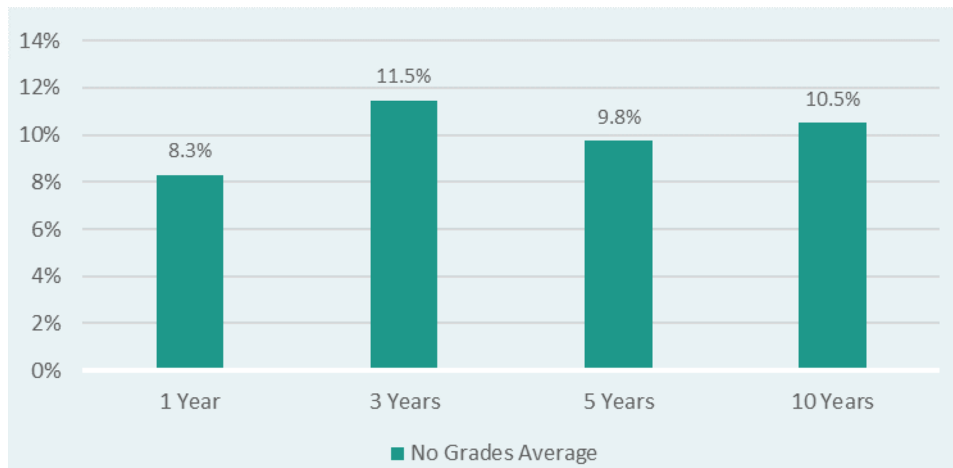
One could argue that the current higher office exposure may be a near-term headwind for higher-rated strategies as the office sector faces continued challenges in the current environment. We would point out however, that these allocation differences are point-in-time snapshots with dynamic and changing allocations. Conversations with highly rated managers indicate a desire to reduce office exposures and add exposures to markets with higher growth over time, such as the South.

Even in markets where there is a lower prevalence of union labor, many highly rated strategies are not precluded from investing in those markets but must use best efforts to make open project bids, report hours, etc. which will be a benefit to organized labor in those markets.

RECENT PERFORMANCE DIFFERENCE DUE TO COVID-19



RETURNS OF NON-GRADED STRATEGIES



Source: North America's Building Trades Unions, as of year-end 2022. Verus survey responses.

Conclusions

Taft-Hartley pension funds in the United States often make allocations to private real estate with the dual objectives of generating robust returns and supporting union workers by investing in “labor-friendly" real estate strategies.

While there occasionally may be a misconception that investing in these real estate strategies involves a sacrifice of performance, the data suggests that the performance of private real estate managers with robust Responsible Contractor Policies and strong enforcement measures is competitive with the broader private real estate universe. This is important because as fiduciaries, Boards of Trustees must act in the best interest of the plan participants.

The higher-graded strategies that more actively engage with labor may offer a dual benefit of competitive returns and contribution hours.

For additional perspectives on this topic, please reach out to your Verus consultant.

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