



Date: June 14, 2017
To: Members of the Board of Retirement
From: Annette Cain-Darnes - Chair
Subject: Summary of June 14, 2017 Investment Committee Meeting

The Investment Committee met on Wednesday, June 14, 2017 at 9:33 a.m. The Committee members present were Dale Amaral, Ophelia Basgal, Annette Cain-Darnes, Liz Koppenhaver, Elizabeth Rogers, and George Wood. Members of the Staff present were David Nelsen – Chief Executive Officer, Kathy Foster – Assistant Chief Executive Officer, Margo Allen – Fiscal Services Officer, Harsh Jadhav – Chief of Internal Audit, Betty Tse – Chief Investment Officer, and Susan Weiss – Associate Counsel.

Action Item: Matters for discussion and possible motion by the Committee

1. Discussion of and Possible Motion to Recommend to the Board to Adopt a new U.S. Equity Manager Structure
 - Representatives from Verus presented a new U.S. Equity Manager Structure recommendation as a follow-up to an update of the U.S. Equity Manager Structure adopted in April 2016. Verus recommended increasing the target passive index allocation from 70% (65% - 75% range) to 80%. Once a passive index manager is hired for the Russell 1000 equity index and the April 2016 U.S. Equity Manager Structure is implemented at the 70% target, Verus recommends moving toward the 80% level (Alternative 2) over time by taking monies from active managers, as discussed below.
 - To meet ongoing capital calls and/or month-end payroll, and to incrementally move toward a passive index structure. Verus suggested Staff draw down from the most overweight active manager within the most overweight asset class (U.S. Equity, International Equity, or Fixed Income asset classes).
 - After further discussion, Ms. Ophelia Basgal moved, seconded by Mr. George Wood, to recommend to the Board to approve the new 80% passive asset allocation target for the U.S. Equity Asset Class.
 - The motion carried with 6 yes (Amaral, Basgal, Cain-Darnes, Koppenhaver, Rogers, and Wood), 0 no, and 0 abstention.
2. Discussion of and Possible Motion to Recommend to the Board to Adopt an Investment in ACERA's Real Estate Portfolio
 - Representatives from Heitman Real Estate presented to the Committee the history, background, and culture of the firm, as well as the opportunity set, investment team and strategy of the Heitman Value Partners IV (HVP-IV or Fund).
 - The representatives discussed the Fund's strategy related to income-orientation, defensive characteristics, long-term demographics-driven opportunity, and its successful partnerships with its operating partners. The portfolio manager for HVP IV is Thomas McCarthy, who also manages HVP II (ACERA's prior commitment of \$25.0 million). The representatives also emphasized that, if ACERA



would like to commit additional capital before the final close, it would extend the same management fee at 90bps.

- After further discussion, Mr. George Wood moved, seconded by Mr. Dale Amaral, to recommend to the Board to adopt an investment of \$10.0 million in the Fund, pending completion of legal due diligence, background investigations, and successful contract negotiation.
- The motion carried with 6 yes (Amaral, Basgal, Cain-Darnes, Koppenhaver, Rogers, and Wood), 0 no, and 0 abstention.

INFORMATION ITEMS

3. Quarterly Performance Review for the First Quarter of 2017 – Real Estate

- ACERA's real estate portfolio returned an 1.81% gross return (1.61% net) for Q1 2017 and 8.26% gross return (7.32% net) for the 1-year period ending 3/31/2017 compared to the gross NCREIF-ODCE benchmark of 1.77% (1.54% net) and 8.34% (7.36% net), respectively.
- The total market value of ACERA's real estate portfolio was \$516.2 million; approximately 7.1% of ACERA's total Fund.
- Callan Associates reported that U.S. economic growth is starting to slow, US property fundamentals are still healthy but may be peaking, and return expectations are moderating. The ACERA Core Portfolio outperformed the benchmark during the past year and has also outperformed the benchmark over the medium and long term.

4. Quarterly Performance Review for the First Quarter of 2017 – Equities and Fixed Income

- For 1Q2017, ACERA's Total Fund returned 5.8% gross (5.7% net), compared to the Policy Index return of 5.3%. For the year ending 3/31/2017, the Total Fund Returned 13.5% gross (13.1% net), compared to the Policy Index return of 13.4%. The Total Fund's results ranked in the top 2nd and 5th percentile for the quarter and one year periods, respectively.
- For 1Q2017, ACERA's U.S. Equity, International Equity, and Fixed Income asset classes returned 6.4% net, 9.9% net, and 2.8% net, compared to the respective benchmarks with returns of 5.7%, 8.1%, and 1.2%, respectively.
- As of 03/31/2017, U.S. Equity accounted for 33.5% of the Total Fund, International Equity 29.1%, and Fixed Income 16.1%. As of 3/31/2017, the market value of the Total Fund was \$7,321,660,745.



- A Verus representative said that Verus and staff intended to bring several actions to the Committee in the next few months. These actions may include: (1) proposal of a Liquid Alternative investment and (2) review of ACERA's Alternative sub-asset class.

Recommendations

- The Committee recommends, and I move, that the Board Adopt a new U.S. Equity Manager Structure utilizing Alternative 2, increasing the current target allocation for the Russell 1000 Passive Equity Index from 70% to 80%, decreasing the Large Cap Growth and Value components from 10% to 5% each, while increasing the Small Cap Growth and Value components from 4.0% to 5.0% each, and removing the All Cap Core which is at 2%.
- The Committee recommends, and I move, that the Board Adopt an investment of \$10 million in Heitman Value Partners IV in ACERA's Real Estate Portfolio, pending completion of legal due diligence, background investigations, and successful contract negotiation.

TRUSTEE/PUBLIC INPUT

Betty Tse, ACERA's Chief Investment Officer informed the Committee the following;

Status of various manager searches, as approved by the Board:

- The Passive Index Manager Search, adopted on 4/20/2017, is now in the site visit stage of the due diligence.
- The Emerging Markets Equity Manager Search was adopted on 1/19/2017. The RFP was published on 5/31/2017.
- The General Investment Consultant Search, adopted on 12/15/2016, the RFP is now expected to be published in July 2017
- The Small Cap Growth manager search will be scheduled as time permits.

The preliminary value of ACERA's Total Fund as of May 31, 2017 was \$7.5 billion.

FUTURE DISCUSSION ITEMS

None

ESTABLISHMENT OF NEXT MEETING DATE

July 12, 2017 at 9:30 a.m.

ADJOURNMENT

The meeting adjourned at 11.31 a.m.