MINUTES

INVESTMENT COMMITTEE MEETING
MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION (MCERA)

One McInnis Parkway, 1st Floor
Retirement Board Chambers
San Rafael, CA

September 15, 2016 – 9:00 a.m.

CALL TO ORDER Chair Shore called the meeting to order at 9:02 a.m.

ROLL CALL

PRESENT: Brenk, Cooper (alternate safety), Gladstern, Jones, Murphy, Piombo, Shaw (ex officio alternate), Shore

ABSENT: Bolger, Given, Stevens, Thomas

A. OPEN TIME FOR PUBLIC EXPRESSION

Note: The public may also address the Committee regarding any agenda item when the Committee considers the item.

No public comment.

B. MANAGER ANNUAL REPORTS

1. Manager Overview – Callan Associates – *Jim Callahan* – 9:00 a.m.

   Jim Callahan, Executive Vice President, Callan Associates, stated that following the manager annual reports, a review of the private equity pacing plan will take place along with a discussion of potential new commitments to the private equity program.

2. UBS Realty Investors – Core Real Estate – *Tom Klugherz, Steve Olstein* – 9:10 a.m.

   Tom Klugherz, Executive Director and Portfolio and Client Services Officer with UBS Realty Investors LLC (UBS), introduced Steve Olstein, Executive Director and Portfolio Manager of the Trumbull Property Fund. Mr. Klugherz reported that the head of acquisitions retired and the transition to his successor was seamless. As of June 30, 2016 the UBS Core Real Estate portfolio returned 9.64% over one year (as compared with 11.24% for NFI-ODCE benchmark) and 10.13% over three years (versus 12.08% for the benchmark). Mr. Klugherz stated the Company's expectations for economic growth have been reduced. Currently, the real estate market remains healthy based on rising incomes, good demand and moderate supply. Returns are favorable relative to the U.S. 10 year Treasury Note, capitalization rates are 4 to 5% and real estate is still well priced, though market specific. Responding to Trustee Shore's inquiry on the outlook for inflation, Mr. Klugherz pointed to the lack of price pressure on commodities and the slowing world economy. Mr. Olstein reported that Executive Director

Timothy Walsh has been appointed Assistant Portfolio Manager of the Trumbull Property Fund. Reviewing the portfolio, he stated that as compared with the benchmark NFI-ODCE the portfolio is overweight apartments and underweight to the office sector. Geographically the relative underweight to the west coast of the United States has been rebalanced as the returns for the east and west coasts are similar. Responding to Chair Brenk's inquiry, he stated there is still healthy growth in the apartment market as people change their idea of how to live.

Trustee Jones joined the meeting at 9:16 a.m.

According to Mr. Olstein the large size of the Trumbull Property Fund is an advantage since research shows large properties outperform small properties over time. He said the fund provides major market exposure, superior diversification, and significant cash flow. The investment strategy called for selling into last year's strong market, with proceeds reinvested in newer properties to hold for the next 10 or 15 years. Planned new commitments this year include multifamily and industrial properties. The portfolio is 94% leased and net operating income has increased 5.1% year to date. The Trumbull Property Fund is rated second in the 2015 Global Real Estate Sustainability Benchmark (GRESB). Leverage as compared with the benchmark is low though higher than normal to lock in low interest rates, Mr. Olstein said in response to Chair Brenk's inquiry.

In conclusion Mr. Olstein explained that the Fund is managed to the lower end of the risk spectrum and over ten years returns are similar to the benchmark with a lower risk profile. Moving forward the portfolio manager expects the total return to moderate as income outperforms appreciation, with no change in the expected long-term real return.

3. AEW Capital Management – Core Real Estate – *Jon Martin, Lily Kao* – 9:35 a.m.

Jonathan Martin, Portfolio Manager of the AEW Core Property Trust, introduced Lily Kao, Portfolio Manager for the West Coast, who is a recent addition to the investment team. Mr. Martin reported that MCERA's investment is valued at nearly $85 million today including reinvested dividends. Returns are moderating following strong appreciation over the last five years. With increasing rents in the United States returns are expected to be attractive relative to other asset classes. As of June 30, 2016 the AEW Core Real Estate portfolio returned 10.59% net of fees over one year (as compared with 11.24% for NFI-ODCE benchmark) and 11.18% over three years (versus 12.08% for the benchmark).

Ms. Kao reported that most assets are invested in the top markets in the United States. The overweight to the benchmark in the southeast will be trimmed over the next few quarters. Since the beginning of 2015 total occupancy has risen to 96% from 92%. The industrial sector dominates the portfolio, followed by office and retail.

Trustee Gladstern asked how climate change factors into investment decisions. In response Mr. Martin said there is considerable effort to manage sustainability. As a result the Fund's ranking in the Global Real Estate Sustainability Benchmark has improved to Number 10. Mr. Martin emphasized the importance of operating efficiency which is part of every investment committee presentation.

Total return projections for the next five years are lower due to falling yields. Longer term Mr. Martin expects moderate new development and strong rent levels to result in significant income returns that historically have comprised the majority of returns. Responding to Trustee Shore's inquiry, Mr. Martin explained that private core real estate differs from public REITs as the latter are publicly traded, exhibit greater volatility, and are more liquid. Leverage is limited to 40% and sources of funds include major insurance companies, he said in response to Chair Brenk's inquiry.

4. Parametric – Emerging Markets – *Dan Ryan, Jeff Brown* – 10:00 a.m.

Dan Ryan, Managing Director, Client Relationship Management with Parametric Portfolio Associates LLC, introduced Jeff Brown, Director and Institutional Portfolio Manager of the emerging markets portfolios. Mr. Ryan reported that in March the firm hired Randall Hegarty as Chief of Compliance. Effective September 1, 2016 the redemption fee has been removed from the mutual fund vehicle, and effective November 1, 2016 the fee for the collective investment trust vehicle will be reduced. Responding to Chair Brenk's inquiry, Mr. Ryan explained fee reductions bring the portfolio in line with industry practice. As of June 30, 2016 the emerging markets portfolio returned negative 8.56% over one year (as compared with negative 12.05% for the MSCI Emerging Markets benchmark) and negative 1.49% for the prior three years (versus negative 1.56% for the benchmark).

Mr. Brown reviewed the investment strategy that is based on diversification away from the index, lack of correlation and a non-fundamental view. As compared with the benchmark, the portfolio is broadly diversified and more equally weighted. The portfolio is structured by grouping countries into different tiers based on liquidity profiles. Specific companies representing the countries are of lesser importance, Mr. Brown explained. Frontier markets serve as volatility dampeners. The key driver of the investment process is rebalancing according to an over- or underweight trigger. Since the portfolio is underweight large countries, performance will trail the index when China performs well and vice versa. The firm is adding direct access to the China market, to supplement its current indirect access through Hong Kong markets.

Trustee Cooper asked if the portfolio duplicates holdings in the MCERA Fund, thereby introducing added risk. In response Mr. Brown stated they are agnostic as to particular securities and the average low correlations among tiers reduce risk. As to political events, he stated that if markets are trading freely it has been proven it makes sense to remain invested.

Trustee Shore asked whether there still promise for growth in emerging markets. In Mr. Brown's view, all the drivers of population growth and demand for commodities are still in place for the emerging markets. Mr. Callahan added that emerging markets growth rates are still meaningfully higher than the developed world.

Chair Brenk recessed the meeting for a break at 10:31 a.m., reconvening at 10:40 a.m.

5. Abbott Capital Management – Private Equity – *Jonathan Roth, Charles van Horne* – 10:25 a.m.

Jonathan Roth, Senior Partner and President, Abbott Capital Management, introduced Charlie van Horne, Managing Director, Client Relations. Mr. van Horne stated the firm is recognized for its fundamental investment style and high-conviction focus. The goal of attractive performance is achieved through a collegial and consensus-driven decision-making process. Once general partners are selected about half of the firms are monitored by sitting on their advisory boards.

Mr. Roth stated that the overall approach is to capture a swath of different investment strategies over different vintage years. The MCERA Fund is in a position to continue receiving distributions from the 2008 fund, ACE VI, he said, that experienced a long start-up period. Most holdings in ACE VI were initiated in 2012 and 2013. Mr. Roth highlighted the 17% internal rate of return for the venture capital growth strategy, noting specific successful companies. In the buyouts and special situations strategies, some holdings were affected by weakness in the energy sectors.

In response to Trustee Shore's inquiry on whether the private equity market is too popular, Mr. Roth indicated the market may be overcapitalized which calls for raising the bar this year in favor of vintage year diversification. He noted the firm invests in only 2 to 3% of managers raising capital in any given year. Trustee Jones inquired about the effect of elections on the markets and Mr. Roth indicated the sole focus is on fundamental investing. Responding to Chair Brenk's inquiry, Mr. Roth expects returns to increase as management fees are reduced over time. One tactic used to address the long investment time frame has been to introduce secondaries sooner in each vintage year to improve early returns.

Mr. Roth reviewed the firm's transition to the Annual Program (AP) funding model set up in 2016 for all investors. MCERA recommitted to AP 2016 which is 25% committed through August 2016. There is a three-year time frame planned for commitments to a total of 30 to 35 managers.

Trustee Gladstern inquired about new regulations on private equity fee disclosures that will now be required as part of a bill passed by the California Legislature. In response Mr. Roth stated there is transparency on management, auditing and brokerage fees. Underlying partners are being asked to report the fees investors pay which would be available on a request basis. The level of detail varies for each manager and Abbott is working to capture needed information. All fees are reflected in the net-of-fee returns reported by Abbott, he stated. Retirement Administrator Jeff Wickman stated staff will be talking with the Finance and Risk Management Committee on what information to request from private equity managers as required by the new law.

The next fundraising vehicle is AP 2017 which will consist of similar types of general partners and diversification as the prior funds. Commitments for AP 2017 will begin in January of 2017 and continue over three years. There are reduced fees for MCERA as a loyal investor and further discounts for the size of the commitment and an early close.

In response to Trustee Shore's inquiry, Mr. van Horne stated he expects AP 2016 distributions to take over in the 7th or 8th year with a total of 12 years for final distributions. On leadership continuity, Mr. Roth said the firm is into the third generation of leaders and is well positioned to continue.

6. Pathway Capital Management – Private Equity – *Valerie Ruddick, Jim Reinhardt* – 10:50 a.m.

Jim Reinhardt, Senior Managing Director of Pathway Capital Management, reviewed MCERA's commitments to private equity funds PPEF 2008, I-7 and I-8 in 2008, 2013, and 2015, respectively. Reporting on the PPEF 2008 portfolio, Mr. Reinhardt stated all funds are distributing capital back to PPEF 2008 and the market value exceeds the capital committed. Distributions have exceeded contributions in 4 of the past 6 quarters. In preliminary results PPEF 2008 generated a since-inception net-of-fee return of 8.6% as of June 30, 2016.

PPEF 2008 has been fully committed since 2013 and consists of 33 primaries and 1 secondary investment. Mr. Reinhardt explained that its lengthy investment period is a result of the financial crisis. The portfolio is well diversified with 28 managers and 34 funds, the largest of which represents 9% of the portfolio. Of three investment strategies, buyouts represent the majority of holdings, followed by special situations and venture capital.

Ms. Ruddick explained that PPEF 2008 is overweight buyouts because of favorable risk/return characteristics. Buyouts and venture capital strategies are performing well, she said, noting performance drivers include a distressed debt fund that is returning capital at a relatively fast pace. Special situations were negatively impacted by weakness in energy-related investments. Holdings are geographically diversified, with the majority in the United States. Six of PPEF 2008's 7 vintage years have exceeded median industry benchmarks with respect to the internal rate of return and the distributed to paid-in (DPI) ratio. PPEF 2008 is expected to be cash-flow positive annually going forward.

PPEF I-7 has been fully committed since June 2015, completing its investment phase in just over 2 years. The portfolio is diversified over 539 companies and contributions are expected to increase as underlying partnerships progress through their investment phases. According to Ms. Ruddick, PPEF I-7 commitments were made in a favorable market environment and there have been early distributions from the portfolio's secondary partnership interests.

PPEF I-8 was initiated in March of 2015 and held a final close in March of 2016. PPEF I-8 is in the development phase and is 71% committed, 15% drawn and consists of 104 companies to date. Investment activity is picking up for general managers and strategies that favor buyouts (targeted at 70%) are within projected ranges.

Responding to Trustee Gladstern's inquiry, Ms. Ruddick stated Pathway follows the Institutional Limited Partners Association (ILPA) fee reporting template and is receiving requested fee information, including carried interest, from underlying funds. In response to Chair Brenk's inquiry, Mr. Reinhardt indicated private equity is in the latter part of the investment cycle as evidenced by higher purchase prices and strong distributions. Over the long term Mr. Reinhardt expects private equity to perform significantly better than public equities.

Chair Brenk recessed the meeting for a lunch break at 12 p.m., reconvening at 12:25 p.m. and directing deliberations to **Agenda Items C.2** and **C.3**.

C. NEW BUSINESS

2. Private Equity Program Funding (**Action**)
   Consider and discuss pacing plan for private equity

   Mr. Callahan introduced Mr. Robertson to review the private equity investment process and pacing study that sets forth annual commitments to maintain the 8% target to private equity. Last year a total of $100 million was committed, divided equally between private equity managers Abbott and Pathway. Based on the updated pacing study, Mr. Callahan recommends committing $15 million to each of the managers' 2017 funds.

   Mr. Robertson explained the goal of investing in private equity is to achieve returns greater than public equity returns. The general partners who buy private companies take a majority ownership and create high-impact value to help the companies grow to create long term gains. Challenges of private equity include illiquidity and implementation risk. Private equity strategies include buyouts, special situations, venture capital, and subordinated or distressed debt. The time frames from the initial commitment to the end of partnerships vary.

   Mr. Robertson presented a history of private equity returns showing outperformance to the S&P 500 over the majority of time frames over 20 years. The typical premium over public equity is between 3 and 5% and private equity outperforms in negative markets. Because of late-cycle conditions in the private equity market, Callan Associates is encouraging clients to be conservative with new commitments. Factors cited include flattening prices, strong distributions industry-wide and lower levels of funding raised as federal regulation tightened capital requirements for lenders.

   In addition to the current 8.7% level of the private equity portfolio, the pacing study takes into consideration uncalled commitments that are over target, distribution levels, and future benefit payments. Eventually the private equity program is expected to become self-funded through distributions. Abbott and Pathway offer fee discounts based on the amount of the investment and Abbott is waiving the initial fee if the close is by end of the year. Callan Associates recommends opting out of Pathway's co-investment sleeve due to its unfavorable risk-return tradeoff.

3. Private Equity Managers (**Action**)
   Consider and take possible action on new commitments to private equity program

   Mr. Wickman stated the proposal of Callan Associates and staff is to commit $15 million to each private equity manager's 2017 fund.

It was M/S Shore/Gladstern to commit $15 million to Abbott's AP 2017 and $15 million to Pathway's PPEF I-9 subject to contract negotiations, any other due diligence and the exclusion of any co-investments options.

Trustee Piombo indicated that relative fees of Abbott and Pathway should be considered for the new private equity commitments. Mr. Callahan noted that considerations would be that the two private equity programs emphasize different strategies which lends diversification and have similar cumulative internal rates of return over time. Mr. Robertson stated the management fee would average 41 basis points for Abbott and 61 basis points for Pathway. In Trustee Jones's view the performance or risk level may justify the higher fee.

Trustee Murphy was excused from the meeting at 1:24 p.m.

Trustee Gladstern inquired as to Mr. Wickman's opinion and he recommended committing $15 million to Abbott's AP 2017 and a conditional $15 million to Pathway's PPEF I-9 subject to fee negotiation.

Trustee Shore revised his motion to commit $15 million to Abbott's AP 2017, subject to contract negotiations and any other due diligence, and have a discussion with Pathway about a fee break for PPEF I-9 with further commitment to be considered at the November Board meeting. Trustee Gladstern seconded the motion.

AYES:	Brenk, Cooper, Gladstern, Piombo, Shaw, Shore
NOES:	None
ABSTAIN:	None
ABSENT:	Bolger, Given, Murphy, Stevens, Thomas

Chair Brenk directed deliberations to **Agenda Item C.1**.

1. Parametric Emerging Markets Portfolios (**Action**)
   Review and consider consolidating emerging markets equity investments into a single fund

   Anne Heaphy, Vice President of Callan Associates, explained that MCERA is invested in two vehicles for its emerging markets portfolio: 1) the Parametric Tax-Managed Emerging Markets Fund that had a 2% redemption fee, and 2) the Parametric Emerging Markets Equity Collective Investment Trust which has no redemption fee. As announced by Mr. Ryan of Parametric, the redemption fee for the mutual fund vehicle has been removed, and further, the fee for the commingled investment trust vehicle will be reduced to 78 basis points as of November 1, 2016. Therefore, Callan Associates recommends consolidating the emerging markets equity investments into the commingled investment trust vehicle. The investment models are identical, Mr. Callahan stated in response to Chair Brenk's inquiry.

It was M/S Shore/Gladstern to consolidate the emerging markets equity investments into a single fund after November 1, 2016 by redeeming shares of the Parametric Tax-Managed Emerging Markets Fund and reinvesting the proceeds into the Parametric Emerging Markets Equity Collective Investment Trust.

AYES:	Brenk, Cooper, Gladstern, Murphy, Piombo, Shaw, Shore
NOES:	None
ABSTAIN:	None
ABSENT:	Bolger, Given, Stevens, Thomas

D. INVESTMENT CONSULTANT QUARTERLY REPORT AND PERFORMANCE UPDATE

For period ending June 30, 2016

Ms. Heaphy presented the quarterly investment report as of June 30, 2016. In reviewing portfolio managers on the Watchlist, the question arose as to whether to leave Columbus Circle Investors, on the Watchlist. Mr. Callahan stands by his prior recommendation to wait for a more favorable time frame to make any changes to the Columbus Circle small cap growth portfolio. Ms. Heaphy noted that the small cap equity sector has been out of favor. Trustee Piombo observed the 10-year performance of Columbus Circle has been good.

Ms. Heaphy reported that as of June 30, 2016 the total market value of the Fund was $2.086 billion, an increase of $32 million from the prior quarter. The total Fund annual net-of-fee return of 1.68% outperformed Composite Benchmark return of 1.02% and is a relatively strong performance as compared with the peer group, Ms. Heaphy stated.

Domestic equity performed in line for the quarter, with large cap equities performing better than small cap equities over the past year. The Dimensional small cap value equity portfolio underperformed due to lack of exposure to utilities and REITs. The Columbus Circle small cap portfolio outperformed its benchmark during the 2nd quarter of 2016. International equities were negatively impacted by Brexit, Great Britain's decision to withdraw from the European Union. The Morgan Stanley international equity portfolio protected well in the downturn, as did the Parametric emerging markets portfolio, which outperformed its benchmark for the quarter and the year. Fixed income portfolios continue to have strong returns, with both Wellington and Western Asset performing in line with benchmarks. The Colchester global bond portfolio had strong returns for the Fund over the last year although trailing its benchmark.

Trustee Jones was excused from the meeting at 2:03 p.m.

Public real assets were mostly in line with benchmarks. The Invesco commodities portfolio funded in May 2016 outperformed its benchmark as of June 30, 2016 and was additive to the Fund. The winding down process continues for value-added real estate portfolios; AEW will return the amount invested, Mr. Callahan reported.

There being no further business, Chair Brenk adjourned the meeting at 2:08 p.m.

Greg Brenk, Chair

Attest: Jeff Wickman
Retirement Administrator