



# National Employers Retirement Trust

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## Principal U.S. Property Fund Update

Dear Retirement Plan Participant:

Enclosed please find a letter to participants who are investing in the Principal U.S. Property fund. In this letter, Principal describes the current situation facing the portfolio resulting from the economic distress associated with COVID-19. Consequently, the portfolio manager has made the determination to limit withdrawals from the fund to a pro-rata queue. They have taken this step in order to achieve several outcomes:

1. To protect the long-term interests of Plan Participants who have interests in the account,
2. To avoid forced liquidation of income producing properties at a disadvantageous point in time, and
3. To provide generally for fair treatment to those participants wishing to retain their interest in the portfolio, as well as those who are redeeming.

Although properties generate income, real estate is by nature an illiquid asset and this action is taken to preclude forced sales in a panicked market. Even though NERT's advisor, Acorn Financial Advisory Services, is troubled by this action, they agree it is far better than any of the alternatives.

Participants who have followed the returns of Principal U.S. Property fund know it has generated very good returns with low volatility for NERT participants. However, because of operational limits being imposed by Principal currently, NERT will not be processing transfer requests out of the fund except in the case of death or retirement.

Additionally, NERT will not be processing transfers into the Principal U.S. Property fund unless specifically directed by the participant on a per transaction basis.

As a result, unless directed otherwise, participant contributions are being allocated as follows:

**Self-directed Plan Participants:** Contribution allocated towards Principal U.S. Property Fund will be re-allocated to Wells Fargo Government Bonds, our safest fund available fund option.

**Model Asset Allocations Plan Participants:** Acorn Financial Advisory Service has revised the NERT Model Asset Allocations to meet their stated objectives without contributing to the Principal U.S. Property Fund. Participants who have elected the model will have new plan contributions allocated as described below.

| ELECTED MODEL ASSET ALLOCATION |               |                     |                     |                 |
|--------------------------------|---------------|---------------------|---------------------|-----------------|
| Fund                           | Stable Income | Conservative Income | Traditional Pension | Equity Oriented |
| MetLife Stable Value           | 20%           | 15%                 | 8%                  | 5%              |
| Wells Fargo Govt. Securities   | 25%           | 20%                 | 10%                 | 0%              |
| Wells Fargo Income Plus        | 20%           | 15%                 | 8%                  | 0%              |
| PIMCO International Bond       | 10%           | 10%                 | 5%                  | 0%              |
| Principal U.S. Property        | 0%            | 0%                  | 0%                  | 0%              |
| Vanguard Wellington            | 15%           | 10%                 | 0%                  | 0%              |
| Dodge and Cox Value            | 0%            | 0%                  | 10%                 | 15%             |
| Vanguard S&P 500 Index         | 5%            | 15%                 | 16%                 | 20%             |
| T.Rowe Price Growth            | 0%            | 0%                  | 10%                 | 15%             |
| Hennessey Focus Small/Mid Cap  | 0%            | 5%                  | 14%                 | 15%             |
| Pimco Commodity                | 5%            | 5%                  | 5%                  | 10%             |
| Artisan International          | 0%            | 5%                  | 14%                 | 20%             |
| Total                          | 100%          | 100%                | 100%                | 100%            |

### **NERT – A Cornerstone for Your Secure Future**

In view of the current struggles facing retirement plan participants, we feel confident that our diversified program is continuing to meet the type of risk management people require to plan for their long-term needs both pre and post-retirement.



Principal US Property Separate Account  
Plan sponsor Q&A

**What makes the Principal US Property Separate Account different from other separate accounts established by Principal Life Insurance Company?**

- The Principal US Property Separate Account (Separate Account) is unlike most other retirement plan investment options. It invests primarily in owned private equity commercial real estate rather than securities.
- These holdings primarily include developed, commercial properties such as warehouses, office buildings, apartments and retail properties.
- Unlike public securities sold on an exchange, real estate assets are sold in private transactions that take a period of time to process.

**Why is this limitation being applied?**

In the first quarter of 2020, the global spread of COVID-19 dramatically altered public life throughout the world. Efforts to mitigate the risk of infection and slow the transmission of the virus have impacted nearly all facets of the U.S. economy, reflected in a quick and volatile correction in the public equities market. The exogenous shock of COVID-19, the collapse of oil and increased risk of recession have led to deteriorating market and economic sentiment as we grapple with management of a health crisis, a public equities market that remains in bear territory, and liquidity challenges in certain segments of capital markets.

As investors rebalance portfolios, investors in the Separate Account have submitted withdrawal requests. The dollar amount of the withdrawal requests in a concentrated period resulted in reduced liquidity for the Separate Account. As a result, Principal Life Insurance Company is applying a withdrawal limitation in accordance with the terms of the group annuity contract that provides access to the Separate Account. This limitation will be in place at least until adequate liquidity exists to meet withdrawal requests and maintain ongoing operations.

**What are the specifics of the limitation applied to the Separate Account?**

- List of transactions and whether they are or are not subject to the limitation:

|                          | Event   |
|--------------------------|---|
| No withdrawal limitation | Death and Disability Benefit Payments   |
|                          | Minimum Required Distributions  |
|                          | Life Insurance Premiums   |
|                          | Plan Termination  |
|                          | Hardship Withdrawals  |
|                          | Small Amount Force Outs and Distributions   |
| Withdrawal limitation    | Transfers out <ul style="list-style-type: none"><li>• Participant</li><li>• Plan Sponsor</li><li>• Advisor directed</li></ul> |
|                          | Participant Terminations  |
|                          | Voluntary Withdrawals   |
|                          | Contract Terminations   |
|                          | Rewrite, Spinoff, Merger (except transfers-in-kind)   |
|                          | Rebalances (scheduled & one-time requests)  |
|                          | Retirement payments   |

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**How will Defined Benefit plans be impacted?**

- Since individual participant accounts are not held under a defined benefit plan, the limitation applies a bit differently to these plans.
- The limitation applies to contract-level employer investment transfers. It may also apply to benefit payments depending on how the plan sponsor chooses to handle the situation.

**When did the limitation take effect?**

On Friday, March 20, 2020, after market close.

**How long will it be before all withdrawals requested by plan fiduciaries or participants can be made?**

- The dollar amount and timing of future payments is uncertain and may depend upon developing changes in the economy and resultant performance of commercial real estate. The funds derived from property sales proceeds, rents from tenants and investor contributions are used for ongoing property and portfolio level cash needs, interest payments on debt, acquisitions, retirement of debt and funding of payments to investors whose requests are subject to the withdrawal limitation. It is possible that multiple payments over time will be necessary to fully satisfy all requested withdrawals given the current environment, dollar amount of requests subject to the withdrawal limitation and the cashflow forecast of the Separate Account. Property sales may be a contributor to funds available for distribution, though the determination to sell a property will be based upon portfolio investment strategy, liquidity considerations and expected property performance.
- The Separate Account will continue to be managed according to all pre-set portfolio diversification and leverage ranges, in compliance with relevant legal and financing obligations, and in a manner consistent with the strategic objectives of a core commercial real estate portfolio. This is consistent with managing the Separate Account in the best interest of all contract holders and their participants.
  - Additional withdrawal requests may impact the time that the withdrawal limitation continues to be in effect.
  - Regular processing of all withdrawal transactions will resume once the Separate Account has adequate liquidity and all withdrawal requests subject to the limitation have been satisfied.

**How does Principal Life Insurance Company disclose the liquidity risk associated with this Separate Account?**

The disclosure of the risk has been communicated within the group annuity contract that makes the Separate Account available for investment

**What gives Principal the right to delay processing withdrawal transactions or processing them in a series of payments?**

- The group annuity contract that makes the Separate Account available for use includes a section referring to this special provision. The pre-existing contractual limitation in the group annuity contract allows us to manage the Separate Account and satisfy withdrawal or transfer requests proportionately over time and fairly among all those making a request. Please refer to your contract for more information. If you don't have a copy of your contract, contact your Principal representative for a copy of your contract language.

**If withdrawal requests are subject to the limitation, could multiple distributions be received by plan participants or financial institutions?**

- Yes. As additional cash becomes available from investments under the Separate Account, transactions subject to the limitation will be paid among plans and plan participants proportionately over time and fairly among all those making a request.
- This means transactions may be processed in a series of payments until enough cash is available to pay all obligations.

**How was the limitation communicated?**

- All impacted parties were notified after market close, March 20, 2020, through an email or Message Center message

**Why did employees, financial professionals, plan sponsors and participants all find out at the same time?**

- To ensure accuracy and equal treatment for all investors, it was necessary and appropriate to communicate to all audiences at once.

**Are the holdings under the Separate Account safe, given this recent announcement?**

- The application of the withdrawal limitation does not change the values of the real estate properties held in the Separate Account. In fact, the withdrawal limitation is a way to help manage the Separate Account in the best interest of all investors.
- The highest priority in the management of the Separate Account is protecting the investment that our clients have in the Separate Account and its properties.
- Consistent with the operation of the Separate Account, the market value of the underlying real estate holdings, and therefore the unit value, will continue to fluctuate in response to market and property-specific considerations.
- Notwithstanding the current volatility in the U.S. economy and real estate markets, the portfolio management team intends to maintain the core, low-risk strategy and high asset quality of the Separate Account. They maintain their dual focus on return generation and risk management, with the interest of all investors at the forefront of their management of the Separate Account.

**How does the implementation of a withdrawal limitation affect the overall unit value of the Separate Account?**

- The implementation of a withdrawal limitation does not impact the calculation of the unit value of the Separate Account because requested withdrawals remain invested until they are distributed. The market value of the underlying real estate holdings, and therefore the unit value, continues to fluctuate as normal.
- It's important to understand that not implementing a withdrawal limitation could have had an adverse effect on the Separate Account. The withdrawal limitation allows those wanting to leave the Separate Account to receive their withdrawal amounts over time in a manner that does not compromise the strategic objectives of the Separate Account. It also helps protect the amounts of cash needed to preserve and operate the real estate investments held in the Separate Account.

**Do our competitors offer an owned real estate product similar to the Principal U.S. Property Separate Account?**

- Yes, the Separate Account is one of many similar real estate strategies available today and is one of 24 data contributing members of the NCREIF Fund Index – Open-end Diversified Core Equity (NFI-ODCE) index to measure performance of comparable investment vehicles. Many of these strategies offer their open-ended real estate

products to institutional-sized defined benefit plans. The types of clients, plans, and amounts eligible to invest in this type of investment option will vary.

**Are there any other real estate products that have applied this kind of limitation?**

- Yes. There are a number of NFI-ODCE data contributors that invest in owned private equity commercial real estate who can delay payment of withdrawal requests and some have done so in response to current market conditions.

**A plan termination date was set for our plan and we'd like to transfer funds currently invested in the Separate Account into other investment options. Is that possible without the withdrawal limitation?**

- When plan assets are distributed at plan termination, the amount of the plan's interest in the Separate Account will not have a withdrawal limitation and will be available for distribution.
- If, before the termination date, the client wishes to transfer out of the Separate Account, transfers will have a withdrawal limitation and transferred as directed by the client to the extent that the payment of restricted requests allows.
- If, at the plan's termination date, there are transfers from the Separate Account still restricted by the withdrawal limitation, they will no longer be restricted and paid out when the plan makes its distributions.

**How is the Separate Account positioned?**

The Separate Account is well positioned in the current market environment given its philosophical foundation of equal emphasis on return generation and risk management. The core portfolio, comprised of high-quality assets diversified across 43 markets, is approximately 93% occupied.<sup>1</sup> The relative strength of the Separate Account's current position was constructed on:

- Strategy: For several quarters, we've communicated a late-cycle awareness of increased risk and began increased implementation of risk management and mitigation strategies. That includes:
  - A reduction in the utilization of leverage (22.4% leverage at 12/31/17 relative to 18.8% leverage at 12/31/19).
  - A reduction in the Separate Account's office allocation (41% at 12/31/17 relative to 37% at 12/31/19) through the sale of nearly \$1.5b in office properties.
  - Modest utilization of the Separate Account's value-add allocation to execute on short duration build-to-core opportunities in property sectors and markets that clearly align with long-term strategic investment objectives. The Separate Account's current development pipeline (included in the value-add allocation) is comprised almost entirely of multifamily properties, all of which are expected to be construction complete within the next two-year period.
- Defensive property sector allocation: The Separate Account's research-based property sector allocation strategy includes a portfolio with no exposure to regional and super regional malls or senior living/assisted care facilities, two potential areas of weakness in the current environment. The Separate Account's underweight position to retail and focus on ownership of neighborhood and community centers results in strong tenant credit and a diverse base of industry exposure. The Separate Account's property sector allocation strategy includes an overweight position to industrial, which may report reduced tenant demand due to short term supply chain disruptions caused by a slowdown in Asian exports, with some mitigation from the potential acceleration in

consumer transition to e-commerce. Long term, the secular change in distribution and e-commerce adoption is expected to foster continued tenant demand and strength in relative performance. The Separate Account has also actively grown its allocation to the multifamily sector, increasing multifamily as a percentage of portfolio gross assets from 21% at the end of 2017 to 27% at the end of 2019. Underlying economic fundamentals, demographic trends and increased construction costs limiting additional new supply led to the increased allocation, now further augmented by multifamily historical strength in late-cycle and transitional economic environments.

- Income return and income growth: The Separate Account delivered significant same-property net operating income (NOI) growth throughout the current cycle, most recently ending 2019 with 7.0% year-over-year growth. Given the long-term nature of many commercial leases in the portfolio and structural growth from future stabilization of the value-add portfolio, we anticipate continued relative strength in NOI growth and income generation.

#### **Where can I find additional information about the Separate Account?**

- [USPSA Quarterly Flash Report \(FF5929\)](#)
- [2019 Annual Report](#)

If you would like a copy of the above performance reports, please reach out to your Principal contact.

<sup>1</sup> Occupancy excludes value-add assets which are acquired at less than 85% occupancy, are under development or redevelopment. Occupancy for the total portfolio is 93.1% as of 12/31/2019. Occupancy shown is percentage leased and is based on square footage.

**Before directing retirement funds to a separate account, investors should carefully consider the investment objectives, risks, charges, and expenses of the separate account as well as their individual risk tolerance, time horizon and goals. For additional information contact us at 800.547.7754 or by visiting [principal.com](http://principal.com).**

**Investing involves risk, including possible loss of principal.** Real Estate investment options are subject to investment and liquidity risk and other risks inherent in real estate such as those associated with general and local economic conditions. Property values can decline due to environmental and other reasons. In addition, fluctuation in interest rates can negatively impact the performance of real estate investment options.

Sub-Advised Investment Options include Separate Accounts available through a group annuity contract with Principal Life Insurance Co.

Separate Accounts are available through a group annuity contract with Principal Life Insurance Co. Insurance products and plan administrative services provided through Principal Life Insurance Company, a member of the Principal Financial Group, Des Moines, Iowa 50392. See the group annuity contract for the full name of the Separate Account. Certain investment options and contract riders may not be available in all states or U.S. commonwealths.

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