

MINUTES
INVESTMENT COMMITTEE MEETING
MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION (MCERA)
One McInnis Parkway, 1st Floor
Retirement Board Chambers
San Rafael, CA
December 6, 2023 – 9:00 a.m.

This meeting was held at the address listed above and was accessible via videoconference and conducted in accordance with Government Code section 54953 and 54954.2.

CALL TO ORDER

Chair Klein called the meeting to order at 9:03 a.m.

ROLL CALL

PRESENT: Gladstern, Klein, Martinovich, Murphy, Poole, Silberstein, Vasquez, Werby, Shaw (ex officio alternate)

ABSENT: Cooper, Gullett (alternate safety), Jones (alternate retired)

CONSIDER ANY BOARD MEMBER REQUESTS TO TELECONFERENCE FOR “JUST CAUSE” OR “EMERGENCY,” AS SET FORTH ON THIS AGENDA BELOW

No Board members requested to teleconference.

A. OPEN TIME FOR PUBLIC EXPRESSION

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

Open time for public expression, from three to five minutes per speaker, on items not on the Committee Agenda. While members of the public are welcome to address the Committee during this time on matters within the Committee'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 Committee concerning a non-agenda item. Members of the Committee may (1) briefly respond to statements made or questions posed by persons addressing the Committee, (2) ask a question for clarification, or (3) provide a reference to staff for factual information.

No members of the public provided comment.

B. MANAGER REPORTS

1. Manager Overview – Jim Callahan, Callan LLC

Jim Callahan, President of Callan LLC, stated AEW manages one of two core private real estate portfolios for MCERA. Mr. Callahan noted the real estate sector has had challenges over the past year.

2. AEW – Real Estate – Lily Kao, Candida Hoeberichts

TIME CERTAIN: 9:05 a.m.

Lily Kao, Senior Portfolio Manager for the AEW Core Property Fund, reported after 13 years of appreciating real estate values, the past year has been volatile with declining valuations reflecting a real estate correction. Ms. Kao said the quick rise in interest rates and post-Covid environment have affected valuations and contributed to headwinds in the Office sector. Nevertheless, the Fund continues to outperform by investing in high-quality assets with durable income.

Ms. Kao reported average occupancy in the Fund is 95% and nearly 70% of assets are invested in the Industrial and Residential sectors. Since 2021 the Industrial allocation has been increased and the Office sector reduced. These sector allocations and increasing net operating income are driving portfolio performance. Ms. Kao noted the core strategy limits risk through relatively low leverage of 28% loan-to-value and limited debt maturity risk. Trustee Werby asked about the marked difference between income and appreciation returns for one year, and Ms. Kao said she will get back to him on those calculations.

Chair Klein asked about the appraisal process. In response, Ms. Kao stated all properties are valued every quarter by a third party based on cash flows and replacement cost. She noted in general real estate trades are down from what is normal activity and the buyer pool has more private buyers rather than institutions.

Trustee Silberstein asked if Ms. Kao anticipates changing sector allocations. Ms. Kao replied historically the portfolio has been weighted to the East and West Coasts of the U.S. and also the South. Sectors have a material weight to Industrial which is diversified by investing in cold storage. Going forward they will look for opportunities to purchase more multifamily properties, and the Office allocation will continue to be reduced. Ms. Kao said due to the quiet transaction market, AEW is being patient and disciplined about acquisitions.

Trustee Vasquez asked about the makeup of Industrial properties, which Ms. Kao said are primarily warehouses with a small allocation to cold storage. Geographically, most Industrials are located in Los Angeles, northern New Jersey, and Miami because they have the best supply-demand drivers. Trustee Werby asked how climate risk is assessed for properties in South Florida. Ms. Kao replied AEW provides information to the Global Real Estate Sustainability Benchmark and has a Chief Sustainability Officer who assesses physical and governance risk for properties across the portfolio.

Trustee Werby asked if fewer people are using office space and Ms. Kao indicated occupants are 50 to 60% of prior levels depending on the location. She indicated some industries and jobs are completely virtual and therefore is expecting structurally lower office occupancy going forward.

Addressing debt, Ms. Kao stated the portfolio is not exposed to loans with high interest rates and 84% of loans have fixed rates. Ms. Kao noted in 2023 AEW was able either to pay off or extend loans with no paydowns. For 2024, Ms. Kao said the plan is to exercise extension rights which most loans have.

Chair Klein asked about apartment rents, which Ms. Kao said are rising at a modest pace due to people moving to the suburbs and working from home. Trustee Silberstein noted it is cheaper to rent rather than own housing and asked if this disparity would continue. Ms. Kao replied she likes the housing sector, explaining the U.S. is undersupplied and she expects demand to be strong, noting that every submarket has different drivers. In the near term an economic slowdown would be likely to result in less robust growth in the multi-family sector.

Chair Klein asked if Ms. Kao would consider repurposing office buildings and she replied that is not a strategy for this core real estate fund because of the risk. Trustee Vasquez asked if the government would buy distressed properties and then sell them later, such as happened in the savings and loan crisis. In response, Ms. Kao stated that she did not see the government taking this approach due to the potential risk. She is expecting a long-term structural vacancy in the Office sector.

Jim Callahan asked how AEW is working on the redemption queue. Ms. Kao replied that the redemption queue is being paid down, but not with significant amounts due to the quiet real estate market. The redemption queue began in 2022 and is just under \$1 billion, about 15% of the Net Asset Value (NAV) of the Fund.

C. NEW BUSINESS

1. Watch Period Review – Callan LLC – Jim Callahan, Anne Heaphy
 - a. Invesco Balanced-Risk Commodities Fund (ACTION)
Consider and take possible action regarding Watchlist status

Anne Heaphy, Senior Vice President with Callan LLC, stated Callan's proposal is to remove the Invesco Balanced-Risk Commodities Fund from the Watchlist because it no longer qualifies based on quantitative criteria. Ms. Heaphy explained the 3-year net-of-fee return has improved this year.

It was M/S Werby/Vasquez to remove the Invesco Balanced-Risk Commodities Fund from the Watchlist for one year. The motion passed by a vote of 8-0 as follows:

AYES: Gladstern, Klein, Martinovich, Murphy, Poole, Silberstein, Vasquez, Werby
NOES: None
ABSTAIN: None
ABSENT: Cooper, Gullett

b. Wellington Core Plus Fixed Income (ACTION)

Consider and take possible action regarding Watchlist status

Ms. Heaphy stated the Wellington Core Plus Fixed Income portfolio qualifies for the Watchlist based on its 5-year peer group ranking being slightly below the median. She noted duration positioning above the index has been a headwind to performance. Trustee Vasquez asked what the strategy was going forward and Ms. Heaphy replied the manager expects interest rates to decline. Mr. Callahan added Wellington is definitely overweight long duration, which has helped performance over the short term. He noted the guidelines for fixed income portfolios constrain interest rate bets.

It was M/S Vasquez/Gladstern to place the Wellington Core Plus Fixed Income portfolio on the Watchlist for one year.

Trustee Werby asked if Mr. Callahan is recommending adding the Wellington portfolio to the Watchlist. In response, Mr. Callahan suggested following the Investment Policy Statement provisions on qualifying for the Watchlist. Trustee Silberstein supported this view.

The motion passed by a vote of 8-0 as follows:

AYES: Gladstern, Klein, Martinovich, Murphy, Poole, Silberstein, Vasquez, Werby
NOES: None
ABSTAIN: None
ABSENT: Cooper, Gullett

2. International Equity Allocation – Passive Manager (ACTION)

Consider and take possible action to select passive manager

Ms. Heaphy said at its last meeting the Investment Committee determined to reallocate the international equity portfolio as follows: 50% passive non-US Developed, 25% active non-US Small Cap, and 25% active emerging markets. For the 50% passive sleeve the Committee narrowed manager candidates to State Street Global Advisors (SSGA) and BlackRock. Current active managers Fidelity Institutional Asset Management and TimesSquare will continue managing the Emerging Markets and non-US Small Cap funds, respectively.

Ms. Heaphy presented fee proposals from SSGA and BlackRock to manage the MSCI World ex-U.S. Index as the vehicle for the 50% passive Non-U.S. sleeve. For the securities lending vehicle, SSGA fees totaled \$112,561 and BlackRock fees totaled \$104,501 (based on recent market values). SSGA's fee proposal also lowers the fee for

the Russell 1000 Index portfolio it manages to 2 basis points and removes the annual fee, saving approximately \$35,000 per year. By comparison, BlackRock fees would be the same for the current TIPS and REIT portfolios it manages.

Ms. Heaphy discussed the difference between the lending and non-lending vehicles in response to Trustee Gladstern's inquiry. Trustee Vasquez asked if securities lenders know the borrowers. Mr. Callahan explained borrowers may be hedge funds or institutions needing to settle trades. He stated Callan is comfortable with the securities lending vehicles. Trustee Silberstein asked if using one supplier would help operations. Mr. Wickman replied MCERA has relationships with both managers, noting that SSGA manages MCERA's Russell 1000 portfolio and BlackRock is the manager for TIPS and REITS.

It was M/S Silberstein/Murphy to select State Street Global Advisors to manage the passive MSCI World ex-U.S. Index lending equity portfolio. The motion passed by a vote of 8-0 as follows:

AYES: Gladstern, Klein, Martinovich, Murphy, Poole, Silberstein, Vasquez, Werby
NOES: None
ABSTAIN: None
ABSENT: Cooper, Gullett

3. Investment Policy Statement updates (ACTION)

Consider and take possible action on recommended amendments to the Investment Policy Statement.

- a. Investment Goal Statement: Add PEPRA reference
- b. Investment Goal Statement: Update rebalancing procedure
- c. Appendix A – Long-Term Strategic Asset Allocation Targets and Ranges: Update rebalancing procedures

Mr. Wickman stated the Governance Committee is recommending that updates to the Investment Policy Statement be considered by the Investment Committee. The first update is to include a reference to the Public Employees' Pension Reform Act (PEPRA) in the Policy. Other updates have to do with the process of rebalancing the Fund. The intent is to tighten up the time frames for the physical rebalancing of portfolios when they pierce target ranges.

Mr. Callahan explained that Parametric monitors target ranges on a daily basis for major categories such as fixed income and U.S. equities. Trustee Werby asked if the word "materially" should be defined and it was generally agreed to remove the word.

It was M/S Silberstein/Vasquez to approve amendments to the Investment Policy Statement with the word "materially" removed. The motion passed by a vote of 8-0 as follows:

AYES: Gladstern, Klein, Martinovich, Murphy, Poole, Silberstein, Vasquez, Werby
NOES: None
ABSTAIN: None
ABSENT: Cooper, Gullett

4. Future Meetings

No discussion.

D. INVESTMENT CONSULTANT QUARTERLY REPORT

1. Summary Report as of September 30, 2023

Mr. Callahan reported on the capital markets for the quarter ending September 30, 2023. Public equity returns were negative for the quarter due to concern about rising interest rates. For the calendar year to date, large cap stocks have performed meaningfully better than small caps, with the 'Magnificent Seven' large cap stocks driving the vast majority of market performance. As a result, the Fund's overweight to small cap equity has been a headwind to performance. International equities have been underperforming U.S. equities. Interest rates rose during the quarter, causing the bond index to be down. Real estate and private equity assets are still undergoing write-downs.

Asset allocations are within target ranges and the total Fund value is just over \$3 billion. For the quarter the total Fund return net of fees was negative 3.2% and up 8.5% for the prior 12 months. The fiscal year net return to date is 6.5%.

Net of fees, the domestic equity portfolio returned negative 3.2% for the quarter. The Dimensional Fund Advisors small cap core portfolio has been outperforming the Russell 2000 benchmark over the past few years. The international equity portfolio underperformed the MSCI EAFE Index for the quarter with a negative 5.5% net return versus negative 4.1% for the Index. Active managers Morgan Stanley, Fidelity Institutional Asset Management, and TimesSquare underperformed. Mr. Callahan said it was a tough quarter for the core plus fixed income portfolio which returned negative 3.9% net of fees versus negative 3.2% for the Bloomberg Aggregate Index.

The core real estate portfolio returned negative 1.2% net of fees for the quarter versus negative 2.1% for the NFI-ODCE Equal Weight Net Index. MCERA's two managers, AEW and UBS, employ leverage to a smaller degree. Relative to their peer group, both AEW and UBS rank high for income. The UBS Trumbull Property Fund has struggled due to lower valuations for its closed malls.

The real assets portfolio returned negative 3.2% net of fees for the quarter and rose 5.2% over the prior 12 months. Commodities manager Invesco had solid results, outperforming the index for both the quarter and prior 12 months. The KBI Global Resources Fund underperformed its index due to having no traditional energy assets.

For the private equity program, MCERA has paid in 83% of the \$500 million committed. MCERA has received over \$477 million in distributions and the remaining net asset value

is \$355.7 million. Adding these together, the total realized and unrealized value is over \$833 million. This translates to a total value to paid-in capital (TVPI) ratio of 2.0x, signifying successful performance for the private equity portfolio.

Of \$100 million committed to the Opportunistic portfolio, \$65 million has been paid in since its inception in 2020. This portfolio is in the investment stage.

a. Flash Performance Update as of October 31, 2023

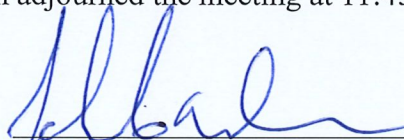
Mr. Callahan reported on preliminary net-of-fee returns for the Fund as of October 31, 2023. The U.S. equity portfolio is down 6.4% for the fiscal year to date, trailing the Russell 3000 Index return of negative 5.8%. The DFA small cap core portfolio outperformed the Russell 2000 Index in the period. The international equity portfolio is modestly ahead for the calendar year to date, slightly outperforming its index. Both the TimesSquare international small cap and FIAM emerging markets portfolios added value in the period. The fixed income portfolio is slightly negative for the calendar year to date, outperforming the Bloomberg U.S. Aggregate Index. The total Fund returned negative 5.2% for the fiscal year to date and 1.3% for the calendar year to date.

Trustee Vasquez asked about the correlation of returns between private real estate and REITs. Mr. Callahan explained the correlation is low since the underlying assets in REITs are valued every day.

There being no further business, Chair Klein adjourned the meeting at 11:45 a.m.



Sara Klein
Investment Committee Chair



Attest:
Jeff Wickman, Retirement Administrator