

**SONOMA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
INVESTMENT COMMITTEE MEETING MINUTES**

Thursday, September 29, 2022
8:31 a.m.

In accordance with Retirement Board Resolution #156, adopted on September 23, 2021, and reaffirmed on September 22, 2022, the Sonoma County Employees' Retirement Association Investment Committee meeting was held virtually and in compliance with California Government Code section 54953(e).

Individuals interested in participating in the meeting were invited to join using one of the two following methods:

1. WebEx meeting application via computer, tablet or smartphone:

<https://sonomacounty.webex.com/sonomacounty/j.php?MTID=meb1f92e872317b892a83995a98526252>

2. Call-in:

1-408-418-9388

Meeting ID: 2499 591 1657

Password: 09292022

Public comments were solicited prior to the meeting by emailing rebecca.gay@sonoma-county.org. Members of the public that joined the WebEx meeting via the app or dial in were provided with the opportunity to submit live public comment for each agenda item after the Committee members and staff provided their comments.

Presiding in

SCERA Boardroom: Greg Jahn, Chair

Present via WebEx: Trustees Neil Baker (Alternate Retiree) and Tim Tuscany; Accountant III Susan Begun, Accountant I Chris Carli, and incoming Investment Officer Mickey Nguyen

Present in

SCERA Boardroom: Trustees Travis Balzarini, Amos Eaton, Erick Roeser, Joe Tambe, Brian Williams, and Bob Williamson; Chief Investment Officer Jim Failor, Senior Investment Officer Steve Marsh, Finance and Retiree Services Manager Cheryl Enold, Retirement Analyst Rebecca Gay, and Administrative Aide Julia Smith; Chris Behrns and John Lee (of Aon)

Also Present

via WebEx: Tom O'Shea, Paul Canning, and Kurt Edwards (of UBS); Ryan Kandah and Tom Daniels (of Aon); John Powell (of State Street Securities Finance); Gar Chung, Joe Ebisa and three unidentified callers (members of the public)

Absent: Trustee Chris Coursey

Greg Jahn, Chair
Erick Roeser, Vice Chair

I. MINUTES APPROVAL

Approval of the August 25, 2022, Investment Committee meeting minutes

Recommendation: Approve the August 25, 2022, Investment Committee Minutes.

A motion was made by Trustee Tambe, seconded by Trustee Eaton, to approve the August 25, 2022 minutes. The motion carried 8-0-0-1 with voting as follows:

Mr. Balzarini	Aye
Mr. Coursey	Absent
Mr. Eaton	Aye
Mr. Jahn	Aye
Mr. Roeser	Aye
Mr. Tambe	Aye
Mr. Tuscany	Aye
Mr. Williams	Aye
Mr. Williamson	Aye

II. PRESENTATIONS

UBS Realty – Senior Portfolio Manager Paul Canning, Head of Research & Strategy Kurt Edwards and Head of Portfolio & Client Services Tom O’Shea provided an organizational update and commented on the performance and positioning of the Trumbull Property Fund (TPF) in which SCERA invests.

Mr. O’Shea reviewed SCERA’s account history investing in the TPF which dates back twenty years and with a current market value of approximately \$151 million. The strong absolute return of 24.6% over the trailing 6 months ending 6/30/2022 was discussed. In response to a Trustee question about establishing appraised valuations in an environment with fewer transactions Mr. O’Shea commented that they are comfortable with their valuation process. The strong recent performance was largely due to the post-COVID bounce back and appreciation in Industrial and Apartment properties. He also noted that we should not expect that level of strong performance over the succeeding 12 months. Last, he reviewed the real estate assets managed by UBS.

Mr. Edwards then discussed the economy, noting that they expect real US GDP growth to be negative in 2023. In discussing the various real estate sectors, he noted that they expect the Office Sector, probably the most uncertain sector because of the trends in remote working, to experience

14-16% structural vacancy rates over the next 5 years. Regarding Retail, which has been hit hard by the growth of on-line shopping, there was some optimism with the view that the worst may be behind us and that new services such as medical spas and fitness centers could bring some customers back to brick-and-mortar retail. Mr. Edwards also reviewed property sector rent growth, noting the strong growth in Retail and Industrial rents over the prior year. Last, he reviewed national cap rates and total returns by sector forecast through 2023. Valuations are generally expected to moderate in 2023 to be relatively flat. Comment was also made that bid-ask spreads were beginning to widen as debt financing has become more expensive and this should slow the number of transactions.

Mr. Canning then reviewed the TPF in particular, noting that 73% of the Non-Strategic Assets (NSA) had been liquidated and \$3.1 billion of redemptions paid out. It was also noted that the TPF had experienced their strongest 12 month return in the Fund's history over the year ending 6/30/2022. Refinements to the asset management team and the investment process were also discussed. Regarding positioning, Mr. Canning noted that the Fund has a Net Asset Value of \$14.8 billion, 155 investments, is 92% leased and has 18.6% leverage. Comment was made that they have changed their strategy regarding leverage which has historically been managed to 5-10% less than the ODCE average. They now intend to keep it closer to that of the benchmark though they are currently keeping it below the benchmark due to uncertainty over the economy. Regarding targeted positioning by sector, on the margin they would like to reduce their Apartment and Office exposures and increase their weights in Industrial and Retail. In response to questions regarding the economy and a pending recession he stated that commercial real estate would clearly be impacted, and that the TPF would feel the impact, but that the Fund's positioning should help to mitigate the impact. Last, a Cambridge office property which is being repurposed into a life science facility was reviewed as a value adding activity. After UBS signed off, comments generally reflected a view that there continue to be concerns regarding this Fund which has struggled over recent years but that, on the margin, the presentation served to lift confidence.

III. INVESTMENT STAFF AND CONSULTANT

A. Securities Lending Review

Chief Investment Officer Jim Failor introduced the topic, noting that we would hear from the Plan's investment consultant, Aon, on securities lending (SL) and then our SL agent, State Street Securities Finance (SSSF), and finally he would draw some conclusions for the Board's consideration.

1. Primer and Industry Trends – Associate Partner Ryan Kandah and Senior Consultant Tom Daniels, both with Aon Custody Advisory Services, reviewed the basics of securities lending as well as trends in the industry. Mr. Kandah reviewed the mechanics of securities lending and some of the terminology. He commented that industry lending revenue had increased 20% in 2021 over 2020 and that 2022

was also expected to be a strong year. Mr. Daniels reviewed the impact of securities lending on the capital markets, which they believe increases market efficiency, and plays a critical role in certain hedging strategies. The benefit to asset owners is that they consider it a generally low risk way to enhance returns and offset pension obligations. It was also mentioned that the asset owner's custodians are often the lending agents but, with modern technology, - larger plans might find it worth considering a 3rd party agent. The client's role was also reviewed which includes stipulating what assets may be lent, who they may be lent to, the types of acceptable collateral and how cash collateral is to be invested.

Mr. Daniels went on to discuss the impact of the 2008 Financial Crisis and the subsequent increase in regulation which included, among other things, money market reforms which has increased the safety of money market collateral pools. Last, they reviewed trends in revenue sharing, minimum spreads, non-cash collateral, cash collateral vehicles and counterparty risk.

2. SCERA's Securities Lending Program with State Street Securities Finance (SSSF) - John Powell, a Vice President with SSSF, reviewed SCERA's securities lending program. After reviewing some of the mechanics of SL he noted that SCERA's investment program is a conservative low-risk approach with cash collateral being invested in the State Street Navigator US Gov't Money Market Portfolio and State Street indemnifying SCERA for losses due to borrower default. SCERA lends securities in three different ways – from our separately managed accounts (with SSSF acting as our agent), through the State Street Global Advisors (SSGA) commingled index funds (with SSSF also acting as the agent to the funds) and through State Street's Enhanced Custody platform which custodies the Jacobs Levy 130/30 portfolio. Mr. Powell then reviewed the last five years of SCERA's separate account lending program. SCERA's lending revenue has significantly declined over the last three years with 2021 generating \$48,525 in revenue and the first half of 2022 generating \$14,099. Low interest rates, a lack of market volatility and the decline in SCERA's actively managed separate account portfolios (and importantly the termination of a number of non-US and global equity portfolios) have all contributed to this decline in revenue. The industry move to taking some additional measured risk with the cash collateral investment has also probably contributed to this.

Mr. Powell went on to discuss issues for SCERA's consideration. First, he recommended we consider moving from a 5 to a 15-basis point minimum spread. The minimum spread is the difference between the rate credited to the borrower on their cash collateral and what SCERA expects to earn on that cash being invested in the Navigator Fund. The minimum spread serves to reduce the chance of making a

loan that actually loses money since the actual return experienced on the Navigator Fund is not known at the time that the loan is priced. With the increased volatility we have seen over recent quarters and higher interest rates there is an increased probability of losing money on a loan without widening the minimum spread. SCERA staff will investigate the issue and inform the Committee of the decision made. Mr. Powell also suggested we consider State Street's "Direct Access" peer-to-peer lending program which can result in increased portfolio utilization and wider spreads, leading to increased program revenue. SCERA staff will investigate this issue, with input from Aon, and return with an update for the Committee.

3. Conclusions & Recommendation. Mr. Failor reviewed the long history of SCERA's separate account SL program and the decline in revenue. It was also noted that, while the revenues are currently very modest, it is possible that it will be more profitable in future market environments and the risk is virtually inconsequential as currently designed. Given the low risk, the administrative difficulty of reestablishing the program at a later date if it were to be discontinued now, and the potential of future higher revenues, staff and consultant recommend continuing the program. Staff will work with Aon to assess the value of a securities finance evaluation project by Aon's Custody Advisory Services to more thoroughly evaluate the program and recommend adjustments to it. In addition, staff will evaluate State Street's recommendations to increase the minimum spread from 5 to 15 basis points and to consider participation in their "Direct Access" peer-to-peer lending program. The Committee has delegated the selection of the minimum spread to staff but a recommendation on the other issues would be brought back to the Committee if staff views any action as warranted.

B. KKR Diversified Core Infrastructure Fund – update

Mr. Failor informed the Committee of a capital call for the KKR Fund due October 3rd in the amount of \$33.9 million. When this capital call is satisfied approximately 65% of the \$135 million commitment to the Fund will be invested.

C. Investment Policy Statement – update for infrastructure expansion

At the April 28, 2022 Investment Committee meeting the Board approved the revised Investment Policy Statement (IPS) reflecting the increased policy weight to Infrastructure but delegated the date of implementation to staff with the understanding that they would make the new IPS effective when a majority of the commitment to the new KKR infrastructure fund had been invested. That threshold was met at the beginning of October and, consequently, the updated IPS will become effective as of September 30, 2022.

D. Investment Policy Statement – update for Farmland expansion

Mr. Failor reviewed the draft IPS which reflects the 3% increase in Farmland (going from 5% to 8%) and the corresponding 2% decrease in Core Fixed Income and 1% decrease in Global Equities. The draft IPS also included a widening of the range for Real Assets from +/-3% to +/-5% to accommodate the higher total weight in Real Assets and the current overweight to Real Assets resulting from the recent downdraft in both stocks and bonds. The draft IPS also included clarifying that the asset class benchmark for Farmland will be the NCREIF Farmland Index even though the individual manager benchmark for the UBS Farmland Fund will continue to be the custom Core Farmland Index. As with the implementation of the IPS change for the expansion of Infrastructure, staff recommended the Committee authorize staff to implement the new IPS when more than half of the capital committed to the Fiera Comox Global Agriculture Fund is invested.

Recommendation: Approve the updated Investment Policy Statement, as drafted and reflecting the increase in the allocation to Farmland and an expansion of the Real Assets rebalancing range, with the date of implementation to be determined by staff when the preponderance of the capital committed to the Fiera Comox Global Agriculture Open-End Fund is invested.

A motion was made by Trustee Williamson, seconded by Trustee Williams, to approve the updated Investment Policy Statement, as recommended by staff. The motion carried 8-0-0-1 with voting as follows:

Mr. Balzarini	Aye
Mr. Coursey	Absent
Mr. Eaton	Aye
Mr. Jahn	Aye
Mr. Roeser	Aye
Mr. Tambe	Aye
Mr. Tuscany	Aye
Mr. Williams	Aye
Mr. Williamson	Aye

E. Cash Planning

Senior Investment Officer Steve Marsh reviewed the Plan's asset allocation and cash positioning, detailing the major upcoming cash commitments and anticipated receipts.

F. Investment Staff Recruitment

Mr. Failor explained that Ms. Mickey Nguyen had been hired as an Investment Officer and would begin working the following week. Ms. Nguyen has a strong investment background with 10 years as a fundamental stock analyst and also possesses the CFA

charter. She was listening in to the Committee meeting via videoconference and this was an opportunity for the Trustees to meet her telephonically.

Mr. Failor also reminded the Committee that Senior Investment Officer Steve Marsh was retiring and that this was the last Investment Committee meeting he would attend as a member of SCERA's staff. After the Committee meeting there would be cake and a celebration of Mr. Marsh's ten years of service and planned retirement. At the post-Committee meeting celebration the Trustees expressed their appreciation for Mr. Marsh and the many accomplishments he had facilitated through his service at SCERA.

IV. COMMUNICATIONS

- A. SCERA Investment Performance Report, August 2022. Mr. Failor briefly reviewed the Plan's performance in August, commenting that the Plan was down 2.2% for the month with both stocks and bonds declining due to concerns over anticipated Federal Reserve action in raising rates to fight inflation. On a positive note, active management added significant value over the period as the Plan's actual return was well above the Target Policy return of -5.6%. The year-to-date return through August is now -6.5%.
- B. Aon Wealth Conference, Miami Florida, December 7 & 8, 2022.
- C. Axiom Release, "Axiom Infrastructure Opens London Office", September 1, 2022.
- D. The Economist, "China's Ponzi-like property market . . .", September 12, 2022.
- E. Wall Street Journal, "The Other Doomsday Scenario . . .", September 3, 2022.

V. GENERAL DISCUSSION MATTERS

Opportunity was given to advise the Investment Committee of new matters and for Committee members to ask questions for clarification, provide information to staff, request staff to report back on a matter, or direct staff to place a matter on a subsequent agenda.

There were no general discussion matters.

VI. PUBLIC COMMENT

Opportunity was given for public comment on non-agenda items within the jurisdiction of the Investment Committee.

There were no public comments.

VII. NEXT MEETING

The next Investment Committee meeting is scheduled for Thursday, November 17, 2022, at 9:00 a.m. via WebEx. Planned topics for this meeting include a presentation by KKR on their Diversified Core Infrastructure Fund.

VIII. ADJOURNMENT

With no further business to conduct, the meeting adjourned at 11:50 a.m.

IX. APPROVAL

The above minutes from the September 29, 2022 Investment Committee meeting were approved at the Investment Committee meeting on November 17, 2022.

GREG JAHN, CHAIR