MINUTES

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

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

January 17, 2024 – 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 9:01 a.m.

ROLL CALL

PRESENT: Cooper, Gladstern, Klein, Martinovich, Murphy, Poole, Silberstein, Vasquez, Werby, Jones (alternate retired)

ABSENT: Gullett (alternate safety), Shaw (ex officio alternate)

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 MCERA's three private credit managers, AB CarVal Investors, Fortress Investment Group LLC, and Värde Partners, are presenting annual portfolio reviews. MCERA's Opportunistic allocation is targeted at 0 to 5% of the Fund, and about two-thirds of the current $100 million commitment has been called.

2. AB CarVal – Credit Value Fund V – Jody Gunderson, Matthew Hanson
   TIME CERTAIN: 9:05 a.m.

   Matt Hanson, a managing director for AB CarVal Investors, introduced Jody Gunderson, one of three managing principals at the firm. Ms. Gunderson stated the firm is still independently managed following its acquisition by AllianceBernstein. During the last year administrative functions have been integrated. She discussed staff transitions and noted one recruitment focus is for expertise in the clean energy transition growth area.

   Mr. Hanson reported Credit Value Fund V was 70% called as of the end of November 2023 with five months left in the Fund's investment period. The team employs a multi-strategy global investment approach across private credit. Capital is deployed into illiquid credit situations with strong underlying contractual cash flows. In addition, investments are made in liquid credit opportunities where there are market dislocations. Two current investment themes are structured credit opportunities and energy transitions. Of 130 investments representing 578 underlying instruments, 38% is invested in asset-backed securities and 33% invested in loan portfolios. On the energy transition side, 15% of the Fund is invested in senior secured loans.

   Ms. Gunderson said AB CarVal provides solutions for banks that are trimming portfolios as market conditions across U.S. and European markets lead to falling prices. She said the broad theme is the beginning stages of assets moving from the banking industry to private debt. This is due to banks facing new regulations and being under further pressure to manage their growth. Investments include the structured products market of consumer asset-backed securities, residential mortgage-backed securities, commercial mortgage-backed securities, and corporate collateralized loan obligations. Ms. Gunderson noted banks are selling $1 trillion of consumer loans that tend to have higher risk than other portfolios. She gave examples of high-quality consumer loan portfolios that mitigate AB CarVal's downside risk with the expectation of a meaningfully positive return. Most consumer loan portfolios are performing as expected, she said, and include a large residential portfolio in Italy being sold by a European bank.

   The commercial real estate debt markets are also under pressure as $2.75 trillion in commercial debt maturities come due. AB CarVal takes positions in senior loans backed by hospitality assets such as hotels and multi-family properties. In some cases, extensions are employed to de-risk an investment.

   Another opportunity is the energy transition market, Ms. Gunderson said. Recent issues in this space have included rising interest rates, the increasing cost of funds, supply chain issues, and cost inflation. Investment strategies are to provide financing to developers of projects such as solar and battery storage assets. Chair Klein asked to what extent changes to incentives have impacted the energy transition market. In response, Ms. Gunderson said extending tax credits for 10 plus years and tax credits for building in areas dominated by fossil fuels or low income earners makes projects more viable and accelerates their development.

In conclusion, Ms. Gunderson stated the expectation is that banking stress will continue for a number of years and provide for the apparatus to take meaningful risk. Trustee Gladstern asked how interest rates have affected private debt strategies. Ms. Gunderson replied the firm is hedging interest rate risk for longer duration residential mortgage or energy transition markets. Due to the higher cost of funds, the focus is on lending since equity value is getting squeezed. She explained that power rates will need to rise to justify the cost of projects, and that is in the process of happening.

Trustee Vasquez asked where we are in the credit cycle, given $2.5 trillion of corporate debt coming due by 2026 and rising corporate defaults in Europe. Ms. Gunderson replied the assumption is that in Europe corporate market performance will continue to deteriorate. She noted spreads are not wide enough to make a good return and there are delinquencies for consumers and residential borrowers who do not have fixed rate mortgages. The protection is not having as much exposure. She indicated in the U.S. delinquencies are increasing.

Chair Klein asked how the number of banks would be reduced. In response, Ms. Gunderson said the expectation is that very small banks needing to comply with new regulatory elements will consolidate through mergers and acquisitions. Trustee Werby asked how returns are generated for direct real estate loans. Ms. Gunderson explained that in the case of a hotel, the 20% return is levered.

3. Fortress Investment Group LLC – Credit Opportunities Fund V Expansion – Danny Kayne, Jill Chanes
TIME CERTAIN: 9:35 a.m.

Danny Kayne, Global Head of Consultant Coverage, and Jill Chanes, Senior Product Specialist with Fortress Investment Group LLC, presented the Credit Opportunities Fund V Expansion portfolio review. Mr. Kayne reported the Fund has invested over 80% of commitments across 97 investments, and remaining committed capital is expected to be invested by November of this year. Ms. Chanes reported the team is sourcing and underwriting investments across the entire credit spectrum, including real estate, corporate debt securities, direct lending, specialty assets, and structured finance. The focus is on stressed, distressed, and special situations to produce the best risk/reward returns. She stated the Fund is achieving high-quality returns with diversification and downside protection.

Ms. Chanes indicated the Fund takes advantage of uncertainty in the capital markets. Expectations are for a greater demand for capital in the wake of an upcoming maturity wall in real estate and corporate debt. In addition, banks are trimming balance sheets due to a change in the regulatory environment. Ms. Chanes expects there to be more than enough transaction volume as other forms of liquidity have dried up. She highlighted real estate debt as most compelling due to the increase in interest rates and lack of available credit to address pending maturities.

The Fund is engaging in forward flows by purchasing consumer, small business or residential loans that are being sold by originators at attractive prices. In some cases, warrants provide additional upside to the stand-alone asset return. The idea is to capitalize where there is a mismatch between risk and reward.

Discussing other investment opportunities, Ms. Chanes noted legal assets and intellectual property are not correlated to the broader markets. As such, these holdings provide for diversification and defensiveness in the portfolio. Corporate securities are a core area of expertise where patience is being exercised to wait for a mispriced security or mispriced sector. Given a favorable risk/return profile, the Fund may engage in refinancing or providing capital. Another opportunity is non-performing loans in Europe. Ms. Chanes observed there is a higher likelihood of finding good companies with poor balance sheets in Europe than in the U.S.

Ms. Chanes reported as of November 30, 2023, $21 million of MCERA's $33 million committed capital has been called. The Fund has invested $28 million, 85% of the commitment, with 10 months remaining in the Fund's investment period. The Fund has distributed approximately $4.8 million to MCERA. Ms. Chanes estimates 75% of remaining cash flows will be received by the Fund by the end of 2026.

Trustee Vasquez asked why legal assets have performed so well. Ms. Chanes replied Fortress has a unique niche as one of the best known and most experienced investors in this category. The process involves de-risking by assessing the confidence level of cases. Fortress may advance expected payouts and structure payment based on a percentage of expected proceeds. This area is very diversified and includes loans to law firms and investing in litigation for forward flow. As to Trustee Vasquez's inquiry on which legal jurisdictions are used, Ms. Chanes replied the United Kingdom, the U.S. and Australia, where the team feels comfortable that the legal process is fair and judicial. Trustee Werby asked if there are energy-related investments and Ms. Chanes replied the Fund may finance infrastructure, but nothing directly correlated to commodities.

4. Värde Partners – Värde Dislocation Fund – Brad Bauer, Tom Knechtel
TIME CERTAIN: 10:05 a.m.

Tom Knechtel, Värde Partners Managing Director, Client Relations team, introduced Brad Bauer, Co-Chief Executive Officer (CEO) and Co-Chief Investment Officer (CIO), responsible for Global Private Markets. Mr. Bauer reported the Värde Dislocation Fund investment period began in June of 2020 and ended in June of 2022. He reported the Fund is 80% drawn of original capital commitments. Halfway through the harvest period, the Fund has an 8.5% Internal Rate of Return (IRR) and 1.2x multiple. During 2023, about 30% of Assets Under Management (AUM) was distributed to investors. In 2024 distributions to investors are expected to be around 60% of the current AUM.

Portfolio composition of the Fund began predominantly in the corporate credit markets. These positions with steady cash flows have largely been liquidated. The current composition is mostly in liquid private credit, with about 1/3 exposure in real estate and another 1/3 in private corporate credit. Drivers of return used to be travel related through hotels, cruise lines and travel services. The second theme driving returns was housing, one being credit to home builders secured by their inventory and, secondly, housing for students. Beginning in the fourth quarter of 2023, student housing positions were sold into a strong market to provide liquidity for upcoming distributions to investors. Mr. Bauer noted there is stress in regional banks and their balance sheets as capital is tight. Geographically, he noted pricing has recovered in Asia and the U.S. continues to be volatile.

Trustee Silberstein asked for more specifics on Asian business locations. In response, Mr. Bauer said the Fund operates in India (mostly in senior corporate financing), Indonesia, and Australia. Chair Klein inquired about India being preferred, and Mr. Bauer replied India was a starting point because its legal system and bankruptcy code are well regulated. Trustee Vasquez asked about leverage and Mr. Bauer replied there is very little leverage at the Fund level. At the deal level, the amount of leverage varies with investments; for example, there is 50 to 60% leverage in student housing and about 75% leverage in senior hotel loans. No leverage is employed with corporate securities, he said.

C. NEW BUSINESS

1. Investment Policy Statement Updates (ACTION)
   Consider and take possible action on recommended amendments to the Investment Policy Statement.

   Mr. Wickman presented updates to the Investment Policy Statement that have already been authorized by the Investment Committee. The updates reflect replacing Morgan Stanley and Artisan international equity portfolios with the State Street Global Investors MSCI World ex-US Index.

It was M/S Werby/Vasquez to approve recommended amendments to the Investment Policy Statement listed in Agenda Items C.1.a-d below. The motion passed by a vote of 9-0 as follows:

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

a. General Investment Objectives and Guidelines: Change International Large Cap Stocks index from MSCI EAFE to MSCI World ex-US Index.

b. Appendix A – Long-Term Strategic Asset Allocation Targets and Ranges: For Non-US Equities, remove Large Cap Value and Large Cap Growth; add Developed at 11.0% target with a range of 9.0% to 13.0%; increase Small Cap Core and Emerging Markets targets to 5.5% with a range of 4.5% to 6.5%.

c. Appendix B-3 and B-4 – Morgan Stanley and Artisan Partners Statements of Objectives, Guidelines & Procedures: Remove.

d. Appendix B-3 – State Street Global Advisors MSCI World ex-US Index Fund: Add.

2. Future Meetings

Trustee Gladstern suggested discussing the future of the Opportunistic allocation.

D. INVESTMENT CONSULTANT PERFORMANCE UPDATE

1. Flash Performance Update as of December 31, 2023

Mr. Callahan presented preliminary Fund returns as of December 31, 2023. For the fiscal year to date the domestic equities portfolio returned 8.8% and 24.4% for the 2023 calendar year. He reported during the fourth quarter of 2023 equity markets rallied on the assumption the Federal Reserve would cease raising interest rates. The Fund is overweight to small cap which was a headwind to Total Fund returns. The Dimensional Fund Advisors (DFA) small cap core equity portfolio has outperformed the Russell 2000 calendar year to date. In the international portfolio, active managers Fidelity Institutional Asset Management and TimesSquare will have increased allocations once the new passive international manager allocation has been fully funded.

In the fixed income portfolio, both Wellington and Western Asset portfolios significantly outperformed the Bloomberg US Aggregate Index for both the fiscal year and calendar year. Both active real asset managers Invesco and Kleinwort Bension have positive fiscal year returns. The Invesco commodities portfolio outperformed the Bloomberg Commodities index significantly for the fiscal year. The private real estate portfolio has negative returns for the fiscal and calendar years. The private equity portfolio will have positive returns for the fiscal and calendar years once final valuations are in.

Mr. Callahan reported the Opportunistic allocation has been a successful investment. He said the idea was to invest in potential dislocations in the market following Covid. In addition, the three managers, AB CarVal, Fortress, and Värde, are focusing on different parts of the market. Returns have been additive to the Fund return so far, and the expectation would be returns would exceed that of the total Fund return.

Trustee Vasquez expressed an interest in the amount of leverage in the private equity portfolio, given early signs of default and maturing debt. Mr. Callahan noted the commercial banking sector is slowly going away and the result is the cost of capital goes up. Under stress, private credit capital will be deployed. He emphasized the importance of implementation in the private credit space, which he said is becoming more mainstream.

There being no further business, Chair Klein adjourned the meeting at 11:05 a.m.

Sara Klein
Investment Committee Chair

Attest:
Jeff Wickman, Retirement Administrator