MINUTES

MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION (MCERA) RETIREMENT BOARD STRATEGIC WORKSHOP

One McInnis Parkway, San Rafael, California
October 17-18, 2017

Day 1
October 17, 2017

Chair Laurie Murphy

9:00 a.m.
Call to Order

Chair Murphy called the meeting to order at 9:01 a.m.

Roll Call

PRESENT: Bolger, Cooper, Given, Gladstern, Jones (alternate retired), Murphy, Piombo (alternate safety), Shaw (ex officio alternate), Silberstein, Stevens

ABSENT: Thomas

Open Time for Public Expression

Open time for public expression, from three to five minutes per speaker, on items not on the Board Agenda. While members of the public are welcome to address the Board during this time on matters within the Board's jurisdiction, except as otherwise permitted by the Ralph M. Brown Act (Government Code Sections 54950 et seq.), no deliberation or action may be taken by the Board concerning a non-agenda item. Members of the Board may (1) briefly respond to statements made or questions posed by persons addressing the Board, (2) ask a question for clarification, or (3) provide a reference to staff for factual information.

No members of the public provided comments.

Board Chair Bernadette Bolger

9:00 a.m. – 10:00 a.m.
2017 Experience Study - Final Economic Assumptions (Action)
Graham Schmidt, Cheiron
Consider and take possible action to adopt recommendations for economic assumptions reviewed in the Experience Study

Retirement Administrator Jeff Wickman introduced Actuary Graham Schmidt of Cheiron to present recommendations for the economic assumptions portion of the tri-annual Experience Study. At the September Board meeting, Mr. Schmidt previewed proposed economic assumptions.

Mr. Schmidt reviewed MCERA's current economic assumptions, the outlook for those assumptions, and preliminary results for proposed future economic assumptions. The actuary explained that the economic assumptions – inflation, wage growth, the cost of living adjustment (COLA), and the expected return on assets – are the key building blocks, with inflation being the foundation for the economic assumptions. For example, the expected return for assets is made up of two pieces: inflation plus the real return. Mr. Schmidt noted that the actuarial standards of practice require the economic assumptions to be reasonable both individually and in aggregate.

Trustee Given joined the meeting at 9:04 a.m.

Mr. Schmidt explained the Cost of Living Adjustment (COLA), which is tied to San Francisco Bay Area consumer price index, and the inflation rate assumption, which is based on United States inflation data.

As of the June 30, 2016 actuarial valuation, MCERA's economic assumptions are:

- Inflation, 2.75%
- Wage Growth, 3%
- Cost of Living Adjustment for retirees, either 1.9% (2% cap), 2.60% (3% cap), or 2.70% (4% cap)
- Return on Assets, 7.25% net of investment expenses

The time horizon for economic assumptions, according to the actuary, is for as long as the pension system is expected to pay benefits. The weight of the benefits for current members is in the 15 to 20-year range, but assumptions need to be set for the long term, Mr. Schmidt stated. He discussed a broad array of data considered in determining the inflation rate. Observing inflation has been low for a long period of time, Mr. Schmidt stated Callan Associate's 10-year inflation projection is 2.25% and the historical national average is about 2.5% over the last 10 years. Other sources of inflation data include market yields and the Cleveland Federal Reserve that projects 2% inflation for the long term. For CalAPRS pension plans, forecasts for inflation range from 2.5% to 3%. At 2.75%, MCERA's inflation assumption is below the median for its peers. The actuary said the current inflation assumption is reasonable and within the range of expectations; however, the trend for public plans has been to reduce the assumed rate of inflation.

Reasons for expecting lower inflation include pressures in the market reducing expectations for wage growth. Overall wages gains are at the high end of the pay scale, Mr. Schmidt said, and for Marin County wage gains are somewhere in the middle. A Bureau of Labor Statistics (BLS) survey reported a less than 0.25% increase in median weekly (non-farm) real wage growth over the last ten years. Mr. Schmidt indicated retaining a positive real wage growth assumption is reasonable, given the relaxing of some pressures restraining wage increases. In response to Trustee Stevens' inquiry, the Administrator stated the current wage growth assumption of 3% is in line with Marin County general service contracts for the last several years.

Updated stochastic testing of COLA growth for MCERA supports the current COLA assumptions, according to the actuary. If the Board decides to reduce the inflation rate, that would lead to a different set of COLA assumptions.

Mr. Schmidt explained the steps to calculate expected returns. Cheiron collects capital market assumptions and their expected variations from Callan Associates. Modeling the current target portfolio based on Callan data results in a 6.49% nominal geometric mean return, 2.25% inflation, and 4.24% real return. Results were rerun using capital market assumptions from several other investment consultants active in California public pension plans, including '37 Act systems, and a broader survey of 10- and 20-year capital market expectations. The average results across consultants, adjusting for different time periods and average duration of MCERA liabilities, is a nominal geometric mean return of 6.77% at 15 years and 4.34% real mean return. The return projections are based on a passively managed portfolio with no additional alpha assumed for active managers. Mr. Schmidt stated over 15 years there is a slightly better than 50% chance of achieving a 4.25% real rate of return, and slightly less than 50% chance of achieving a 4.5% real return; these probabilities increase over long time periods.

Responding to Trustee Stevens' question on whether a 50% chance is a good probability, Mr. Schmidt explained the probability is based on the specific number and is therefore not analogous to Las Vegas odds when there is a 50-50 chance of either winning or losing money. For example, if less than the nominal return assumption is achieved there will still be increased assets coming into the Plan. Because it was less than expected, an adjustment to contribution rates is made for the following year. The goal over the long term, he stated, is to fund the pension system in a stable manner; if over the long run our best estimate is the middle of where we think we are going to be, then that is the number that preserves intergenerational equity.

In summary, Mr. Schmidt stated the current real return assumption of 4.50% is reasonable, but slightly higher than Callan's 4.24% 10-year projection or the duration-weighted average real return expectation of 4.34%. He recommended focusing on the real rate of return, which affects our costs more than the other assumptions. Cheiron recommends lowering the real return from 4.50% to 4.25% and keeping all other economic assumptions the same. The preliminary total cost and funded ratio impact of different sets of assumptions were presented.

It was M/S Gladstern/Piombo to adopt the recommendation by Cheiron to reduce the real rate of return from 4.50% to 4.25% and retain remaining economic assumptions of 2.75% inflation, 3% wage growth, and the COLA structure stated above. This would result in a 7.00% discount rate/investment assumption.

Trustee Bolger proposed a substitute motion to adopt Cheiron's second option to reduce the real rate of return from 4.5% to 4.25% and reduce the inflation rate from 2.75% to 2.50%. This would result in a 6.75% discount rate/investment assumption. Trustee Stevens seconded the substitute motion.

Discussion centered on balancing paying down the unfunded liability more quickly vs. less volatile employer contributions. Trustee Gladstern called for the question and Trustee Piombo seconded the call.

The vote on the call for the question was as follows:

AYES:	Cooper, Given, Gladstern, Murphy, Piombo, Silberstein
NOES:	Bolger, Stevens
ABSTAIN:	None
ABSENT:	Thomas

The vote on the above substitute motion by Bolger/Stevens was as follows:

AYES: Bolger, Stevens
NOES: Cooper, Given, Gladstern, Murphy, Piombo, Silberstein
ABSTAIN: None
ABSENT: Thomas

The vote on the above original motion by Gladstern/Piombo was follows:

AYES: Cooper, Given, Gladstern, Murphy, Piombo, Silberstein
NOES: Bolger, Stevens
ABSTAIN: None
ABSENT: Thomas

Mr. Wickman stated Mr. Schmidt will present the second part of the Experience Study, demographic assumptions, at the December Board meeting.

Chair Bolger recessed the meeting for a break at 10:14 a.m.

Investment Committee Chair Roy Given

Chair Given reconvened the meeting at 10:27 a.m.

10:00 a.m. – 11:00 a.m.
Private Equity Pacing Plan (Action)
Gary Robertson, Senior Vice President, Callan Associates
Jim Callahan, Executive Vice President, Callan Associates

Jim Callahan, Executive Vice President with Callan Associates (Callan), introduced Senior Vice President Gary Robertson to review the private equity program and pacing analysis. Mr. Robertson said private equity consists of unlisted companies and provides a different, long-term return stream and diversification for the Fund. The expectation is to earn a rate of return higher than public stocks. Drawbacks to private equity include illiquidity and complexity. A key differentiator from public equities is that private equity managers have more control over companies they are funding. Mr. Robertson emphasized the importance of not investing with untested partnerships. Mr. Callahan added that implementation and strategy go hand in hand.

Private equity strategies include buyouts of mature companies, special situations involving industry-focused funds, venture capital (early stage, multi-stage, and later stage), subordinated debt, and distressed debt. After initial commitments by MCERA, capital is called as general partners make investments over a multi-year time frame. Distributions begin to come back to MCERA after about 3 years (in general), with key distributions expected in years 8, 9, and 10. Mr. Robertson presented historical returns showing private equity outperforms public stocks by approximately 5% over 20 years. Responding to Trustee Stevens's inquiry, Mr. Robertson said the premium to public stocks has come down to 2% to 2.5% over the last several years. He pointed out that private equity holds value better than public equities in bear markets. Private equity returns should be calculated over a full market cycle, he explained, adding market expectations are good right now.

Trustee Silberstein asked about leverage used for buyouts. In response, Mr. Robertson stated banks are limited to borrowing no more than 6 times cash flow, and the average debt level is about 6.5 times cash flow (about 30% equity and 70% debt), down from 10 to 1 before the financial crisis. He explained that measuring private equity against a leveraged S&P 500 is not analogous because there would be a margin call if you leveraged the S&P 500. Mr. Callahan said this is a fair point that private equity uses leverage.

MCERA's initial commitments in 2008 to Abbott Capital Management (ACE VI) and Pathway Capital Management (PPEF 2008) are 91% and 82% paid in and have 11% internal rates of return as of March 31, 2017. Mr. Robertson explained that due to economic contraction, the private equity program developed slowly. In 2013 valuations had come back to 2008 levels and MCERA began making additional commitments to fund the private equity program to the target allocation. Last year there was a significant drawdown that reduced distributions to MCERA and slowed down the investment pace. Since then, conditions have recovered and MCERA is now receiving distributions. Mr. Robertson reported that in 2017 there has been record private equity fundraising in the United States and in Europe; the average purchase price is a relatively high 10 times cash flow. Exits and distributions are strong and it is the opinion of private equity managers that there will be substantial distributions coming.

As of March 31, 2017, the private equity program value rose to approximately 9.7% versus the 8% target allocation, and Callan therefore advises forgoing additional commitments for 2018. The program is doing well, Mr. Robertson said, and advised waiting to see what distributions look like in the next year. MCERA will not miss opportunities because there is still uncalled capital that will be invested over the next few years. Performance metrics were presented showing both private equity portfolio composite returns are in the second quartile of the Cambridge Private Equity Database. MCERA's private equity managers are executing the way they are supposed to, Mr. Callahan stated.

11:00 a.m. – 12:00 p.m.
Investment Consultant Quarterly Report and Performance Update
Jim Callahan, Executive Vice President, Callan Associates
Anne Heaphy, Vice President, Callan Associates
12:00 p.m. – 1:30 p.m.

Mr. Callahan reported the markets are performing well, valuations are high, and yet the markets keep going up. The underlying economic data are good, he said, and Gross Domestic Product (GDP) was a little higher than expected. The weakening U.S. dollar this year helps non-U.S. investments as their currencies appreciate. Post-financial crisis, returns have been dominated by the U.S. stock market and volatility has been way below historical numbers. Over the next several years, Callan expects capital market returns will be challenged in comparison to historical returns.

Anne Heaphy, Vice President with Callan Associates, reported as of the fiscal year ending June 30, 2017, the Fund increased $58 million from the prior quarter to $2.3 billion. Asset allocations are at or near targets and within prescribed ranges. The Fund's preliminary fiscal year return net of fees is 11.73% (versus 11.85% for the Composite Benchmark). Over three, 5 and 10-year periods, the Fund is outperforming its Composite Benchmark.

Mr. Wickman reported staff is tracking preliminary fiscal year (as of June 30, 2017) returns of '37 Act systems. MCERA underperformed some peers over the fiscal year. As a result, the Administrator does not expect MCERA to be at the top of the list in the new R.V. Kuhns survey. Mr. Callahan added that one of the biggest headwinds was the public real asset portfolio that was modestly positive but underperformed private real estate – most public plans have more real estate.

During the fiscal year, the domestic equity portfolio returned 19.31%. The two small cap equity portfolios managed by Dimensional Fund Advisors (DFA) and Columbus Circle Investors returned 22.73%, outperforming large cap equities, so the overweight to small cap benefited the portfolio for the fiscal year. International equities returned 17.43% versus 20.43% for the international benchmark, with small cap equities leading performance in the group. The Parametric Emerging Markets portfolio had strong absolute returns (up 18%) but trailed the benchmark on a relative basis. Ms. Heaphy explained that Parametric has a smaller allocation to China than the benchmark and therefore will underperform when China performs well. The Parametric portfolio has broad exposure to emerging markets and is not as concentrated in large countries as the benchmark.

The fixed income portfolio returned 0.99% versus negative 0.83% for its custom benchmark. All three fixed income managers outperformed individual benchmarks. Global bonds were a headwind for the last year but lend diversification to the Fund, Ms. Heaphy said. The private real estate portfolio returned 5.59% versus 7.23% for the NFI-ODCE Equal Weight Net Index benchmark return. There is less leverage in the UBS Trumbull Property Fund than the benchmark, which was a positive factor when we selected them, Ms. Heaphy explained. The public real assets portfolio returned 0.03% versus 0.87% for the custom benchmark; commodities detracted from performance and the global natural resources portfolio had good absolute returns. MCERA received meaningful distributions from early investments in its private equity program.

Ms. Heaphy reported Morgan Stanley Portfolio Manager Christian Derold will retire from the industry as of December 31, 2017. Portfolio Manager William Lock is the key founding member of the strategy and going forward he and senior team member Bruno Paulson will oversee the team. The Morgan Stanley international equity portfolio is performing well, Mr. Callahan said, so Callan will just be monitoring management.

Trustee Jones was excused from the meeting at 12:03 p.m., returning at 1:45 p.m.

Chair Given recessed the meeting for lunch at 12:03 p.m. and reconvened the meeting at 1:31 p.m.

Lunch (on site)

1:30 p.m. – 3:00 p.m.
Education on Small Cap Equity Allocation Vehicles (Action)
Jim Callahan, Executive Vice President, Callan Associates
Mark Stahl, Senior Vice President, Callan Associates

Mr. Callahan stated education on small cap equity allocation vehicles is presented as a follow up to the small cap equity allocation discussion at the July 2017 Investment Committee meeting.

Mr. Callahan introduced Senior Vice President Mark Stahl who oversees equity research at Callan. Mr. Stahl stated the purpose of equities in the portfolio is capital growth. The biggest driver of return differentials in U.S. equity is size and style. Value stocks trade below the market based on some metric, and growth stocks are those growing faster than others. The two styles can perform differently over time. The typical institutional investor defaults to the market as to size and to style; then, depending on risk tolerance, the size and style allocation can be adjusted. The Russell 3000 Index is the most commonly used benchmark to represent the investable equity universe. Trustee Silberstein noted Schwab just created its own index to avoid paying fees. Mr. Stahl said there is a continuing trend of firms going to private internal indices to avoid fees. According to Mr. Stahl the Russell 2000 is used for the vast majority of indexing for small cap equities.

MCERA's domestic equity portfolio is 70% large cap passively managed in the S&P 500 Index and 30% small cap actively managed in equal portions in the DFA value and Columbus Circle growth portfolios. The MCERA portfolio is overweight to small cap and style neutral as to small cap. Mr. Stahl stated the domestic equity allocation is based on the belief that small cap will perform on average better than large cap over time and active implementation will do well for small cap. Considerations for actively managed small cap portfolios include volatility and tracking risk. Since there can be long intermediate periods when the small cap premium is missing, it may be difficult to stick with the strategy, Mr. Stahl said. The purpose of this discussion is to determine whether to change the domestic equity allocation in some shape or form. Mr. Callahan said the basic questions are whether the Committee is comfortable with a small cap portfolio that is style neutral and overweight relative to the domestic equity benchmark. Callan remains comfortable with a small cap overweight in the 20 to 30% range. Mr. Callahan said it is still prudent to use active management for the small cap portfolios. He advised that active management implies a well-thought-out strategy that can be applied consistently over time.

Trustee Silberstein observed that DFA has become the largest shareholder of most of the companies they invest in and they own most of the index. Mr. Callahan said DFA has always managed numerous small cap assets and is tilting the small cap portfolio toward value in a cost-effective way. Mr. Callahan indicated that DFA is one of the more cost-effective value managers in the marketplace.

Mr. Stahl discussed the following possible implementation solutions for a domestic small cap structure:

- Passive
- Core
- Active Style: Growth and Value
- Factor or Smart Beta

Advantages of *passive management* are simple structure, lower cost, asset class exposure, and liquidity. Considerations are lack of excess or enhanced returns and the current non-recessionary high exposure to companies that have zero to negative earnings in the Russell 2000 Index. Mr. Stahl indicated as a result, the Russell 2000 may underperform in a negative market. Small cap *core* strategies attempt to deliver an attractive risk-adjusted return and include enhanced, quantitative, and fundamental approaches. Advantages include lower volatility, more consistent portfolio characteristics, and lower fees. Considerations include the exclusion of high growth areas of the market and fewer rebalancing opportunities. *Active style using growth and value* is the current structure of the small cap portfolio, resulting in a blended portfolio. Advantages include a larger opportunity set of securities to choose from and rebalancing opportunities. Considerations include idiosyncratic manager risk, investment approaches may produce return patterns that differ from the indices, and volatile returns.

Trustee Jones rejoined the meeting at 1:45 p.m.

Mr. Stahl stated there are many small and mid-cap providers to choose from. He said a fee in the 50 to 60 basis point range would be expected from a quantitative manager in the small cap space, and what we have in place is not that different from what is available today in active management.

Mr. Stahl said *factor* investing is a big topic today and is a different strategic approach from a traditional capitalization-weighted index. The concept is to create a diversified portfolio based on fundamentals that would be less risky and remove the common trait dragging equities down together such as in the financial crisis. Factors can be macroeconomic factors like inflation or interest rates; microeconomic factors include metrics that drive returns. The result is a mechanical, low cost approach. Mr. Stahl observed that money flowing into such indices is a structural change for the equity markets. Mr. Stahl advised that the hiring process and due diligence will dictate the success or failure of implementing factor investing.

Mr. Stahl stated in the past 6 years *smart beta* products have been proliferating. Risk premia for these products supported by the marketplace include value, size, momentum, volatility and quality. Performance for smart beta products is cyclical and lacks a track record. Performance data for value, size and momentum factors show long cycles of disappointing performance; single factor portfolios can be out of favor for a significant period of time. Due to challenges with single factor investing, multi-factor investing has increased within the smart beta umbrella to 64% of smart beta strategies. Advantages of a multi-factor basket are lower tracking error and allowance for a rebalancing premium; also, customized factor combinations can reduce risk. Considerations for multi-factor strategies are lack of performance history and very few small cap products available.

In summary, Mr. Stahl stated within smart beta, risk reduction, return enhancement, diversification and cost savings are some of the primary drivers of asset owners looking into factor investing. There are significant asset flows into the space; for institutions, low volatility is the most popular single factor strategy. Most investors are waiting for proof in how single factor portfolios perform. Fees for passive single factor strategies should fall between 6 to 12 basis points and for active strategies, fees should be between 30 to 50 basis points.

Trustee Silberstein gave examples of small cap investment vehicles that are computer driven with quality or value tilts and fees in the 20-basis point range. He indicated MCERA pays very high fees and that DFA is a smart beta operation and the fees should be lower. Responding to Trustee Jones' inquiry on the potential for negotiating lower fees, Mr. Callahan stated MCERA's small cap managers are competitive as to their fees.

Mr. Callahan reminded the Board that, at any point in time, each active manager will not look good. The question is, can the Board as a group go through these cycles and the time horizon needed to evaluate performance; if not, then choose a different approach. Mr. Callahan pointed out that Columbus Circle has been successful over the long term and we have seen improvements in the Columbus Circle portfolio. The two small cap managers are complimentary and represent a reasonable approach, he said.

Chair Given recommended bringing the small cap discussion back for more education and detail on the areas we want to look at, including actively managed and indexed alternatives. The Administrator will follow up with Chair Given and Callan on another small cap discussion.

3:00 p.m. – 4:00 p.m.
Closing and Follow-up Items from Today's Agenda

Mr. Wickman reported results of the Board of Supervisors interviews with candidates for vacancies on the Board. Steven Block was appointed to the 5th member position for a three-year term beginning on November 1, 2017, Sara Klein was appointed to the 6th member position with two years remaining in the term, and Todd Werby was appointed as the 9th member beginning November 1, 2017, with one year remaining in the term.

The Chair recessed the meeting at 3:55 p.m.

5:00 PM
Dinner at Wild Fox
225 Alameda Del Prado
Novato, CA

Day 2
October 18, 2017

9:00 a.m.
Call to Order
Chair Murphy reconvened the meeting at 9:01 a.m.

Roll Call

PRESENT: Bolger, Cooper, Given, Gladstern, Jones (alternate retired), Murphy, Piombo (alternate safety), Shaw (ex officio alternate) Silberstein, Thomas

ABSENT: Stevens

Open Time for Public Expression

Investment Committee Chair Roy Given

Manager Annual Reports Overview
9:00 a.m. – 9:05 a.m.
Jim Callahan, Executive Vice President, Callan Associates

Mr. Callahan stated Abbott Capital Management and Pathway Capital Management will review MCERA's private equity program, AEW will review its core real estate portfolio, and State Street will review the securities lending program.

9:05 a.m. – 9:30 a.m.
Abbott Capital Management – Private Equity
Jonathan Roth, Managing Director, President
Charlie van Horne, Managing Director

Charlie van Horne, Managing Director with Abbott Capital Management (Abbott), stated Abbott is an owner-managed firm focused solely on private equity. The Abbott investment team uses a disciplined process to develop concentrated and well-diversified portfolios that perform well in a variety of markets. Mr. van Horne reported that since the inception of the firm, 38% of funds selected by Abbott are in the top quartile and 65% are above the median of a widely recognized private equity index.

Jonathan Roth, Managing Director and President of Abbott, stated the private equity program is based on a cycle of commitment, distribution and recommitment. MCERA has committed a total of $200 million to Abbott funds, of which $111 million is paid in. MCERA initially committed $100 million to the Abbott ACE VI fund nine and a half years ago when the global financial crisis slowed down private equity investments. As of June 30, 2017, ACE VI has an internal rate of return of 11% net of fees and the total value is 1.4 times paid in capital. The ACE VI fund is a high-conviction portfolio of 41 primary funds with diversification across different market cycles. Mr. Roth highlighted venture strategies with an internal rate of return of 17% and buyouts involving mature controlled companies that have nearly doubled in value. Mr. Roth said ACE VI is expected to continue returning far more cash to MCERA than the amount being called.

MCERA committed $35 million to the ACE VII fund that has 10.8% internal rate of return as of June 30, 2017. ACE VII is through the j curve given strong early performance from secondary acquisitions made early in the fund's life. Mr. Roth explained that secondary investment opportunities involve buying another limited partner's investment when Pathway can find hidden value for investors. Initial investments in the ACE VII fund are generating better returns at a faster pace and the firm intends to use the same strategy to get similar results moving forward.

In 2016 Abbott initiated the annual program (AP) that allows clients to determine commitment levels each year. Clients may also customize allocations. MCERA committed $50 million to AP 2016 and $15 million to AP 2017. In response to Trustee Silberstein's inquiry, Mr. Roth stated MCERA may allocate up to 15% in secondaries; another option is to invest in Abbott's pure secondary fund. Trustee Gladstern asked for more detail on secondaries. In response, Mr. Roth explained that Abbott representatives serve on advisory boards of about 100 funds it commits to and is therefore in a position to be familiar with the quarterly reports of companies it may offer to purchase.

In summary, Mr. van Horne pointed out that MCERA's initial investment in the ACE VI fund is self-liquidating and helps to fund the ongoing private program; as ACE VI and ACE VII funds mature, MCERA will have more capital to invest. General partners have been told to seek liquidity and Abbott will continue to focus on cycle-tested managers who know how to position investments and structure risk.

9:30 a.m. – 9:55 a.m.
Pathway Capital Management – Private Equity
Jim Reinhardt, Senior Managing Director
Valerie Ruddick, Managing Director

Jim Reinhardt, Senior Managing Director with Pathway Capital Management, reported MCERA has committed a total of $200 million in four Pathway funds since December of 2008. As of June 30, 2017, the initial $100 million commitment in PPEF 2008 is 89% paid in, $47 million has been distributed back to MCERA, and the net internal rate of return (IRR) is 11.9%. Of MCERA's $35 million commitment in PPEF I-7, $21 million is paid in, $2 million has been distributed back to MCERA, and the net IRR is 7.2%. MCERA invested $50 million in PPEF I-8 in late 2015 and $15 million in I-9 in early 2017. At the total fund level, PPEF I-8 is 36% paid in and PPEF I-9 is 5% paid in, so these funds are still in early stages.

Pathway began making co-investments in PPEF I-9 that will be no more than 15% of each fund. He explained in response to Trustee Silberstein's inquiry that Pathway is able to invest in companies alongside general partners without charging fees. The result is significant value for investors and a reduction in the depth and the length of the j curve.

As of September 30, 2017, PPEF 2008 has invested in 34 funds over 4.9 years due to starting at the tail end of the financial crisis. The investment plan is to allocate over half of investments to buyouts and the rest to venture capital and special situations. Geographically the plan is to invest the majority of holdings in the United States with up to a maximum of 40% in the rest of the world. PPEF 2008 is in the value creation phase, becoming cash-flow positive in 2015 when distributions back to investors exceeded capital calls; distributions during 2017 have been notably higher. Responding to Trustee Bolger's inquiry, Mr. Wickman stated distributions from MCERA's private equity funds are deposited into a short-term investment fund at the custodial bank and are used for immediate cash needs like monthly benefit payments or new commitments to the private equity program.

Mr. Reinhardt stated PPEF 2008 is diversified across numerous industries with the largest allocation to software at 22% of the fund. Relative to the MSCI World Index, PPEF 2008 has lower risk as evidenced by a lower standard deviation. Mr. Reinhardt said Pathway focuses on risk management and he encouraged the trustees to visit the firm to learn more about its operations. Trustee Silberstein asked about the amount of leverage in a typical buyout. In response, Mr. Reinhardt stated there is a spectrum of levels of leverage employed, up to five to one at most; the safer the company, the more leverage applied. Pathway takes a conservative approach, he said, noting that public companies have leverage, too. Mr. Reinhardt presented data showing PPEF 2008's vintage years, 2010 excepted, outperform median industry benchmarks with respect to net IRR and distributions to paid-in capital. Buyouts and special situations strategies lead returns.

Valerie Ruddick, Managing Director with Pathway, discussed the progress of developing Pathway funds. PPEF I-7 was formed in 2013, is fully committed, and holds 35 investments of which 45% are buyouts and 35% are special situations. Software represents the largest industry group at 37% of PPEF I-7. Meaningful distributions have begun, Ms. Ruddick said, and since inception the net internal rate of return is 7.2%.

PPEF I-8 was formed in 2015 and is just wrapping up the investment phase. Pathway has two co-investments in PPEF I-8 that are about to close. Ms. Ruddick explained that co-investments allow for an early exit with no fee impact on the internal rate of return. The 59 holdings in PPEF I-8 are in line with investment guidelines, with 62% in buyout strategies. Software is the largest industry group with a 39% allocation. Ms. Ruddick stated that PPEF I-8 emerged from the j curve earlier as a result of changes Pathway made to reinvest early distributions that investors do not pay fees on and scale down early fees to reduce the fee drag for investors.

PPEF I-9 is a new fund with a commitment target of $300 million and 14 investments so far, the majority of which are buyouts, followed by venture capital and then special situations. Up to 30% of PPEF I-9 may be invested outside of North America and over 65% will be primary investments.

Trustee Gladstern asked whether MCERA is the only Pathway client not participating in co-investments. In response, Mr. Callahan said MCERA is not co-investing because at the time Callan was not comfortable with the potential risk. Trustee Silberstein asked whether MCERA's two private equity portfolios overlap. Mr. Callahan replied there is a reasonable amount of overlap; in private equity access to the top partnerships is key, he said, so Callan views the overlap as a positive.

9:55 a.m. – 10:20 a.m.
AEW – Core Real Estate
Mike Byrne, Portfolio Manager
Lily Kao, Portfolio Manager – West Coast
Candida Hoeberichts, Investor Relations

Mike Byrne, Portfolio Manager for the AEW Core Property Trust (CPT), reported that MCERA's $65 million investment is valued at $90.3 million as of June 30, 2017. For the fiscal year, CPT returned 6.80% versus 7.23% for the benchmark NFI-ODCE Equal Weight Net Index. Mr. Byrne said the majority of returns come from income for the core real estate strategy.

Mr. Byrne stated after nine years of economic expansion, conditions are favorable for real estate which lags the economy. Most markets around the country are at peak occupancies and operating fundamentals for landlords are expected to improve for the next several years. CPT is invested in the top 12 markets where there is meaningful growth, occupancies are strong, and rents continue to rise. Since real estate prices are historically high, Mr. Byrne believes the opportunity for further price appreciation is diminishing. Returns from income in the next few years are expected to be around 5%.

The core real estate strategy is to invest in liquid, first-tier markets to provide above average current income while preserving capital and seeking appreciation over the long term. There is a focus on occupancy and being leased, and leverage is limited to 30% at the Fund level. The CPT portfolio is diversified by property type, geographic market within the United States, and underlying economic drivers.

Lily Kao, Portfolio Manager for the West Coast, reported the Net Asset Value of CPT is $5.8 billion and there is a $175 million investment queue and no redemption queue. As compared with the benchmark, CPT benefited from an overweight to the southeast that had strong growth and will begin to move out of this area. Trustee Gladstern asked how hurricanes affected CPT properties. Mr. Byrne replied there was no impact from Hurricane Irma in Miami. In Houston one office building flooded and an apartment building will be repaired that was covered by insurance. Trustee Gladstern inquired whether climate change is factored in. In response, Mr. Byrne expects that on some level CPT will be exposed to the effect of climate change. Properties are diversified and managers are thoughtful about how properties are built and have comprehensive insurance in place.

Mr. Byrne said the CPT portfolio is underweight office and never more than neutral to the benchmark because office requires capital reinvestment. Locations with amenities and transportation are important factors for holdings. The industrial market is strong and CPT owns properties in the last mile close to population centers that are critical to the supply change. He indicated retail is more challenging although the best retail centers are doing well. CPT is always overweight in residential properties that have demand, according to Mr. Byrne.

In response to Trustee Gladstern's inquiry on the effect of consumers shopping online, Mr. Byrne said it will be a challenge as consumers are looking for value. He said there is a tough filter for new purchases with a preference for new state-of-the-art properties. The portfolio is well positioned to drive opportunities for core growth, Mr. Byrne stated. Ms. Kao stated she is on a committee monitoring sustainability for CPT holdings. CPT Global Real Estate Sustainability Benchmark (GRESB) scores are consistently rising due to improved operational efficiencies.

10:20 a.m. – 10:45 a.m.
State Street – Securities Lending Program
Henry Disano, Managing Director
State Street Securities Finance

Mr. Callahan explained that custodian State Street Bank may act as MCERA's agent to lend the securities in MCERA's separately managed portfolios. Investors borrow securities to take a short position or settle trades. MCERA receives collateral back at 102% which is invested in an investment fund earning a return that is split 70% to MCERA and 30% to State Street. Since the financial crisis, the investment pools have been reigned in, so the underlying cash collateral pools in a better state.

Henry Disano, Managing Director with State Street Bank, stated MCERA's securities lending program began in October 2007. Lendable securities include U.S. Corporate bonds, domestic equities, and U.S. Government securities. Cash collateral is invested in State Street's Quality D portfolio managed by State Street Global Advisors. State Street provides indemnification against borrower default and maintains 102% value with the borrower. Borrowers must be on State Street's approved list. Mr. Disano stated State Street is one of the largest and most experienced securities lending providers in the industry.

MCERA has earned a total of $3.8 million from the securities lending program since inception in 2007. In the fiscal year ending June 30, 2017, MCERA earned $187,155 from securities lending. Over the last five years annual revenue has averaged approximately $200,000 per year and the return to lendable assets is in the 7 to 9 basis point range. Mr. Disano indicated most holdings in the Quality D portfolio have strong credit quality and are highly rated.

Mr. Disano noted that the level of assets to lend is smaller than when the program began. He said 2017 has been a slow year muted by regulatory questions. Recently securities lending activity has picked up and he expects that to continue.

Chair Given recessed the meeting for a break at 10:54 a.m., reconvening at 11:08 a.m.

Trustee Piombo was excused from the meeting at 11:00 a.m.

11:00 a.m. – 12:30 p.m.
Proxy Voting and Corporate Governance Policy – Education and Discussion of Proxy Voting Processes
Matt DiGuiseppe, Head of the Americas Asset Stewardship Group
Sonya Park, Senior Relationship Manager
State Street Global Advisors
Jeff Wickman, MCERA
Ashley Dunning, Nossaman LLC

Mr. Wickman introduced Matt DiGuiseppe, Head of the Americas Asset Stewardship Group, and Sonya Park, Senior Relationship Manager at State Street Global Advisors, to talk about what they do and what they expect out of their proxy voting processes. Then Board Counsel Ashley Dunning will discuss the Board's responsibility for proxy voting from a legal standpoint. Mr. DiGuiseppe said he will discuss how SSgA approaches asset stewardship and the reasoning behind their processes for corporate engagement. He stated that SSgA is a large global asset manager with a corporate engagement process driven by two elements: have an impact, and use a risk-based approach to allocate limited resources. Chair Given asked how the conversation with corporations comes about. Mr. DiGuiseppe replied there are a number of different ways, mainly because SSgA wants to have that conversation. SSgA develops a target list of companies based on portfolio exposure, proprietary ESG screens, and thematic and sector priorities. This prioritization process works for SSgA and involves unique engagements with 600 companies per year. They have found that companies want to hear what they have to say.

Mr. DiGuiseppe said SSgA brings its agenda when meeting with corporations. There was a learning process for these companies and the market has responded positively to how SSgA wants to conduct its engagement program. He estimated 25% of companies are reactive to these engagements. Trustee Silberstein asked how effective the engagements have been. Mr. Silberstein asked if SSgA expresses dissatisfaction by voting no on executive pay, for example. Mr. DiGuiseppe replied SSgA uses its vote more frequently than peers, specifically on executive compensation and board tenure. Overall, SSgA makes sure to use a constructive approach to relationships. Engagements have a duration of 10 years and during that time about half of engaged companies address SSgA's concerns. Mr. DiGuiseppe said dialogue is creating change and more companies are becoming involved.

Trustee Bolger asked if the engagements add value. Mr. DiGuiseppe replied the fundamental thesis is everything SSgA does has value, whether it is a financial benefit to the client or risk mitigation. For example, ESG matters are largely based on the probability of events occurring over the long run. Trustee Silberstein noted SSgA has identified diversity on corporate boards as an important issue. Mr. DiGuiseppe said part of SSgA's corporate engagement campaign is to use its vote to advance gender diversity on corporate boards. SSgA sent a letter to companies with no women on the board of directors saying research shows it makes financial sense to have diverse boards. Further, SSgA voted against 400 companies for not having a single woman on the board. Many companies came back and committed to changing policies; seven companies have added women to their boards. Mr. DiGuiseppe stated the core thesis for SSgA is to help to move the market and continue the dialogue.

Chair Given asked how MCERA can express its wishes when SSgA votes on behalf of MCERA. In response, Mr. DiGuiseppe discussed how strategic priorities are set on an annual basis that include client feedback. Each year 3 to 4 sectors are selected so that over a 4-year cycle, the whole market is covered. We pick SSgA topics we feel are important, Mr. DiGuiseppe said, and incorporate what MCERA has to say. Ms. Park added typically clients' policies are not inconsistent with those of SSgA. Trustee Silberstein asked whether MCERA's account could be moved from the commingled account to a separate account and Ms. Park replied affirmatively.

In summary, Mr. DiGuiseppe stated SSgA engagement priorities are not static but evolve over time. He highlighted the Investor Stewardship Group (ISG) formed two and a half years ago by SSgA among other firms to develop a private market expectation for corporate governance. He highlighted SSgA's involvement in the climate change story SSgA identified as a macro issue before 2012. In 2016 SSgA used its vote to say this is something boards need to pay attention to. Subsequently, SSgA issued a paper on four things it expected from energy companies. SSgA is thinking strategically about how it interacts with investors and companies, Mr. DiGuiseppe said.

Ashley Dunning, Partner with Nossaman LLP, discussed the development of legal standards regarding proxy voting. The first step was a letter written in 1988 by the Department of Labor (DOL) to a company subject to the Employees Retirement Income Security Act of 1974 (ERISA) that is applicable to fiduciaries of pension plans in the private sector. Although DOL guidance is not binding on public plans, public plans often look to the DOL's interpretation of ERISA for guidance, she explained. The letter said the obligation of the company's pension fund advisors includes handling decisions on how proxies should be voted in a prudent manner. State law based fiduciary principles that apply to MCERA also support the same conclusion as to MCERA's Board's decisions regarding proxy voting.

Later the DOL issued an Interpretive Bulletin saying fiduciaries may engage in shareholder activity designed to influence corporate management if the fiduciary concludes that voting proxies is likely to enhance the value of the plan's investments. Ms. Dunning noted that the SSgA representative said SSgA uses proxy voting to enhance investments financially. The DOL cautioned that fiduciaries may not subordinate the economic interests of the plan to social objectives. In another bulletin in 2008 the DOL repealed and replaced its earlier bulletin, issuing revised guidance that fiduciaries may vote proxies only if there would be an increase in the value of its investments as compared with the cost. Ms. Dunning stated this guidance was viewed as very restrictive. More recently in 2016 the DOL issued a new interpretive bulletin because its prior guidance may have been misunderstood to discourage active engagement through proxy voting. Ms. Dunning said the new guidelines are a loosening of guidance on voting proxies in recognition that some ESG objectives may have inherent value to the Fund. Further, the value to all investors can also be considered as to the cost-benefit analysis; the caution being that if an inordinate amount of time is spent to vote shares, then the cost of the proxy voting process should be considered.

Mr. Dunning stated the takeaway from DOL guidance is that the Board should consider when voting proxies whether issues are likely to enhance investments and that the plan fiduciary would not be viewed as subordinating the economic interests for unrelated objectives.

MCERA's Investment Policy Statement (IPS) addresses proxy voting, providing that its proxy voting rights be managed with prudence as responsible fiduciaries in the sole interest of the Plan's members and beneficiaries. The IPS also specifically states MCERA delegates voting authority to investment managers and will be provided with their policies and proxy voting records at least semiannually. MCERA reserves the right to vote proxies. IPS proxy voting provisions are included in MCERA's Proxy Voting and Corporate Governance Policy, which closely tracks the Council of Institutional Investors (CII) corporate governance policy. Ms. Dunning discussed SEC guidance related to proxy advisory firms regarding fiduciary obligation, due diligence, and oversight.

In closing, Ms. Dunning posed three questions on proxy voting processes for the Board to consider:

- Would providing direction on proxy voting, specifically or generally, enhance the value of MCERA's investments?

- Is any such direction enforceable by any means other than divesting from a particular investment (noting that Columbus Circle is MCERA's only non-commingled fund investment)?

- Would retention of a proxy advisory firm be prudent, or is MCERA's current approach, or a modified approach, more advisable?

Trustees Gladstern and Silberstein indicated tracking difference in managers' proxy voting policies from MCERA's proxy voting policy would be useful. Trustee Bolger observed managers have many clients and merging policies may not be possible. In response, Trustee Silberstein said he wants to have that conversation with the managers and then reconcile differences, or have consensus on some things and then decide whether to change the investment.

Trustee Silberstein proposed that the Governance Committee (Committee) suggest some guidelines on a few issues like diversity and CEO pay and analyze how managers vote. The Administrator advised the Board would need to agree to the Committee's proposal. Mr. Wickman said the Board may direct staff and counsel to bring its ideas to the Committee and that will be reported to the Board. Trustee Cooper said we have quality managers who may or may not use their vote as an activist. He indicated MCERA may have to pay more in fees to be treated as an activist, and managers of pooled vehicles do not have to consider our proxy voting policy. Trustee Cooper believes there is no problem to solve because the process for voting proxies and reviewing the manager votes is in place. Trustee Murphy expressed an interest in data supporting that specific proxy voting issues would enhance the value of the Fund.

Chair Given recommended that the Governance Committee consider where there may be potential conflicts in proxy voting policies of MCERA and its managers. He advised processes need to make sense for MCERA. Chair Murphy presided over the rest of the meeting.

Closing and Follow-up Items from Today's Agenda
12:30 p.m. – 1:00 p.m.

Mr. Wickman stated he will work with the Chair of the Governance Committee on a process to work with managers on proxy voting.

As Investment Committee Chair, Trustee Given will discuss small cap investment alternatives with Trustee Silberstein and with the investment consultant. Counsel Dunning responded to Trustee Given's inquiry on the appropriate process for discussing Board matters within parameters permitted by the Brown Act.

Mr. Wickman reported this is the last Board meeting for Board Chair Bernadette Bolger. The Vice Chair, Maya Gladstern, will step in as Chair of the November Board meeting. Trustee Gladstern acknowledged Ms. Bolger for her service on the Retirement Board.

There being no further business, Chair Murphy adjourned the meeting at 12:51 p.m.

Laurie Murphy

Laurie Murphy, Chair

Attest: Jeff Wickman
Retirement Administrator