An interview with:

Mike DiRé
Director of Real Estate Investments
California State Teachers Retirement System

Christina Scarlato
Principal Portfolio Manager, Real Assets
The World Bank Pension Fund

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INVESTOR PERSPECTIVES ON DIVERSITY & INCLUSION

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NAREIM DIVERSITY & INCLUSION SURVEY INTERVIEW SERIES:

CALSTRS AND THE WORLD BANK PENSION FUND

NAREIM
The business of real estate investment management

About the NAREIM Diversity & Inclusion Survey

For more than a decade, NAREIM has produced a Diversity & Inclusion (D&I) Survey for its members. This fall, NAREIM is expanding its survey in an effort to help the entire industry become more diverse.

It's easy to talk of the lack of diversity in the real estate investment management industry. According to the NAREIM 2019 D&I Report, just 16% of executive managers were women and 6% were non-white. However, there is a bigger issue at stake, something which is succinctly articulated by Mike DiRé and Christina Scarlato in the accompanying interview.

Diversity is not just about gender or ethnicity. It's 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, prepares to invite real estate investment managers to participate in its Diversity & Inclusion Survey this Fall, we asked institutional investors to talk about their perspectives on diversity and inclusion and how they are working with investment managers to deliver lasting change for the industry. Enjoy the conversation.

Participant biographies

Mike DiRé is the Director of Real Estate Investments at the California State Teachers' Retirement System (CalSTRS). He leads a staff of 25 and a portfolio of approximately $35 billion, including both discretionary and non-discretionary investments. He joined CalSTRS in July 2000 and has expanded the CalSTRS Real Estate program into joint ventures, international investments and real estate debt. Prior to joining CalSTRS, he worked as a real estate investment specialist for the California Public Employees Retirement System (CalPERS). Prior to joining CalPERS, he worked for Deloitte & Touche Real Estate Consulting Group and Liquidity Fund Financial Corporation. Mike holds a Bachelor's degree in Real Estate and Finance from California State University — Sacramento, and is a member of PREA, NAREIT and ICSC.

Christina Scarlato is Principal Portfolio Manager for real asset investments at the World Bank Pension Fund. She is responsible for strategic planning, monitoring existing managers and evaluating prospective managers across real assets both domestically and abroad. She has worked with the World Bank Pension Fund since 2007, and previously worked for several years in various departments across the Treasury Department of the World Bank. She was past Chairman of the Pension Real Association Board, where she still serves on the Board. Christina received a B.A. in Mathematics and Spanish from Seton Hall University and an MBA from George Washington University.

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 Co-Founder 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.

Intent, traction and asset-level diversity

The desire to change is critical when it comes to improving diversity in private real estate

Mike DiRé, director of real estate at the California State Teachers Retirement System, and Christina Scarlato, principal portfolio manager, real assets at The World Bank Pension Plan, both agree that it's difficult to demand managers meet preset criteria on diversity, either at the ownership or corporate level. However, they say it's not difficult for investors to talk more about the diversity of their manager partners — or for managers to show traction on progress in diversity.

Speaking to Suzanne West, senior advisor of The CenterCap Group, DiRé and Scarlato talk about how their plans have worked with managers to encourage and enact change, and how managers can communicate better with their investors about how they're focusing on diversity at the corporate, as well as asset management, level.

> "We've tried to lean in by looking for ways to make allocations of capital that would lead to more diverse management teams while also achieving strong financial returns."

Key highlights:

- CalSTRS believes that diversity of ideas is important to achieve top-tier returns.
- The World Bank's goal is to find high caliber, interesting groups pursuing unique and compelling strategies that fit within their portfolio. Diversity is a differentiator, but it is not a criteria until there is more diversity within the field.
- LPs are evaluating GP responses to tough questions to determine if the manager is proactive about making improvements, such as setting up a diversity outreach program and hiring senior women or people of color. LPs are looking to invest in managers that are attentive and forward-thinking.
- ESG should not be a check-the-box exercise and reporting numbers, but articulating plans and enacting change with investments at the portfolio and asset level. The best ideas on ESG should always be shared.

Suzanne West: I would like to focus our conversation on the true diversity of organizations and the cultural shift towards inclusivity necessary to effectuate meaningful change within our industry. Supporting the growth in number and scale of firms owned or led by women and people of color continues to be a priority, but it takes time. Can you each share your perspectives and how your organizations are trying to promote positive change?

Mike DiRé: I have been with CalSTRS Investments for about 20 years now and the lack of diversification among our investment managers across the entire investment portfolio has been a concern throughout that time. However, it should be noted that the State of California has had rules in place for decades explicitly stating that you cannot discriminate by gender, race, age or sexual orientation. Ironically, those rules actually work against some of these diversity and inclusion goals since we, CalSTRS, can't effectively make diversification a selection criteria even though our board members and our senior staff recognize the need as well as the benefits.

Historically, we've tried to lean in by looking for ways to make allocations of capital that would lead to more diverse management teams while also achieving strong financial returns. A good and ongoing example has been our urban investment strategies. Real estate is local and so to be most effective, the groups executing urban renewal strategies are advantaged if their teams reflect the communities in which they operate. Because we have the flexibility to invest through joint ventures and separate accounts, CalSTRS is able to form some investment relationships with diverse managers. We've had success and honestly some challenges with that approach. It is time-intensive and we have been challenged to get meaningful amounts of capital out.

The bottom line is, there's engagement at multiple levels. CalSTRS believes that the diversity of ideas is important to achieve top-tier returns. In the course of our ongoing investment activities with our current managers, we raise the subject and try to learn what they are doing to tackle the issues. We can quickly assess the importance to their organizations while also finding new approaches or, hopefully, best practices.

It would be awkward to sit in the chairs we're in, and for me in particular as a white male, to direct people to do better if we didn't look at ourselves first.

We have struggled to get women in senior positions in real estate. At CalSTRS Investments, it has taken time to achieve results but we can now say that 46% of our investment directors are women and more than 50% of CalSTRS' staff self-identify as other than white. We didn't have a female portfolio manager on our team until six months ago, which wasn't on purpose, but simply a function of how long the team has been in place with minimal turnover.

Clearly the events of 2020 relating to racial inequality is a subject that is difficult to address for all parties. I personally have wondered if my perspective is relevant. However, as leaders in our organization and industry, we have to find a path to engage whether or not it's uncomfortable.

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West: You're right. Real estate is local with properties serving a diverse tenant, resident or consumer base. Thus, to be most effective, management firms should broaden their perspective by seeking input from team members representing differing age, gender and cultural backgrounds when making strategic decisions about their assets.

Christina, you have also been a long-time advocate for greater diversification across our industry. What has been the World Bank's impetus for change?

Christina Scarlato: The World Bank is super diverse and, as an American citizen, I am actually in the minority. The Bank has been focused on diversity and inclusion for a long time and women make up over 40% of senior management, with a goal of reaching 50%.

Starting at least seven years ago, the Pension Fund started pushing ESG initiatives that led to building a dedicated three-person team and signing onto the United Nations Principles for Responsible Investment. Ironically, the Pension Fund is a signatory but the Bank is not. The real assets team has focused more on governance issues, including diversification, where others have focused more on environmental issues. Unfortunately, educating the ESG people about what it is that we do as real estate investment professionals has been challenging. Coming up with a due diligence questionnaire that's relevant to real estate is not as easy as one would think. But we're getting there.

It's interesting what you said, Mike, and I've heard other investors say the same thing that, "as a group of white men, who are we to tell a manager that it needs to be more diverse?"

Ironically, in the past, I have felt the same awkwardness but from a different perspective, where my push for increased diversity is somehow diminished as being self-serving. But with more LPs talking about it, I feel less awkward asking those types of questions. There was certainly a time when I felt like I was the token female asking the token female questions on maternity policy. At the end of the day, the reason firms have more diversity is because of policies that support maternity leave and a better work-life balance for families raising children.

As an industry, I think we're making strides in the right direction. When I attended PREA for the first time 12 years ago, there were still relatively few women attending. That has improved dramatically. What PREA is doing with Sponsors for Educational Opportunity is awesome. The key is starting from the ground up, bringing young people into this industry, teaching them about it and getting them excited to pursue a career in real estate. You're not going to, all of a sudden, create a field of female and diverse middle or senior management. You've got to start at the bottom, at the analyst level, and grow them internally.

West: What measures have worked for you, whether making selection decisions based on a firm's commitment to diversity or having candid conversations with your partners around the importance of diversifying away from traditionally homogenous management teams? Is diversity a key component of your management selection process?

Scarlato: It helps, but it's not a must. Our goal is to find interesting, high caliber groups pursuing unique and compelling strategies that fit within our portfolio. Diversity is certainly a differentiator, but I don't think we can make it a criteria until we have more diversity within our field.

DiRé: We are addressing the issue by trying to find the alignment of what makes good investments. Is it racial or gender diversity? We have also discovered the importance of incorporating the views of younger generations when making strategic, sector-specific investment decisions as millennials have become a driving force on office. We are making selections to get an appropriate risk-adjusted return.

We are also focused on how we, as the people putting out the capital, can take additional steps to effectuate change. For us, there are some simple things we do that help. We ask for pictures

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of the management and investment teams when they come and present to us, whether an existing or a potential relationship. We ask them to lay out, not only who works directly on our investments, but also to show us pictures of the management team members not represented in the room. It helps us identify the people who work on our account, which was the original goal; however, we have now found that it also lays out for all to see the diversity of the team — or lack thereof. Managers now often acknowledge upfront when they need to improve the diversity of their teams.

It is with our existing relationships where we believe we have influence. We are in it together and can exchange ideas with the acknowledgement that we all have room to improve the diversity of our teams. Another typical way we raise the subject is to ask about the customer base of assets they manage. Back to what I mentioned earlier, the management of the assets should benefit by having those managers be relatable and in tune with the customers.

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West: How have you managed situations where you liked the team and the strategy, but were disappointed by the firm’s lack of diversity?

Scarlato: We have never told a manager “we’re not going to hire you because you’re not diverse enough.” We’re not there yet. However, we have talked to our managers about ways to become more diverse and we routinely share examples from our other managers. One firm we’re invested with has spent a lot of time on this, including hiring a consultant who pointed out to them that their applications were male-focused. They have since improved their hiring process and started identifying and recruiting diverse talent early through internships.

DiRé: Similar to Christina, we haven’t said it’s a threshold you have to get over. But the conversations are a lot easier to bring up now as with my earlier example of our urban strategies. While it doesn’t come up as much with firms presenting lending strategies because it’s more of a numbers game, there are plenty of opportunities in between to have the conversation. Again, real estate is a customer business. How are you addressing your customers?

Let’s take a simple and arguably extreme example — retail. I hope it’s not sexist to say that the majority of consumer purchasing decisions are made by women. If a team came in and presented a retail strategy where only men were part of the investment and management team, it would raise a question whether they were fully equipped to relate to all of their customers. These are fair questions and have become more commonplace. You can find a way into the dialogue about how firms are managing this, what they are doing that's unique to address what's happening in America today, and how they are going to make us more money and generate a better risk-adjusted return. I think that's the most effective path that we have found that addresses the issues.

We can tell whether a management team genuinely wants to make improvements in any area of their business by their responses to tough questions. For example, have they already taken the initiative by setting up a diversity outreach program and hiring senior women or people of color that are helping them in every conversation to make sure unseen biases are addressed? To me, anyone who is thoughtful about any issue is ultimately a better manager and investor. CalSTRS wants partners who are attentive and forward-thinking to invest our money.

West: Historically, the culture of many real estate firms was a reflection of a single person, or personality, at the top and generally deal-driven. Today, more and more firms are recognizing the importance of human capital and diversity as drivers of a long-term, viable business. For our industry, we need to think outside the box and broaden our recruitment efforts to make it happen. What's going to motivate these firms to put in the extra effort it might take to build out diverse teams?

Scarlato: I think it's us; it's the LPs' responsibility. I don't think the managers would make the effort, without a push by the money that keeps them in the business. Of course, some have made progress but it is on the margins. As uncomfortable as the conversations are, we have them because they are important and they have to happen. If they don't happen, nothing changes.

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The reality is, across ESG, we have had to work closely with our managers on their responses to unveil what they are actually doing. With respect to environmental, as it turns out, some of them are doing all the right things but just haven't had the experience of putting it to paper. We have felt like pioneers on this front and recognize that the LPs have to just keep pushing the managers to continue making progress on the social issues.

DiRé: I agree. LPs may not be able to speak with one voice, but the conversation is going to happen if we are collectively raising the same issues. People have been talking about environmental and sustainability initiatives long enough that it is an easier conversation to have now. However, the social portion of ESG is hard. How do you track progress? Social progress is difficult to track, but it's not difficult to show traction. That said, CalSTRS is finding that managers are being proactive in this area and we have gained recruitment ideas from them.

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West: How can managers show traction?

DiRe: Initial traction is just that they're engaged on the subject matter. The numbers come later. Every company's basic goal is to attract and retain the best employees available. Attracting new people of color or more women into management will come from engagement. It shouldn't come from the law of large numbers. There will naturally be more diversity and more women for larger firms, but managers shouldn't get credit for that. The more progressive companies that have a plan and process will be ahead of the curve.

West: Christina, you mentioned a firm that you're invested with that hired a consulting firm to review and assess their business practices in terms of diversity and inclusion. What was the outcome?

Scarlato: The manager, which is a smaller firm, now recruits SEO interns where they previously focused on students from Ivy League universities. As the firm's strategy is centered on workforce housing, they've also partnered with not-for-profits to create after-school programs for children at their assets. It's a huge value-add to the asset; it helps immensely with retention of tenants and it doesn't cost a lot.

To Mike's point, it's less about the statistics than actually being able to say, "We're doing these things to be better." And it's not just at the manager level; it's at the asset level as well. You're not going to change it today or tomorrow, but what actions are you taking to get there? That's a big piece of enacting change.

I will add that the best ideas on ESG should always be shared. GPs may feel they cannot give away their best ideas but, on the ESG front, people should work together and not fight one another.

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DiRé: I think that what Christina just said is really important. I fear ESG will come down to checking some boxes. It's pretty expensive to hire someone to run your ESG program. I think there should be an emphasis on ways to do ESG without having to check the corporate boxes. LPs are impressed when people think outside the box — it's impactful and what you want them to do with your investments.

West: Is there a way to capture the momentum?

DiRe: It's articulating questions that you utilize for due diligence or periodic reviews that eventually become a shared value. If you spend a significant amount of time with your GP partners across the organization, from top to bottom, you will see and hear if there is momentum.

Scarlato: At the end of the day, things come out through conversation since some of our managers are already doing a lot of the right things. With our encouragement and that of other LPs, we are seeing progress on diversity and ESG. The more that GPs are asked to report annually on ESG, either in writing or at the annual meeting or both, the more progress we will continue to make as an industry.

What's critical is to know that it's not about checking the boxes — it's about intent and actual desire to do better. I do believe our industry is moving in the right direction.

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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 $1 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.

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