KCERA
KERN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

July 25, 2024

Members, Board of Retirement
Employee Bargaining Units
Requesting News Media
Other Interested Parties

Subject: Meeting of the Kern County Employees' Retirement Association Investment Committee

Ladies and Gentlemen:

A meeting of the Kern County Employees' Retirement Association Investment Committee will be held on Friday, August 2, 2024 at 8:30 a.m. in the KCERA Boardroom, 11125 River Run Boulevard, Bakersfield, California, 93311.

How to Participate: Listen to or View the Board Meeting

To listen to the live audio of the Board meeting, please dial one of the following numbers (for best audio a landline is recommended) and enter ID# 858 7579 2290

- (669) 900-9128; U.S. Toll-free: (888) 788-0099 or (877) 853-5247

To access live audio and video of the Board meeting, please use the following:

- https://us02web.zoom.us/j/85875792290?pwd=KjWFgq5VjfSwVUx2OgTCgMIRMYtbNI.1
- Passcode: 758794

Items of business will be limited to the matters shown on the attached agenda. If you have any questions or require additional service, please contact KCERA at (661) 381-7700 or send an email to administration@kcera.org.

Sincerely,

Dominic D. Brown
Chief Executive Officer

Attachments

AGENDA:

All agenda item supporting documentation is available for public review on KCERA's website at www.kcera.org following the posting of the agenda. Any supporting documentation that relates to an agenda item for an open session of any regular meeting that is distributed after the agenda is posted and prior to the meeting will also be available for review at the same location.

AMERICANS WITH DISABILITIES ACT
(Government Code §54953.2)

Disabled individuals who need special assistance to listen to and/or participate in the meeting of the Board of Retirement may request assistance by calling (661) 381-7700 or sending an email to administration@kcera.org. Every effort will be made to reasonably accommodate individuals with disabilities by making meeting materials and access available in alternative formats. Requests for assistance should be made at least two (2) days in advance of a meeting whenever possible.

CALL TO ORDER

ROLL CALL (IN PERSON)

AB 2449 REMOTE APPEARANCE(S)
Items 1 and/or 2 withdrawn from agenda if no trustee(s) request to appear remotely:

1. JUST CAUSE CIRCUMSTANCE(S):
   a) The following Trustee(s) have notified the Committee of a "Just Cause" to attend this meeting via teleconference. (See Government Code § 54953).
      - NONE
   b) Call for Trustee(s) who wish to notify the Committee of a "Just Cause" to attend this meeting via teleconference. (See Government Code § 54953) – RECEIVE/HEAR REQUEST(S); NO COMMITTEE ACTION REQUIRED

2. EMERGENCY CIRCUMSTANCE(S):
   a) The following Trustee(s) have requested the Committee approve their attendance of this meeting via teleconference due to an "Emergency Circumstance." (See Government Code § 54953).
      - NONE
   b) Call for Trustee(s) requesting the Committee approve their attendance of this meeting via teleconference due to an "Emergency Circumstance". (See Government Code § 54953) – TAKE ACTION ON REQUEST(S) FOR REMOTE APPEARANCE DUE TO EMERGENCY CIRCUMSTANCE

3. Discussion and appropriate action on private market fund recommendation presented by Maria Surina, Managing Director, Cambridge Associates[1], and Chief Investment Officer Daryn Miller, CFA – RECOMMEND THE BOARD OF RETIREMENT APPROVE UP TO $30MM COMMITMENT TO COVENANT FUND XII; AUTHORIZE CHIEF EXECUTIVE OFFICER TO SIGN, SUBJECT TO LEGAL ADVICE AND REVIEW

4. Discussion and appropriate action on private market fund recommendation presented by Maria Surina, Managing Director, Cambridge Associates[2], and Senior Investment Analyst Jack Bowman – RECOMMEND THE BOARD OF RETIREMENT APPROVE UP TO $50MM COMMITMENT TO SCULPTOR FUND V AND UP TO $10MM COMMITMENT TO SCULPTOR FUND V RELATED CO-INVESTMENT; AUTHORIZE CHIEF EXECUTIVE OFFICER TO SIGN, SUBJECT TO LEGAL ADVICE AND REVIEW

5. Discussion and appropriate action on private market fund recommendation presented by Keirsten Lawton, Partner, Cambridge Associates[3], and Senior Investment Officer Geoff Nolan – RECOMMEND THE BOARD OF RETIREMENT APPROVE UP TO $25MM COMMITMENT TO FORTRESS CREDIT OPPORTUNITIES FUND VI; AUTHORIZE CHIEF EXECUTIVE OFFICER TO SIGN, SUBJECT TO LEGAL ADVICE AND REVIEW

6. Update and response to referral directing staff to update policies to delegate manager selection and termination to the Chief Investment Officer within parameters selected by the Investment Committee presented by Scott Whalen, CFA, Verus, Governance Consultants Julie Becker, Benita Falls Harper, and David Forman, Aon, Chief Executive Officer Dominic Brown, and Chief Investment Officer Daryn Miller, CFA – RECOMMEND THE BOARD OF RETIREMENT APPROVE PROPOSED PARAMETERS AND POLICY UPDATES

7. Presentation on 2035 Initiative and strategic planning presented by Scott Whalen, CFA, Verus, and Chief Investment Officer Daryn Miller, CFA – HEAR PRESENTATION

8. Discussion and appropriate action on emerging markets equity recommendations presented by Scott Whalen, CFA, Verus, Chief Investment Officer Daryn Miller, CFA, Senior Investment Analyst Rafael Jimenez, and Investment Analyst Melekte Yohannes (MJ) – RECOMMEND THE BOARD OF RETIREMENT INVEST $70MM IN ABS EMERGING MARKETS DIRECT PORTFOLIO AND $70MM IN CARRHAE CAPITAL EMERGING MARKETS EQUITIES FUND; AUTHORIZE CHIEF EXECUTIVE OFFICER TO SIGN, SUBJECT TO LEGAL ADVICE AND REVIEW

1 Written materials and investment recommendations from the consultants, fund managers and KCERA investment staff relating to alternative investments are exempt from public disclosure pursuant to California Government Code § 7928.710, § 7922.000, and §54957.5.

2 Written materials and investment recommendations from the consultants, fund managers and KCERA investment staff relating to alternative investments are exempt from public disclosure pursuant to California Government Code § 7928.710, § 7922.000, and §54957.5.

3 Written materials and investment recommendations from the consultants, fund managers and KCERA investment staff relating to alternative investments are exempt from public disclosure pursuant to California Government Code § 7928.710, § 7922.000, and §54957.5.

9. Presentation on Core Real Estate deep dive presented by Scott Whalen, CFA, Verus, Senior Investment Officer Geoff Nolan, and Senior Investment Analyst Jack Bowman – HEAR PRESENTATION

10. Discussion and appropriate action on core real estate recommendation presented by Scott Whalen, CFA, Verus, and Senior Investment Analyst Jack Bowman – RECOMMEND THE BOARD OF RETIREMENT INVEST $50MM IN ANGELO GORDON ESSENTIAL HOUSING FUND III; AUTHORIZE CHIEF EXECUTIVE OFFICER TO SIGN, SUBJECT TO LEGAL ADVICE AND REVIEW

PUBLIC COMMENTS

11. The public is provided the opportunity to comment on agenda items at the time those agenda items are discussed by the Committee. This portion of the meeting is reserved for persons to address the Committee on any matter not on this agenda but under the jurisdiction of the Committee. Committee members may respond briefly to statements made or questions posed. They may ask a question for clarification and, through the Chair, make a referral to staff for factual information or request staff to report back to the Committee at a later meeting. Speakers are limited to two minutes. Please state your name for the record prior to making a presentation.

REFERRALS TO STAFF, ANNOUNCEMENTS OR REPORTS

12. On their own initiative, Committee members may make a brief announcement, refer matters to staff, subject to KCERA's rules and procedures, or make a brief report on their own activities.

13. Adjournment

ALTERNATIVE INVESTMENTS RECORDS

<u>EXEMPT FROM PUBLIC DISCLOSURE</u>

(CA Gov. Code §7928.710)
(CA Gov. Code §7922.000)
(CA Gov. Code §54957.5)

<u>DO NOT REPRODUCE</u>

<u>DO NOT DISTRIBUTE</u>

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PERSPECTIVES THAT DRIVE ENTERPRISE SUCCESS

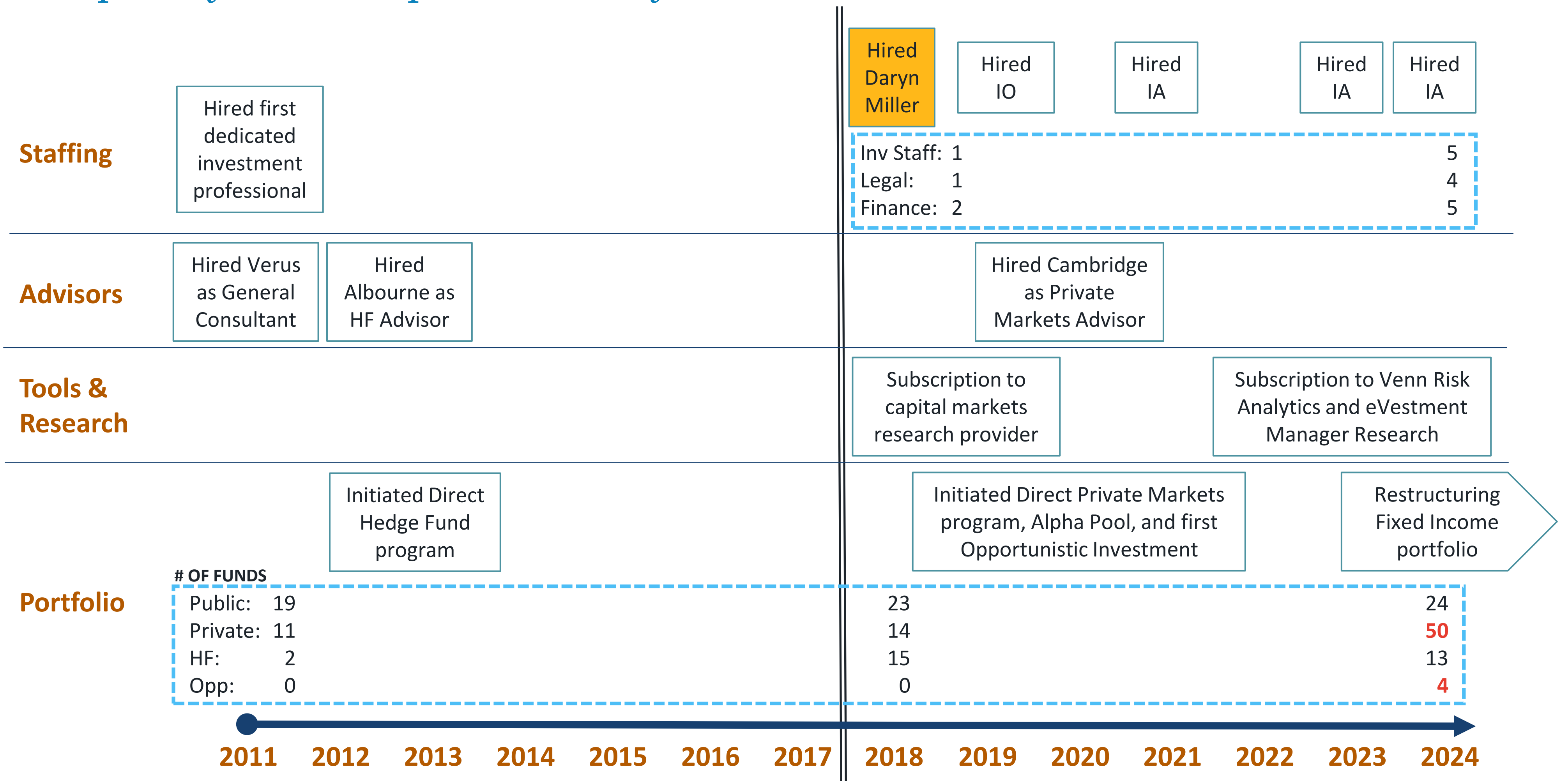
AUGUST 2024

Perspectives on Governance – Delegation of Authority

Kern County Employees’ Retirement Association

Investment program evolution

KCERA's investment program has increased greatly in sophistication and complexity over the past several years



Delegation survey

System*	Delegated Authority
Contra Costa County ERA	• Rebalancing within target ranges • Manager selection up to $150 mm per strategy • Manager termination
Florida SBA	• Rebalancing within target ranges • Manager selection / termination (public markets) • Manager selection (private markets)
Fort Worth ERF	• Rebalancing within target ranges • Manager selection / termination (public markets) • Manager selection (private markets)
Illinois Police Officer's Pension Investment Fund	• Rebalancing within target ranges
Imperial County ERS	• Re-balancing through cash flow management
Missouri State ERS	• Rebalancing within target ranges • Manager selection / termination (public markets) • Manager selection (private markets)
Sacramento County ERS	• Re-balancing within target ranges • Manager selection (private markets)
San Jose ORS	• Manager selection / termination (public markets) • Manager selection (private markets)
South Carolina RISC	• Rebalancing / tactical allocation within target ranges • Manager selection / termination (public markets) • Manager selection (private markets)
State of Wisconsin Investment Board	• Rebalancing within target ranges • Manager selection / termination (public markets) • Manager selection (private markets)

**Data represents a random sample of responses from Verus Public Fund clients*

Many plans with sophisticated and properly resourced investment staffs have chosen to delegate key investment decision making authority

Observations / perspectives

- Many plans with sophisticated investment staff have broadly delegated authority
- No broadly accepted set of best practices has been established for the delegation of investment decision-making authority; nearly as many different governance structures and delegation levels exist as there are public pension plans
- Verus does not have a formal house view on delegation best practices. My personal view has been shaped over many years of experience and observation (much of which was formed following the work of Tom Iannucci from Cortex Applied Research)
- I believe a Board's highest, best use is to focus on setting and monitoring:
  - Enterprise objectives
  - Enterprise risk tolerance
  - Investment philosophy
  - Asset allocation
  - Investment guidelines (e.g., guardrails)
- I further believe all investment program implementation should be delegated to investment staff or qualified third parties with the critically important caveat that robust accountability and monitoring mechanisms are put in place

KCERA

KERN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

Delegation

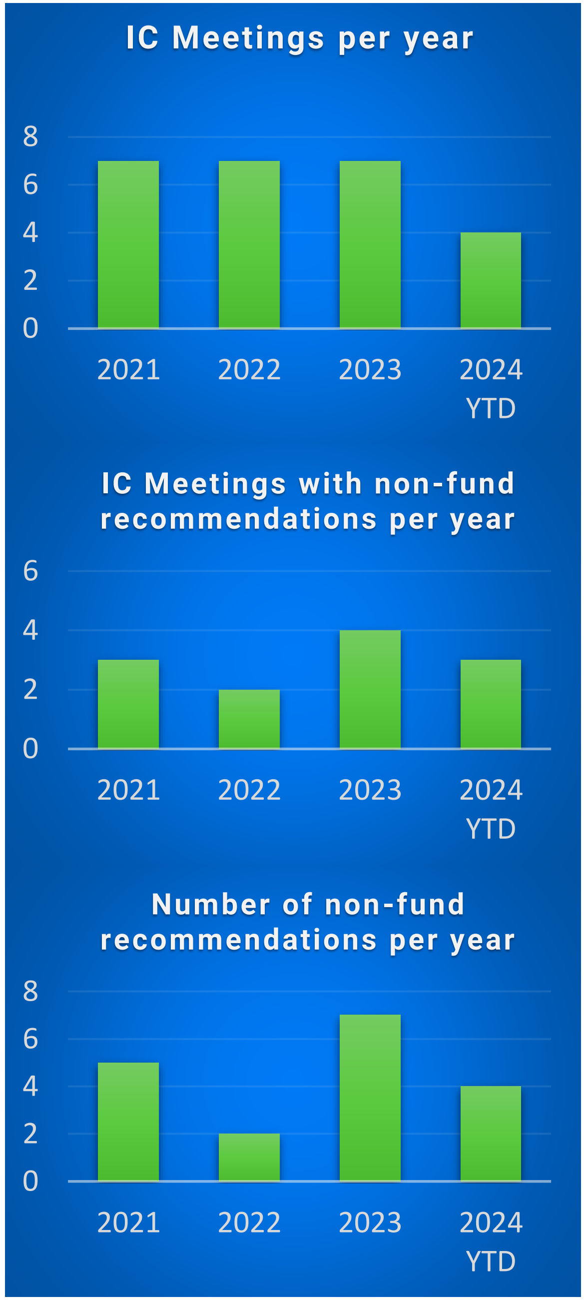
Presented by:

Daryn Miller, CFA

Chief Investment Officer

Historical Perspective on IC Meetings

- From January 2021 through June 2024, the Investment Committee (IC) met 25 times
  - 7 times per year
- On average there were 3 IC meetings per year that included non-fund recommendation agenda items
  - A max of 4 meetings in 2023
  - And min of 2 meetings in 2022
- Looking at the number of non-fund recommendations per year, there were an average of 5 per year
  - A max of 7 in 2023
  - And min of 2 in 2022

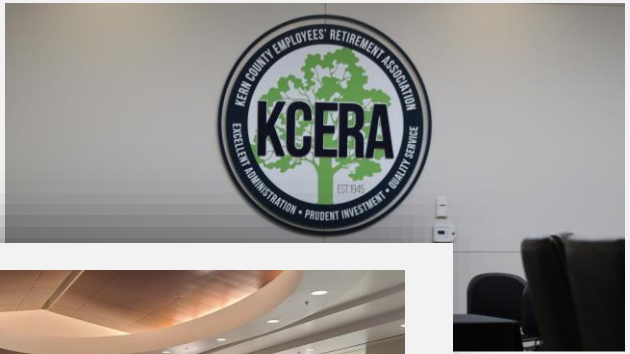


Historical Perspective on IC Meetings, cont.

- From January 2021 through June 2024, the Investment Committee (IC) met 25 times
  - There were 46 selecting new investments (selections) and 3 terminations
  - Of the 46 selections, the average size was $35.7M
    - 45 of the 46 were within the proposed thresholds
  - Of the 3 terminations, the average size was $138.3M
    - 2 of the 3 were within the proposed thresholds

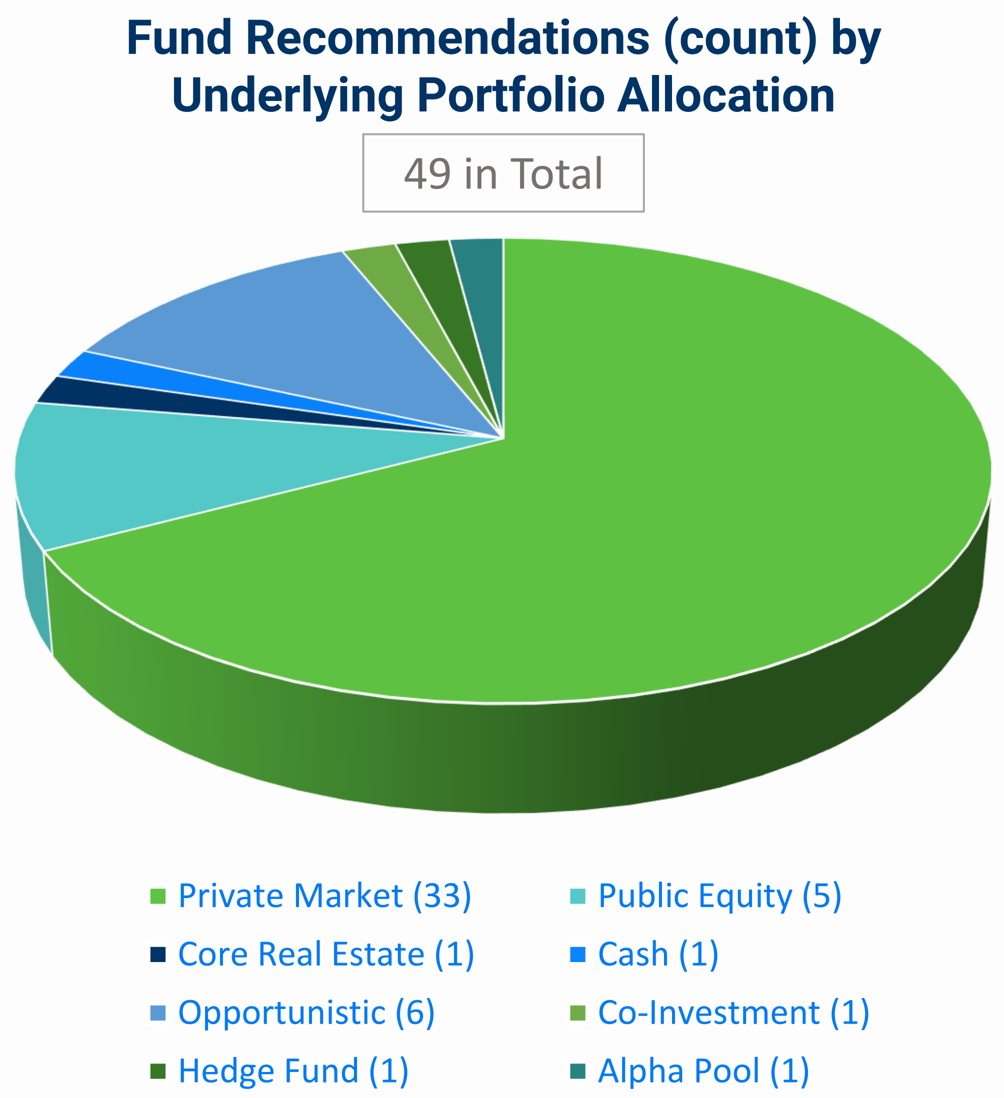
<u>Proposed thresholds</u>

Asset Class	Selection Threshold	Termination Threshold
Hedge Funds	1.0%	2.0%
Private Markets	1.0%	2.0%
Opportunistic	1.0%	2.0%
Co-investments*	0.5%	1.0%
All other investments	2.0%	4.0%



Historical Perspective on IC Meetings, cont.

- From January 2021 through June 2024, there were **a total of 49 fund recommendations**
  - The majority (33) were in Private Markets
    - 13 Private Equity
    - 13 Private Credit
    - 7 Private Real Estate/Assets
  - The next most active allocation was Opportunistic (6)
    - Opportunistic has the highest proportion of non-traditional paths to approval, with 3 of the 6 recommendations skipping the IC and going to a Special Board meeting

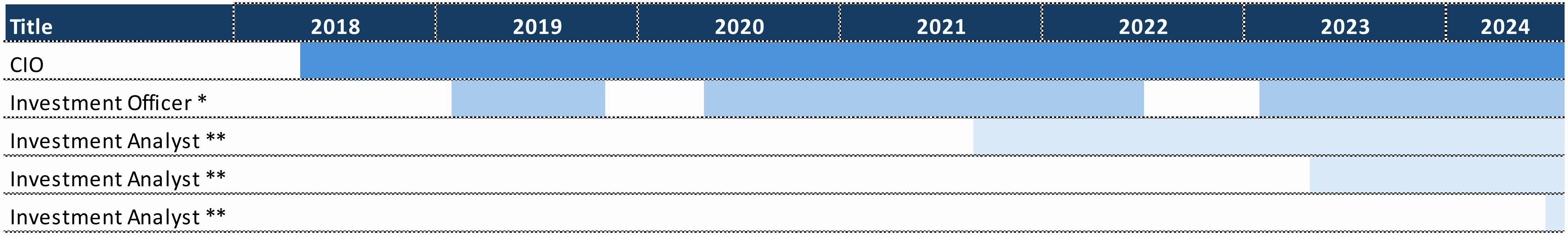


Path to Approval

- From January 2021 through June 2024, there were **a total of 49 fund recommendations**
  - 43 recommendations followed the traditional path to approval
    - IC approves, then a recommendation is presented at a regular Board meeting for final approval
  - 1 recommendation skipped the IC and went straight to a regular Board meeting
  - 5 recommendations skipped the IC and went straight to a Special Board meeting

Evolution of investment program

- The investment team has grown notably over the past several years
- Following the hiring of the CIO in 2018, the investment team has since grown to 5 individuals



** includes Investment Officer and Senior Investment Officer positions*

*** includes Investment Analyst I & II, and Senior Investment Analyst positions*

Forward Calendar

INVESTMENT COMMITTEE				
Meeting Month	Asset Allocation	Strategic Considerations	Asset Class Deep Dive	RFPs
Feb. 2024				
Mar. 2024				
Apr. 2024	*- AA Review*			
May. 2024			*- Public Equity*	
Jun. 2024		*- 2035 Initiative* *- Delegation*		
Aug. 2024		- 2035 Initiative - Delegation	- Core Real Estate	
Sep. 2024			- Midstream	
Oct. 2024		- FX Hedging		
Nov. 2024		- 2035 Initiative, cont.	- Opportunistic	
Dec. 2024			- Commodities	

Proposed. Subject to change.

Forward Calendar, cont.

INVESTMENT COMMITTEE				
Meeting Month	Asset Allocation	Strategic Considerations	Asset Class Deep Dive	RFPs
Feb. 2025			- Commodities	
Mar. 2025		- 2035 Initiative, cont.		
Apr. 2025	- AA Review		- Hedge Fund & Alpha Pool	
May. 2025		- Capital Efficiency review		
Jun. 2025			- Cash	
Aug. 2025		- IPS review		
Sep. 2025		- Multi-asset framework	- Private Markets	
Oct. 2025				
Nov. 2025		- Multi-asset framework, cont.		
Dec. 2025			- Fixed Income	- Private Markets Consultant

Proposed. Subject to change.

Investment Process

- Delegation shifts the steps in the investment process slightly
- The overall process remains largely intact

Current Process	Proposed Process
Investment Staff Diligence	Investment Staff Diligence
Coordinate with appropriate investment consultant	Coordinate with appropriate investment consultant
Preliminary Internal Investment Committee (IIC)	Preliminary Internal Investment Committee (IIC)
Further investment due diligence	Further investment due diligence
Investment consultant diligence	Investment consultant diligence
Staff and consultant internal documentation preparation	Staff and consultant internal documentation preparation
IIC Approval	IIC Approval
Prepare IC/BOR materials	Notify IC
IC approval	
Board approval	
Legal review and negotiations	Legal review and negotiations
	Report investment to IC and Board via CIO Report

Summary of Fund Recommendations 2021- June 2024

KCERA

Date	Meeting Type	Comment	Allocation	Amount ($M)	SELECTION Threshold %	SELECTION Threshold $	SELECTION in Threshold	TERMINATION Threshold %	TERMINATION Threshold $	TERMINATION in Threshold
1/15/2021	IC	traditional	Private Market	40.0	1.0%	52.6	Yes	2.0%		
1/15/2021	IC	traditional	Private Market	40.0	1.0%	52.6	Yes	2.0%		
2/5/2021	IC	traditional	Cash	100.0	2.0%	105.3	Yes	4.0%		
4/6/2021	IC	traditional	Private Market	22.5	1.0%	52.6	Yes	2.0%		
4/6/2021	IC	traditional	Private Market	7.5	1.0%	52.6	Yes	2.0%		
4/29/2021	IC	traditional	Private Market	15.0	1.0%	52.6	Yes	2.0%		
4/29/2021	IC	traditional	Private Market	15.0	1.0%	52.6	Yes	2.0%		
4/29/2021	IC	traditional	Alpha Pool	50.0	1.0%	52.6	Yes	2.0%		
6/2/2021	IC	traditional	Public Equity	-250.0	2.0%			4.0%	-210.6	**No**
6/2/2021	IC	traditional	Public Equity	-112.0	2.0%			4.0%	-210.6	Yes
6/28/2021	Special Board	Skipped IC > Special Board	Opportunistic	50.0	1.0%	52.6	Yes	2.0%		
9/22/2021	IC	traditional	Private Market	30.0	1.0%	52.6	Yes	2.0%		
12/14/2021	IC	traditional	Private Market	40.0	1.0%	52.6	Yes	2.0%		
12/14/2021	IC	traditional	Opportunistic	44.0	1.0%	52.6	Yes	2.0%		
2/4/2022	IC	traditional	Private Market	30.0	1.0%	52.2	Yes	2.0%		
2/28/2022	IC	traditional	Private Market	40.0	1.0%	52.2	Yes	2.0%		
2/28/2022	IC	traditional	Private Market	30.0	1.0%	52.2	Yes	2.0%		
4/27/2022	IC	traditional	Private Market	30.0	1.0%	52.2	Yes	2.0%		
4/27/2022	IC	traditional	Private Market	10.0	1.0%	52.2	Yes	2.0%		
4/27/2022	IC	traditional	Private Market	30.0	1.0%	52.2	Yes	2.0%		
5/22/2022	Special Board	Skipped IC > Special Board	Opportunistic	15.0	1.0%	52.2	Yes	2.0%		
6/1/2022	IC	traditional	Private Market	32.5	1.0%	52.2	Yes	2.0%		
8/3/2022	IC	traditional	Private Market	30.0	1.0%	52.2	Yes	2.0%		
8/3/2022	IC	traditional	Private Market	40.0	1.0%	52.2	Yes	2.0%		
12/12/2022	IC	traditional	Private Market	30.0	1.0%	52.2	Yes	2.0%		
2/27/2023	IC	traditional	Private Market	30.0	1.0%	53.1	Yes	2.0%		
2/27/2023	IC	traditional	Private Market	30.0	1.0%	53.1	Yes	2.0%		
4/5/2023	IC	traditional	Opportunistic	20.0	1.0%	53.1	Yes	2.0%		
6/1/2023	IC	traditional	Private Market	50.0	1.0%	53.1	Yes	2.0%		
6/1/2023	IC	traditional	Private Market	50.0	1.0%	53.1	Yes	2.0%		
6/1/2023	IC	traditional	Private Market	30.0	1.0%	53.1	Yes	2.0%		
6/14/2023	Regular Board	Skipped IC > Regular Board	Co-Investment	10.0	0.5%	26.6	Yes	1.0%		
8/8/2023	IC	traditional	Private Market	30.0	1.0%	53.1	Yes	2.0%		
8/8/2023	IC	traditional	Private Market	30.0	1.0%	53.1	Yes	2.0%		
8/8/2023	IC	traditional	Opportunistic	30.0	1.0%	53.1	Yes	2.0%		
9/5/2023	IC	traditional	Public Equity	100.0	2.0%	106.2	Yes	4.0%		
9/5/2023	IC	traditional	Public Equity	50.0	2.0%	106.2	Yes	4.0%		
10/18/2023	IC	traditional	Private Market	40.0	1.0%	53.1	Yes	2.0%		
10/18/2023	IC	traditional	Public Equity	-53.0	2.0%			4.0%	-212.4	Yes
12/11/2023	IC	traditional	Private Market	25.0	1.0%	53.1	Yes	2.0%		
12/11/2023	IC	traditional	Private Market	25.0	1.0%	53.1	Yes	2.0%		
12/11/2023	IC	traditional	Core Real Estate	75.0	2.0%	106.2	Yes	4.0%		
2/5/2024	IC	traditional	Hedge Fund	65.0	1.0%	56.2	**No**	2.0%		
2/5/2024	IC	traditional	Private Market	50.0	1.0%	56.2	Yes	2.0%		
2/29/2024	Special Board	Skipped IC > Special Board	Private Market	25.0	1.0%	56.2	Yes	2.0%		
4/26/2024	Special Board	Skipped IC > Special Board	Private Market	15.0	1.0%	56.2	Yes	2.0%		
5/31/2024	IC	traditional	Private Market	55.0	1.0%	56.2	Yes	2.0%		
5/31/2024	IC	traditional	Private Market	25.0	1.0%	56.2	Yes	2.0%		
6/24/2024	Special Board	Skipped IC > Special Board	Opportunistic	10.0	1.0%	56.2	Yes	2.0%		

Questions?

Kern County Employees' Retirement Association

Governance — Delegation Policy Discussion

Julie Becker, Partner

Benita Falls Harper, Associate Partner

David Forman, Consultant

August 2, 2024

Aon Recommendation

As the Board's Governance Consultant, Aon recommends that the Board approve delegating investment manager selection and termination for these key reasons:

1. **Delegating tasks to qualified professionals is prudent, is permitted by California law and is encouraged under trust law principles, the Prudent Investor Act and ERISA.**
   - The Board trusts the expertise of Staff and Investment Consultants.

2. **The proposed process ensures clear documentation of roles, responsibilities and appropriate parameters of the delegation.**
   - The Board sets guidelines and policies to ensure accurate implementation by Staff.

3. **The recommended reporting and process are clear, with Staff providing regular reports and updates to the Board and Investment Committee.**
   - The Board has the ability to monitor the program and retains the discretion to revoke or revise the delegation.

Background and Objectives

Board of Retirement meeting November 1, 2023	Investment Committee meetings February 5, 2024 May 14, 2024	Investment Committee meeting Today
The delegation of investment duties was discussed. The matter was referred to the Investment Committee for further development and options for implementation.	Delegation was approved in concept, pending adjustments and additional parameters raised by the Investment Committee. The Investment Committee discussed policy revisions related to delegation of authority to select and terminate investment managers.	This presentation recaps the parameters and controls regarding delegation and sets forth Aon's recommendation.

Proposed Policy Revisions

We recommend that the below changes be made to policy documents to reflect the delegation policy and associated parameters and constraints. These edits have been made to the redlined and clean policy documents found in the Appendix.

Policy Document	Revisions
Investment Policy Statement	• Added that Board has delegated the authority to select and terminate investment managers • Added parameters and constraints, including size thresholds and conditions for rescinding delegated authority • Edited manager search process for both public and private markets • Added language from Due Diligence and Service Provider Selection Policy related to reviewing decision and recommendation procedures • Removed public markets termination approval time constraint exception
Board of Retirement Charter	• Edited the Board’s responsibility to appoint and terminate investment managers to only include those that fall outside of parameters and constraints established in the IPS

Proposed Policy Revisions (continued)

We recommend that the below changes be made to policy documents to reflect the delegation policy and associated parameters and constraints. These edits have been made to the redlined and clean policy documents found in the Appendix.

Policy Document	Revisions
Due Diligence and Service Provider Selection Policy	• Removed some manager due diligence language to avoid inconsistency, as this is covered in detail in the IPS • Moved language to IPS related to reviewing investment manager decision and recommendation procedures
Monitoring and Reporting Policy	• Added that the CIO Report will include information about the investment changes made under the Chief Investment Officer's delegated authority

AON

Proposed Policy Revisions (continued)

We recommend that the below changes be made to policy documents to reflect the delegation policy and associated parameters and constraints. These edits have been made to the redlined and clean policy documents found in the Appendix.

Policy Document	Revisions
Investment Committee Charter	• Edited the Investment Committee’s responsibility to select and terminate investment managers that fall outside parameters and constraints • Added emergency situation where the CIO may terminate an investment manager outside the parameters and constraints with concurrence of the investment consulting firm in a situation that could likely put the Fund at undue risk
Chief Executive Officer Charter	• Added responsibility to ensure that delegated authority relative to the selection and termination of investment managers is exercised within the parameters and constraints set by the Board

AON

Thresholds for Selection and Termination

The authority delegated to the Chief Investment Officer by the Board to select and terminate investment managers will be constrained by a maximum investment size defined as a percentage of total plan assets.

Asset Class	Selection Threshold	Termination Threshold
Hedge Funds	1.0%	2.0%
Private Markets	1.0%	2.0%
Opportunistic	1.0%	2.0%
Co-investments*	0.5%	1.0%
All other investments	2.0%	4.0%

* Limited to co-investment opportunities where the Plan has previously made an investment with the investment manager.

For selection of managers above the threshold amounts, a recommendation memo will be presented to the Investment Committee, followed by a recommendation to the full Board for approval.

Parameters and Constraints to Delegated Authority

Additional parameters are in place to ensure that the investment team has sufficient internal and external resources.

The authority delegated to the Chief Investment Officer by the Board to select and terminate investment managers may be rescinded for any of the following three reasons:

1. The current Chief Investment Officer either leaves the job position of Chief Investment Officer or leaves employment with KCERA.

2. The current consultant is replaced for an asset class (delegated authority will be rescinded for that asset class only).

3. If overall KCERA Investment Staff positions fall below 50% of authorized positions.

The Board maintains discretion to reinstitute delegated authority previously rescinded by the Board.

Manager Search Process

Initiation and Evaluation

- CIO will coordinate with investment consultant for due diligence.
- A written due diligence report will be produced.

Internal Investment Committee Approval

- Investment team will review proposed investments.
- CIO will have the final decision-making authority to select or recommend an investment.

Investment Committee Notification

- For investments within the CIO's delegated authority, IC members will be promptly notified when an investment manager is selected.

Board of Retirement Notification

- At the next available Regular Board meeting, the CIO will report the investment managers selected under delegated authority that have completed the contracting process.

Investment Committee Notification

The Investment Committee will be notified when the Internal Investment Committee selects an investment, and the applicable investment consulting firm concurs with the investment.

The notification shall be provided promptly following concurrence of the investment by the applicable investment consultant.

Illustrative example of Investment Committee Notification:

- *On March 10, 2024 the Internal Investment Committee met and approved a $30 million commitment to ABC Fund IV. Cambridge Associates completed due diligence and provided staff with a supporting recommendation memo for the investment.*
- *ABC Fund IV is a healthcare services focused middle-market buyout strategy and will be part of the KCERA private market program, specifically the Private Equity allocation.*

Board of Retirement Notification

The CIO Report will be used as the formal communication tool to communicate changes in investments. A CIO Report will be implemented at the Investment Committee, where such report does not currently exist.

Illustrative example from the CIO Report:

- *On March 10, 2024, a $30M commitment to ABC Fund IV was approved by the Internal Investment Committee. ABC Fund IV will be part of the Plan's Private Equity allocation.*

Next Steps

1. If the Investment Committee accepts Aon's recommendations as outlined, we will work with Staff on the proposed policy changes and submit revised policy documents to the Board for final approval.
2. Implement changes.
3. Per the Board's request, continue to research other potential areas of delegation.

Appendix I
Policy Documents – Redline

Appendix II
Policy Documents – Clean

AON

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2035 Initiative

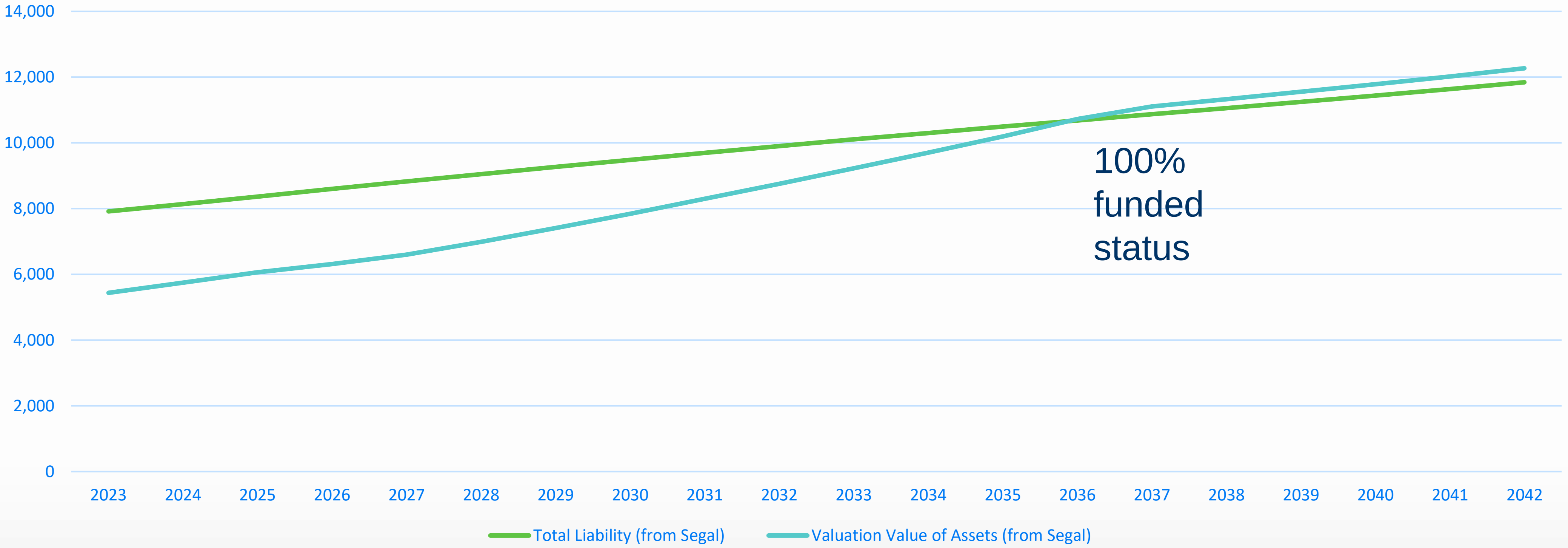
Presented by:

Daryn Miller, CFA

Chief Investment Officer

Fully Funded Status Expected in 2036

- Using data from Segal's open projection, total liabilities are expected to grow from $7.9B in 2023 to $11.8B in 2042
- Assets are expected to grow from $5.4B to $12.3B, over the same time frame
- Fully funded status would be reached in ~2036, assuming all actuarial assumptions are achieved



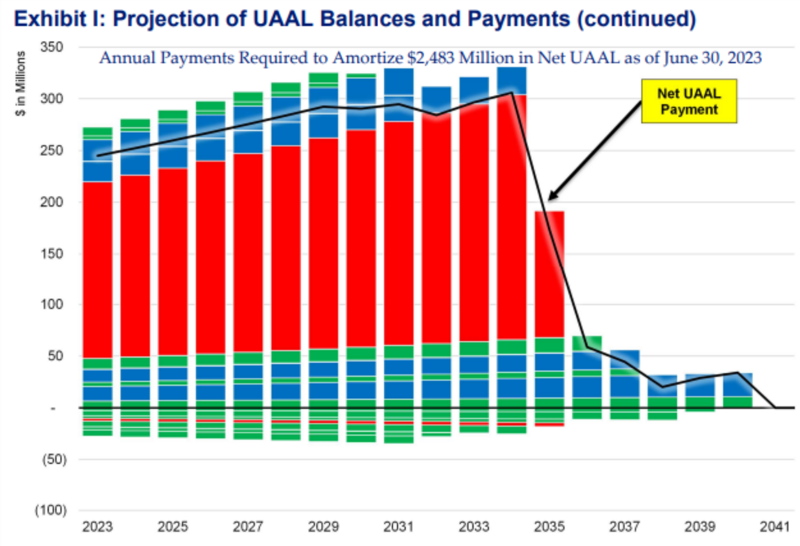
** Assets are Valuation Value of Assets, not market value of assets*

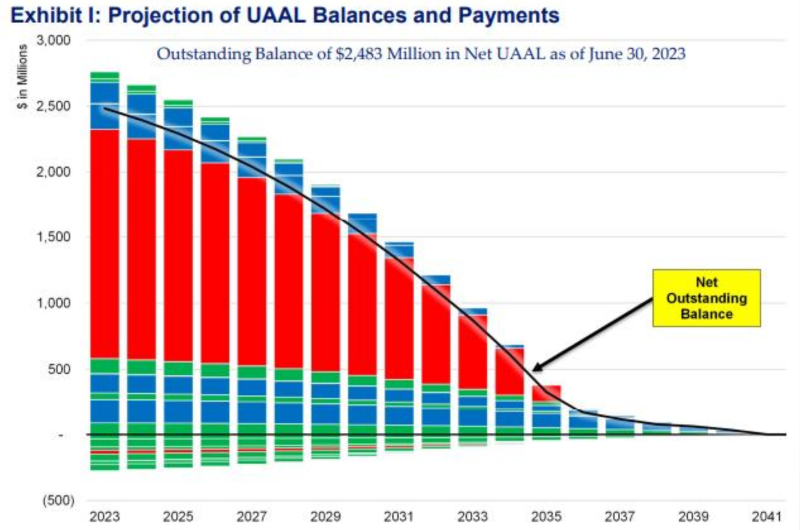
Around 2035, Net Cash Flow Will Change Notably

- Over the past several years the Plan's actuary has highlighted how the expected cash flow profile will change around the year 2035

- The cash flow is expected to shift from a modest net negative cash flow to a material net negative cash flow

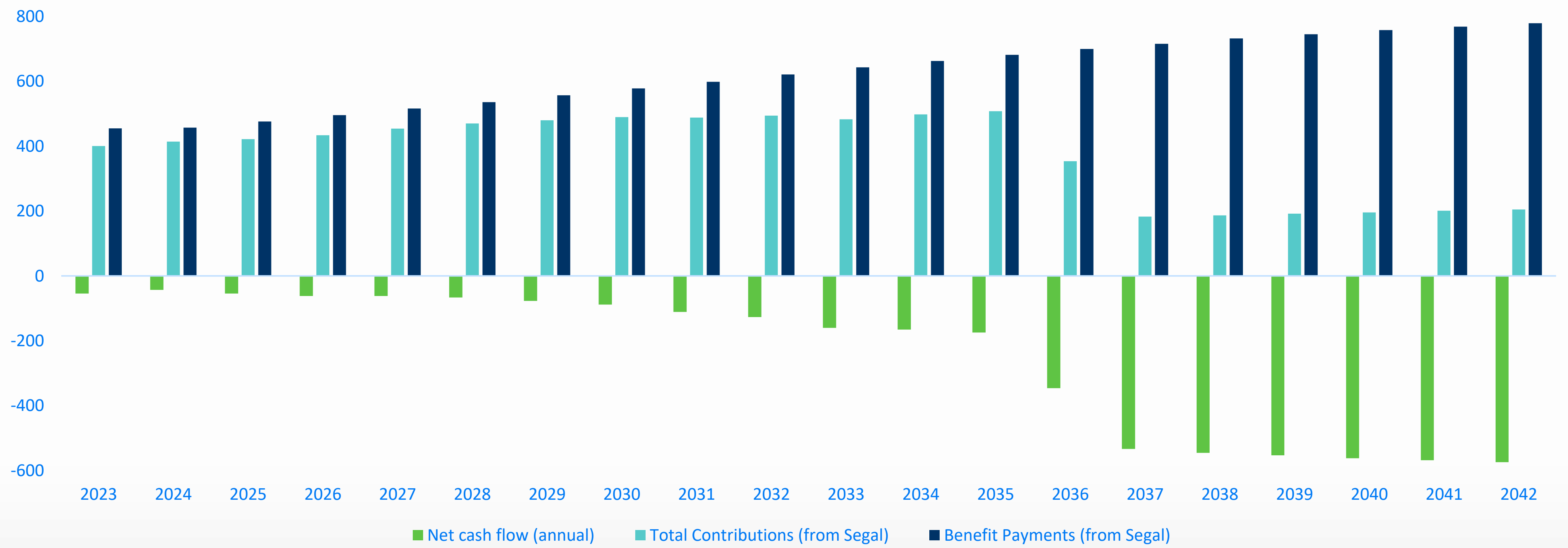
- The change in cash flow is a function of the **UAAL Restart Amortization layer being fully amortized**





Contributions Drive Change in Net Cash Flow

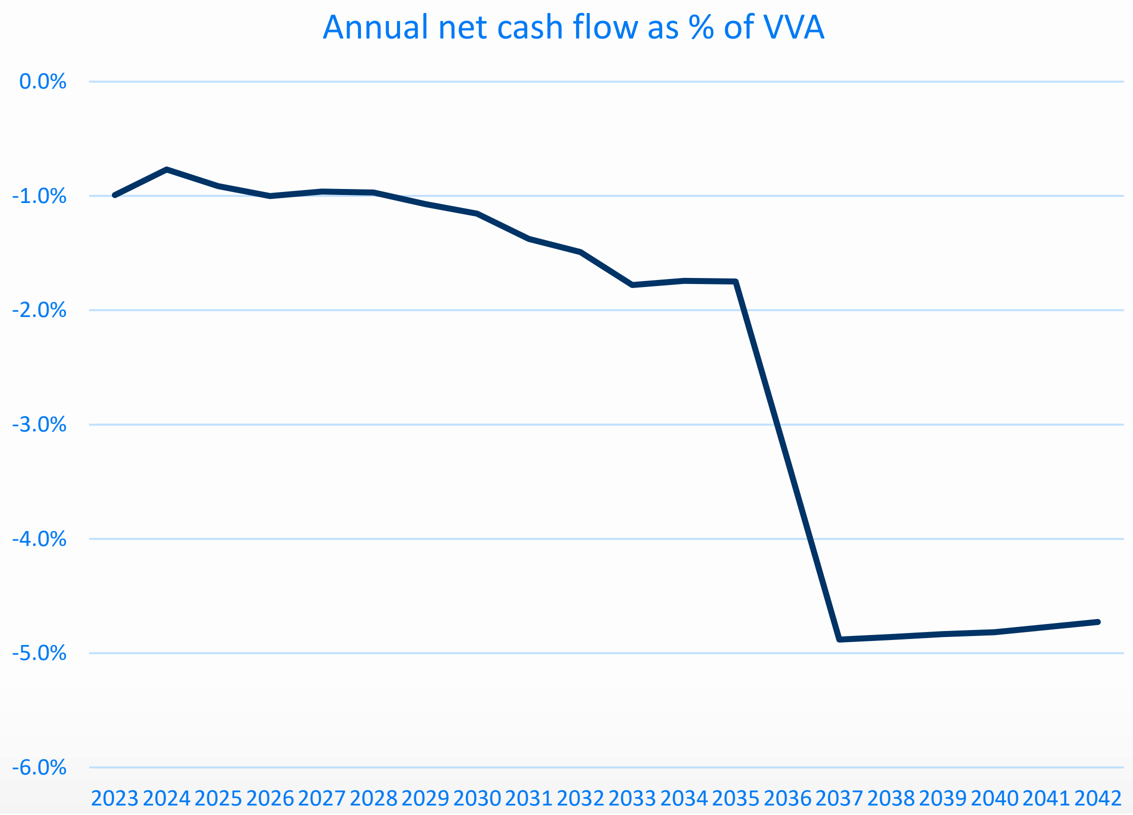
- Annual net cash flow shifts increasingly more negative from -$54M in 2023, to -$174M in 2035, and -$545M in 2038
- The expected change in net cash flow is primarily a function of lower Contributions



Net Cash Flow Shifts to ~-5% of Plan Assets

- The change in net cash flow shifts from -$54M to -$545M which equates to -$4.5M to -$45M per month, respectively

- As a percentage of Plan assets, that is a shift from -1% of Plan assets to about -5% of Plan assets, on an annualized basis



Strategies to Adapt to Change in Cash Flow

- The notion of shifting to more material net negative cash flow raises questions around investment strategy and portfolio construction

- Potential strategies include:
  - A type of Liability Driven Investing (LDI) focused on investments that produce cash flow to match liabilities
  - A hybrid asset allocation approach, which evaluates asset mixes from a more granular perspective—return from cash flows and return from appreciation
  - Other strategies to be explored

Cash Yield from Current Strategic Asset Allocation

Current Strategic Asset Allocation

					Model 1 (b)		Model 2 (c)	
Asset Class	Index	Policy MV	Policy Weight	Total Return (a)	Cash Yield (App1)	Cash Yield in $, (App1)	Cash Yield (App2)	Cash Yield in $, (App2)
Public Global Equity	MSCI ACWI IMI	1,947,000,000	33%	6.9%	2.0%	38,940,000	2.0%	38,940,000
Fixed Income	Bloomberg US Aggregate	1,475,000,000	25%	4.9%	3.2%	47,200,000	3.2%	47,200,000
Core Real Estate	NCREIF ODCE Gross	295,000,000	5%	6.8%	3.3%	9,735,000	3.3%	9,735,000
Hedge Funds	75% 90 Day Tbills + 3%/25% MSCI ACWI II	590,000,000	10%	4.8%	n/a	n/a	n/a	n/a
Alpha Pool (d)	3-Month T-Bill +3%	236,000,000	4%	4.1%	n/a	n/a	n/a	n/a
Private Equity	n/a	295,000,000	5%	9.0%	0.0%	0	9.0%	26,550,000
Private Credit	n/a	472,000,000	8%	9.2%	0.0%	0	9.2%	43,424,000
Private Real Estate	n/a	295,000,000	5%	8.8%	0.0%	0	8.8%	25,960,000
Commodities	Bloomberg Commodity Index	236,000,000	4%	6.6%	n/a	n/a	n/a	n/a
Midstream	Alerian Midstream Energy Index	295,000,000	5%	6.1%	6.1%	17,995,000	6.1%	17,995,000
Cash and Equivalents (d)	90-Day U.S. Treasury Bill	(236,000,000)	-4%	4.1%	n/a	n/a	n/a	n/a
TOTAL		**5,900,000,000**				**113,870,000**		**209,804,000**
Portfolio Cash Yield					2.0%		3.7%	
Portfolio Simple Expected Return				*6.5%*				

<u>Cash Yield Methodology:</u>

MSCI ACWI IMI: Dividend yield
Bloomberg U.S. Aggregate: Coupon yield
NCREIF ODCE Gross: Income portion of returns
Commodities: No cash yield
Alerian Midstream Energy Index: Dividend yield, capped at Total Return

(a) Geometric return forecast from Verus 2024 10-year CMA
(b) Model 1: "Early Private Program Model" assumes that private market asset classes (PE, PC, PRE) are net negative consumers of cash flow near-to-intermediate term
(c) Model 2: "Mature Private Program Model" assumes private market asset classes (PE, PC, PRE) distribute capital inline with target net IRR but is capped at Total Return
(d) Alpha Pool and Cash yield is "n/a" as these allocations offset each other as part of the Capital Efficiency program

High Level Plan

- Following the discussion today, return to future Investment Committee meetings to bring additional data and strategic considerations
- Respond to feedback from the Investment Committee and perform additional research
- Coordinate with Verus to evaluate and research ideas
- Continue discussion with Investment Committee

Questions?

Appendix

Actuarial Projections

Projected Valuation Value of Assets and Actuarial Accrued Liability ($ Millions)

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042
Total Liability (from Segal)	7,919	8,135	8,367	8,597	8,824	9,048	9,269	9,485	9,697	9,904	10,105	10,301	10,493	10,682	10,869	11,056	11,245	11,437	11,635	11,840
		2.7%	*2.9%*	*2.7%*	*2.6%*	*2.5%*	*2.4%*	*2.3%*	*2.2%*	*2.1%*	*2.0%*	*1.9%*	*1.9%*	*1.8%*	*1.8%*	*1.7%*	*1.7%*	*1.7%*	*1.7%*	*1.8%*
Valuation Value of Assets (from Se	5,436	5,749	6,067	6,310	6,601	6,993	7,409	7,843	8,296	8,756	9,227	9,699	10,198	10,723	11,107	11,327	11,551	11,780	12,018	12,265
Funded Status	68.6%	70.7%	72.5%	73.4%	74.8%	77.3%	79.9%	82.7%	85.6%	88.4%	91.3%	94.2%	97.2%	100.4%	102.2%	102.5%	102.7%	103.0%	103.3%	103.6%
Change in VVA		*5.7%*	*5.5%*	*4.0%*	*4.6%*	*5.9%*	*5.9%*	*5.9%*	*5.8%*	*5.5%*	*5.4%*	*5.1%*	*5.1%*	*5.1%*	*3.6%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.1%*
Total Contributions (from Segal)	401	414	422	434	454	470	480	490	488	494	483	498	508	354	183	187	192	196	201	205
y-y		*3.2%*	*1.9%*	*2.8%*	*4.6%*	*3.5%*	*2.1%*	*2.1%*	*-0.4%*	*1.2%*	*-2.2%*	*3.1%*	*2.0%*	*-30.3%*	*-48.3%*	*2.2%*	*2.7%*	*2.1%*	*2.6%*	*2.0%*
Benefit Payments (from Segal)	455	457	476	496	516	536	557	578	599	621	643	663	682	700	716	732	745	758	769	779
y-y		*0.4%*	*4.2%*	*4.2%*	*4.0%*	*3.9%*	*3.9%*	*3.8%*	*3.6%*	*3.7%*	*3.5%*	*3.1%*	*2.9%*	*2.6%*	*2.3%*	*2.2%*	*1.8%*	*1.7%*	*1.5%*	*1.3%*
Net cash flow (annual)	**-54**	**-43**	**-54**	**-62**	**-62**	**-66**	**-77**	**-88**	**-111**	**-127**	**-160**	**-165**	**-174**	**-346**	**-533**	**-545**	**-553**	**-562**	**-568**	**-574**
Net cash flow (monthly)	-4.5	-3.6	-4.5	-5.2	-5.2	-5.5	-6.4	-7.3	-9.3	-10.6	-13.3	-13.8	-14.5	-28.8	-44.4	-45.4	-46.1	-46.8	-47.3	-47.8
Annual net cash flow as % of VVA	*-1.0%*	*-0.8%*	*-0.9%*	*-1.0%*	*-1.0%*	*-1.0%*	*-1.1%*	*-1.2%*	*-1.4%*	*-1.5%*	*-1.8%*	*-1.7%*	*-1.7%*	*-3.3%*	*-4.9%*	*-4.9%*	*-4.8%*	*-4.8%*	*-4.8%*	*-4.7%*
Return needed on VVA		*6.6%*	*6.5%*	*5.1%*	*5.6%*	*7.0%*	*7.1%*	*7.1%*	*7.3%*	*7.2%*	*7.3%*	*7.0%*	*7.1%*	*8.8%*	*9.0%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*

Date: August 2, 2024

To: Trustees, Investment Committee

From: Daryn Miller, CFA, Chief Investment Officer
Rafael A. Jimenez, Senior Investment Analyst
Melekte Yohannes, Investment Analyst

Subject: **Emerging Markets Equity Recommendations**

RECOMMENDATION

Staff recommends a $70M investment in the ABS Emerging Markets Direct Portfolio (“ABS”) and a $70M investment in the Carrhae Capital Emerging Markets Equities Fund (“Carrhae”) both subject to negotiating terms and conditions. The funding source for the recommended additions to the Emerging Markets Equity allocation will be partial redemptions from the passive Mellon Emerging Market Stock Index Fund (“Mellon”) and the DFA Emerging Markets Value strategy (“DFA”).

This recommendation would result in the percentage of active management in the Emerging Markets Equity allocation rising from 44.4% to 91.1%. The Plan’s exposure to active management in Emerging Markets was reduced in November 2023 following the termination and liquidation of Alliance Bernstein Emerging Markets Strategic Core (“AB”). Additionally, the termination of AB resulted in the factor exposures of the Emerging Markets allocation to be tilted toward size and value style factors. Staff’s recommendation is consistent with the view that Emerging Markets is an inefficient asset class where skilled managers can generate alpha and can be expected to be compensated for taking active risk.

EMERGING MARKETS EQUITY ALLOCATION

The Plan’s long-term strategic asset allocation includes a 33% allocation to Global Public Equity and the allocation is benchmarked to the MSCI ACWI IMI Index. The Plan maintains dedicated regional exposure to Emerging Markets within Global Public Equity and the respective allocation to Emerging Markets is in line with the MSCI ACWI IMI Index.

Compared to Developed Markets, Emerging Markets is a more attractive asset class for the pursuit of active management. This can be attributed to the degree of information asymmetry, higher economic growth potential, and the ability for a manager to capitalize on specialized knowledge in a specific country or sector. The ability to generate alpha is further promoted by the lack of institutional market participants and dominance of retail investors in certain markets. Historical data suggests that there is a positive relationship between incremental risk-taking and incremental return generation in Emerging Markets Equity.

Proposed Allocation

	Current Allocation	Proposed Allocation	Proposed Trade	% of EM Portfolio	Active or Passive
Emerging Markets Equity					
Mellon Emerging Markets Fund	$118,979,373	$18,979,373	-100M	8.86%	*Passive*
DFA Emerging Markets Value	$95,168,457	$55,168,457	-40M	25.76%	*Active*
ABS Emerging Markets Direct		$70,000,000	+70M	32.69%	*Active*
Carrhae EM Equities Fund		$70,000,000	+70M	32.69%	*Active*
Total Emerging Markets Equity	$214,147,830	$214,147,830			
Active Management (%)	44.4%	91.1%			

*Market Values as of 6/30/2024

The recommended investments in ABS and Carrhae will have effects on portfolio risk at both the Emerging Markets Equity level and the Total Public Equity level, which Staff has modeled and analyzed through the Venn portfolio risk analytics system.

The dollar amount of the proposed redemptions from Mellon and DFA are not final. However, Staff expects for the respective redemptions to be similar. The risk and return analytics in the Appendix are based on the *Proposed Allocation* illustrated above.

Please find exhibits in the Appendix section at the end of this memorandum.

ABS EMERGING MARKETS DIRECT PORTFOLIO – ANALYSIS

Firm: ABS Global Investments ("ABS") is a global investment management firm that specializes in constructing a portfolio of local managers that focus on stock selection in their respective market. ABS was established in 2003 and the firm has been managing Emerging Markets strategies since 2012. The firm is headquartered in Greenwich, Connecticut and maintains offices in Sao Paulo, Zurich, and Hong Kong.

ABS currently manages approximately $7.1B across a range of equity strategies for a diverse group of clients, including pensions, foundations, endowments and family offices. The firm offers Long/Short, Long-Only, and systematic products for Emerging Markets investors. The ABS Emerging Markets Direct Portfolio ("ABS Direct") represents $211M in assets under management and has a track record dating to April 2018. ABS Direct provides exposure through direct equity investments. The ABS Emerging Markets Strategic Portfolio provides exposure through direct equity investments and Long-Only funds; the strategy has $1,960M in assets under management. Pension clients represent 50% of the firm's AUM.

ABS believes in the importance of young, talented members of its team becoming equity owners of the business in order to promote the alignment of interest with the success of continuity of the firm. The firm has 37 employees; 26 are equity partners and 20 are dedicated investment professionals.

Investment Philosophy & Performance: The investment philosophy for ABS is centered around constructing a portfolio of local, boots-on-the ground, managers that are specialists in their respective country. The portfolio management team is tasked with constructing an aggregate portfolio that minimizes country and sector deviations relative to the MSCI Emerging Markets Index and adds value through the stock selection expertise of the managers it invests in. The firm employs a manager research and selection process that includes elements of both qualitative and quantitative due diligence.

ABS believes that the inefficiency in Emerging Markets is best exploited by local specialists with a physical presence in the geographies they are investing in and an understanding of the culture. The manager allocates capital to independent boutiques that are sourced through relationships with existing managers, sovereign wealth funds, and family offices. ABS strives to invest in local managers with only one strategy and where the CIO, CEO, and Portfolio Manager are all the same person. These managers can be Hedge Fund managers running a Long/Short mandate that are hired to implement a Long-Only strategy for ABS. The local managers run concentrated portfolios that contain between 20 and 40 high conviction positions. It should be noted that while the active risk of a singular local manager in the portfolio can be high, the aggregate tracking error of the strategy is effectively “dampened” through the diversification benefits and consideration of correlation amongst managers. ABS embraces active risk and the weighted average tracking error of the underlying managers is between 9 – 10%. ABS maintains an expansive bench of prospective managers in each country. The strategy’s historic turnover has been low and the manager is patient when a local manager is underperforming their respective country index; ABS motivates underperforming managers to continue to take risk.

The strategy is not limited to investing in any particular segment of the market-cap spectrum; however, the strategy is expected to maintain a relative overweight to small and mid-cap companies and an underweight to large-cap companies. The underweight to large-cap companies can be attributed to the notion that there is less inefficiency in large companies given their degree of global integration. The strategy is expected to maintain an adaptive style profile and can tilt toward Growth or Value depending on the market environment.

The past 10 years of investment performance demonstrate that ABS has been able to generate solid investment results on both an absolute basis and relative to its benchmark. The team at ABS has been able to generate alpha in periods where both Growth and Value have outperformed the broader Emerging Markets index. The strategy has been able to achieve attractive risk adjusted returns through consistent generation of alpha and maintaining a moderate level of active risk. Investors in the strategy have been able to achieve an asymmetrically positive return profile that has captured more of the broader market’s upside and less of the downside in the previous 5, 7, and 10-year trailing periods.

Portfolio Managers & Team: Guilherme Valle, CFA is the Co-Founder of ABS and the Portfolio Manager for the Emerging Markets Direct Portfolio. Mr. Valle has over 30 years of investment experience and has been in an allocator role since 1994; he has been the key decision maker for the strategy since its inception. Valle is based out of Greenwich but spends a material amount of time “on-the-ground” meeting with existing and prospective local managers. Valle is responsible for directing the qualitative due diligence team.

The qualitative due diligence team is dedicated to the firm’s Emerging Markets strategies and is tasked with forming an assessment, monitoring and conducting diligence on the existing roster of local managers in addition to the bench of prospective managers. The goal of the team is to select the managers best equipped to outperform their local benchmark through an evaluation of their investment philosophy and differentiated source of alpha generation, in addition to gauging manager motivation, congruency, and consistency. The qualitative team counts on 6 analysts each dedicated to a specific region. There are 2 Asia analysts based out of Hong Kong; although the rest of the team is based out of Greenwich, the analysts spend a significant amount of time in the geographies they cover. The quantitative due diligence team is a universal resource for the firm and is responsible for the analysis of performance and risk management. The quantitative team aids the qualitative team in portfolio construction by providing further insight into a local manager's performance trends, relative deviations, and risk exposures at the manager and aggregate portfolio level.

Vehicle and Terms: Staff's recommended investment in ABS will be structured in a 3c7, Limited Liability Company (LLC). The firm has established separately managed accounts for each of its local managers in the name of ABS and the Plan will own an interest in the LLC. ABS has proposed a competitive management fee of 65 basis points on all assets under management.

ABS Direct offers investors monthly liquidity and requires a 30-day redemption notice. The strategy also offers daily liquidity, with a 7-day redemption notice. Daily redemptions are subject to a 2% exit fee.

Risks & Considerations: The reliance on Mr. Valle as Portfolio Manager and clear leader of the team presents key person risk to the strategy, and a departure would prompt Staff to re-underwrite the investment. However, this risk is mitigated through the culture that Valle has fostered, particularly within the tenured qualitative due diligence team.

A consideration for investing in this vehicle is the fee structure which inherently involves two layers of fees – the fee paid to the underlying managers and the fee an investor would pay to ABS. Valle and has team have negotiated a competitive fee structure with the local managers the firm allocates capital to and continuously engages with managers to reduce costs. ABS prefers to pursue a fee structure that includes a performance fee to increase the alignment of interest with local specialists. Staff's assessment of the manager's performance is inclusive of both layers of fees.

CARRHAE CAPITAL EMERGING MARKETS EQUITIES FUND – ANALYSIS

Firm: Carrhae Capital ("Carrhae") is an Emerging Markets Boutique founded in 2011 by Ali Akay. Carrhae has 2 distinct strategies: a Long/Short launched in 2011 and a Long-Only launched in 2014. Carrhae is headquartered in London and maintains a global investment team in the UAE, India, China, and Brazil. Carrhae currently has 11 investment professionals with plans to add 2 additional investment analysts to assist senior investment professionals. Carrhae has 18 employees across the investment and operational groups. The firm currently manages $1.77B in assets, $900M in the Long-Only strategy and $871M in the Long/Short strategy.

Investment Philosophy & Performance: The investment philosophy for Carrhae can be described as flexible and opportunistic with a specialty in emerging markets. The firm has established one investment philosophy and relies on the same team and process for both its Long-Only and Long/Short offerings. The Carrhae Long-Only fund is comprised of the long positions in the Long/Short fund and any discretionary deviations in sizing exposures is the decision of Chief Investment Officer, Ali Akay.

Carrhae's security selection process is built on a bottom-up approach that starts with understanding the fundamentals of a company. Carrhae seeks to be in the top quartile of knowledge prior to investing in a certain sector, as such they have on-the-ground analysts in various sectors and countries to gain better insight into micro and macro dynamics

The investment process for Carrhae Capital is based on 3 foundational pillars: fundamentals, adoption of a deal team approach, and risk management. The fundamentals first mindset is a process which allocates significant time and resource towards bottom-up research on companies and industries. The deal team approach combines the expertise of regional and sectors analysts on a single investment thesis to improve the research teams' knowledge and promote pattern recognition across sectors and regions. The risk management framework creates a guideline with the tools to optimize the portfolio based on the risk-reward characteristics and conviction score of their investments.

The Long-Only fund is a concentrated portfolio that can consist of between 30 and 50 positions. The top 10 holdings can be expected to account for 50-60% of the portfolio. The level of security concentration contributes to the strategy's tracking error which can range between 8-9%. Carrhae's security selection and risk management process has resulted in historical excess returns that are in proportion with the level of risk taken by the manager. The strategy has been consistently able to generate positive excess return over different 3-year and 5-year rolling periods. Furthermore, the manager's Information Ratio has been strong, demonstrating that the level of active risk has been commensurate with excess return. Carrhae's track record demonstrates that the manager has been able to generate solid investment results in a consistent and repeatable manner.

Portfolio Managers & Team: Ali Akay, Founder and Chief Investment Officer, counts on 25 years of investment experience and founded Carrhae in 2011. Deputy Chief Investment Officer, Plamen Dokov also has a tenured investing career with close to 20 years in the industry, 10 of those years were with Carrhae alongside Ali Akay. Prior to joining Carrhae Mr. Dokov worked at SAC as a Senior Analyst, where he worked directly with Mr. Akay.

The Carrhae investment team consists of 11 investment professionals, including 7 on-the-ground investment analysts and 2 professionals in the quantitative research group. For the larger country exposures in the Emerging Markets Index, Carrhae employs on-the-ground analysts that understand the local culture and language of the geographies they are investing in. Additionally, the firm has a culture of mentorship that is cultivated through their senior professionals.

Vehicle and Terms: Staff's recommended investment in Carrhae is in a fund structure. The investment would be in Share Class "F". Class F shares have a 75 basis point management fee and a performance fee of 12% on returns in excess of the MSCI Emerging Markets Total Return Index. The fee structure includes a high-water mark which further aids in the alignment of interest and benefits the Plan during periods of underperformance. The strategy offers monthly redemption with a 30-day redemption notice.

Risk & Considerations: Akay is the key decision-maker for the strategy, introducing a notable level of key person risk. This risk is mitigated by the tenure and extensive presence of Deputy CIO, Plamen Dokov. Akay and Dokov have an extensive working relationship and in the absence of Akay, Mr. Dokov undertakes the investment decisions. In the event that Akay would be unable to serve in his current capacity, investors would be given the opportunity to further underwrite Dokov and will have the ability to liquidate their investment in the fund.

The strategy has the ability to invest up to 10% of assets in non-equity investments and has historically invested in credit and commodities. The manager has made use of this allocation to express a macro view when the market of the country is illiquid or the investable equity securities are limited. It should be noted that the level of non-equity investments has historically been nominal, and the highest average annual exposure has been 1.6%.

INVESTMENT PROCESS

Following the termination of AB, Staff initiated a replacement search for an active manager to complement the existing managers in the Emerging Markets allocation. Staff used eVestment to screen the universe of Global Emerging Markets managers and arrive at an initial list of candidates based on historical performance and an emphasis on consistency during different trailing and rolling time periods. Staff conducted preliminary conversations with 19 investment managers for 21 distinct strategies in order to understand the team, investment philosophy, and process. Staff identified the strategies that warranted further consideration through a combination of qualitative and quantitative factors. Staff conducted additional interviews with 8 managers to better understand historical performance, risk considerations, and environments where the strategy can be expected to under or overperform. Staff identified finalists for the mandate and communicated the short list of potential managers to Verus. Staff engaged with Verus actively in the final stage of the investment process. Staff's collaboration with Verus included an assessment of capacity, liquidity and off-benchmark exposures. Staff arrived at an investment decision after thoughtful consideration of performance, investment methodology, and the complementary aspects of each manager. Verus is supportive of Staff's investment recommendation.

Staff relied on Venn to analyze the size of the recommended investments in ABS and Carrhae. Staff was also considerate of the factor exposures of the current Emerging Markets allocation and believes the proposed allocation provides a more balanced exposure to risk factors. Staff has modeled the effects of the proposed investments on portfolio risk and return and has included output in the Appendix section.

VERUS

Verus undertook an independent assessment of the recommended managers to determine their institutional quality and provided a complementary memorandum that is supportive of Staff's recommendation. The Verus memorandum is appended to this document.

SUMMARY

The recommended investments in ABS and Carrhae represent an attractive opportunity for the Plan to gain access to two high conviction managers that have demonstrated the ability to capitalize on the inefficiencies in Emerging Markets Equity. The proposed allocation of the Emerging Markets Equity portfolio is consistent with Staff's view that the asset class is situated for alpha generation and skilled managers are compensated for taking active risk. The managers are complementary and have exhibited a low, and at times negative, correlation of excess return; *demonstrating that the strategies are differentiated in their approach*. The investments in ABS and Carrhae allow the Plan to capture the breadth of the opportunity set in Emerging Markets and earn a return that is consistent with the objective of the Public Equity allocation.

APPENDIX

Emerging Markets Level Risk & Return (Analysis Period July 2018 - May 2024)

Historical Performance	Current Allocation	Proposed Allocation
Volatility (Analysis Period)	18.54%	18.53%
Excess Return (Analysis Period)	-0.29%	3.45%
Tracking Error (Analysis Period)	3.60%	3.06%
Information Ratio (Analysis Period)	-0.06	1.10

Global Public Equity Level Risk & Return (Analysis Period July 2018 - May 2024)

Historical Performance	Current Allocation	Proposed Allocation
Volatility (Analysis Period)	17.46%	17.48%
Excess Return (Analysis Period)	0.05%	0.48%
Tracking Error (Analysis Period)	1.31%	1.26%
Information Ratio (Analysis Period)	0.00	0.31

Correlation of Excess Return

Analysis Period (February 2014 - May 2024)

Excess Return Correlation	DFA	Carrhae	ABS
Dimensional Fund Advisors	1.00		
Carrhae Capital EM Long Only	**-0.26**	1.00	
ABS EM Direct	**-0.05**	**0.13**	1.00

Analysis Period (February 2014 - January 2017)

Excess Return Correlation	DFA	Carrhae	ABS
Dimensional Fund Advisors	1.00		
Carrhae Capital EM Long Only	**-0.56**	1.00	
ABS EM Direct	**-0.46**	**0.65**	1.00

Analysis Period (February 2017 - January 2021)

Excess Return Correlation	DFA	Carrhae	ABS
Dimensional Fund Advisors	1.00		
Carrhae Capital EM Long Only	**-0.24**	1.00	
ABS EM Direct	**-0.05**	**-0.13**	1.00

Analysis Period (February 2021 - January 2024)

Excess Return Correlation	DFA	Carrhae	ABS
Dimensional Fund Advisors	1.00		
Carrhae Capital EM Long Only	**-0.11**	1.00	
ABS EM Direct	**0.31**	**-0.22**	1.00

Verus

Memorandum

To:	Investment Committee, Kern County Employees' Retirement Association
cc:	KCERA Investment Staff
From:	Scott J. Whalen, CFA, CAIA, Managing Director and Senior Consultant
Date:	August 2, 2024
RE:	Emerging Market Equity Mandate

Background

KCERA's investment strategy includes a policy allocation to Global Equity, a portion of which is dedicated to Emerging Market Equity ("EME"). As of 6/30/24, the EME allocation was invested with two managers, one active and one passive, equaling 3.7% of the total investment portfolio, or approximately $214 million. Near the end of 2023, following close observation and evaluation due to an extended period of underperformance, KCERA redeemed its investment in the AB Emerging Markets Strategic Core Equity fund. The assets were placed in an index fund as a holding place until Investment Staff could conduct a thorough asset-class review. Earlier this year KCERA initiated a deep-dive research project with support from Verus to develop a long-term solution for the EME mandate. The evaluation resulted in the identification of the following two managers that are being recommended to the Investment Committee:

- Carrhae Capital Emerging Markets Equities Fund; and
- ABS Emerging Markets Direct Portfolio

These two strategies will work in conjunction with KCERA's current manager, DFA, and a small residual passive allocation to provide a balanced portfolio across growth and value styles and small, mid, and large capitalization ranges.

This memo provides a description of the comprehensive due diligence steps that went into this project, the strategies and sizing that make up the recommended structure, and our favorable view of Staff's recommendation.

Evaluation Process

INVESTMENT STAFF DUE DILIGENCE

Following termination of the AB fund, a thorough search and detailed implementation analysis was carried out in multiple stages, including:

- A review of eVestment's comprehensive database of EME investment managers and strategies;
- 19 introductory manager calls covering 21 separate strategies;
- Deep quantitative analysis;
- Due diligence interviews with 8 semi-finalist candidates;
- Additional due diligence interviews with 4 finalist candidates;
- Manager structure analysis; and
- Mandate sizing analysis.

Through these stages, Investment Staff assessed various factors and attributes, including:

- Historical risk and return;
- Investment team, philosophy, and process;
- Approach to risk management;
- Discreet periods of out and underperformance; and
- Factor exposures across managers.

VERUS PARTICIPATION

Verus supported KCERA Investment Staff through the evaluation process by providing additional analytical resources related to emerging market asset class capacity constraints, off benchmark and developed market holdings, and benchmarking analysis. Verus actively participated in finalist candidate interviews and provided additional analytical rigor in relation to final manager selection and structure.

Strategy Description

Currently, KCERA's EME portfolio consists of a value manager, DFA, and a passive core index fund. Through the search process, two additional active managers have been identified that fit well within KCERA's EME portfolio.

CARRHAE CAPITAL EMERGING MARKETS EQUITIES FUND

Carrhae is a boutique investment shop based in London with a geographically disperse employee base of 18 employees and 11 investment professionals. The firm manages two investment strategies, long-short equity and long-only equity, both of which are based on the same investment philosophy and approach. KCERA Investment Staff is recommending investing in the long-only strategy.

Carrhae firmly believes emerging market equities are a highly inefficient asset class, which leads to compelling opportunities for fundamental investors. They further believe this opportunity is increasing with a significant and growing trend toward passive investing. The firm's fundamental investment approach seeks to take positions in growing companies that can be obtained at a reasonable price. The Fund's investment process consists of the following six basic steps:

- Idea generation;
- Idea analysis;
- Idea refinement;
- Execution;
- Management; and
- Exit.

During idea generation, the investment team monitors key macro variables and extraordinary events around the world, leverages its global network of contacts, meets with company management and their competitors, and follows cross-border corporate actions. They also monitor relative valuations of same-sector companies and stock dividend yields.

Idea analysis and refinement involves covering the basics of the trade and developing proprietary analysis identifying where their view may differ from that of the market. Part of the idea analysis is focused on determining the target position size, which considers liquidity, risk tolerance, conviction level and expected return. Ideas are presented to the CIO and are brought up for team discussion. Carrhae is conscious of spending time efficiently. The firm uses sell-side research to obtain background for investment ideas and also commissions custom analysis and proprietary surveys. Internally, the investment team spends most of its time sourcing proprietary information and developing in-house models.

For idea execution, the CIO works with the trader to determine entry points and the pace of fund deployment. Positions are sized dynamically both ahead of and after key trading milestones.

The firm utilizes a proprietary dashboard for managing and exiting positions that provides a real-time road map for each security in the portfolio and whether it should be increased or reduced in size. The dashboard tracks country risk, industry risk, performance relative to price targets, and ongoing conviction in the investment thesis. In practice Carrhae tends to marginally add to positions during selloffs, as a security's risk/reward profile improves, and reduce position sizes as risk/reward deteriorates and a stock moves toward its price target.

ABS EMERGING MARKETS DIRECT PORTFOLIO

ABS Investment Management (ABS) is a global investment firm focused on building differentiated equity portfolios using a fund-of-funds structure. The ABS Emerging Markets Direct strategy is a highly active, yet still diversified, portfolio of local specialist managers with a geographical and cultural advantage in identifying alpha opportunities. The ABS team packages these unconstrained underlying managers into a single core portfolio designed to provide consistently strong relative results regardless of the market environment.

The Emerging Markets Direct strategy is intended to be an all-cap, core portfolio with an all-weather return profile. Because the process strives to minimize factor exposures outside of beta, the strategy should perform well in normal market environments where fundamentals are rewarded. Sharp, technical moves (up or down) would present a more difficult environment for the strategy.

ABS is majority employee-owned with a stable and diverse team of experienced investors. The team employs a well-articulated philosophy and process that focuses on minimizing unwanted exposures, which leads to results driven primarily by stock selection. The fund-of-funds structure often leads to exposure to smaller and mid-size companies. The firm's highly sophisticated, proprietary portfolio and risk management database facilitates thorough insight into stock, sub-fund, and portfolio-level exposures.

Even though the fund-of-funds structure leads to a double layer of fees, ABS has been able to demonstrate strong relative net-of-fee performance across its product suite. Also, the firm is continually focused on lowering fees for investors. In recent years, the team has been able to attain material fee reductions through transitioning underlying exposures to separately managed accounts from commingled fund structures.

Mandate Structure and Sizing

Through factor and structure analysis, Investment Staff has concluded that the three managers (Carrhae, ABS, and DFA), when taken together, will provide complementary return streams with a strong chance of producing excess returns for the overall EME mandate. Our independent analysis confirms this. The first table below provides excess returns correlation of the three strategies over a 10-year period ending 3/31/24. As one can see, correlations are low to negative, indicating high diversification benefit from the recommended structure.

	ABS	Carrhae	DFA
ABS	1.00		
Carrhae	-0.15	1.00	
DFA	0.32	-0.15	1.00

The second table shows the characteristics of a representative 10-year historical return stream constructed from the three managers' composite returns, combined in proportion to the recommended allocation. As one can see here, combining the three managers would have provided far superior performance versus the passive benchmark.

Metric	Combined Portfolio	MSCI EM Index
Annualized Return	6.99%	3.58%
Standard Deviation	16.46%	16.94%
Beta	0.95	--
Alpha	3.47%	--
Information Ratio	0.98	--
Sharpe Ratio	0.34	0.13
Upside Capture	102.5%	--
Downside Capture	89.6%	--

Verus and Investment Staff agree that Emerging Market Equity is a relatively inefficient space where active management can have a favorable impact on overall asset class returns. Therefore, the recommended mandate is predominately invested utilizing active management with a modest allocation of less than 10% remaining in a passive index for the purpose of maintaining operational efficiency and flexibility.

Verus Position

Based on our review of the evaluation work of KCERA's Investment Staff and the independent work conducted by Verus research, we are supportive of Staff's recommendation.

KERN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

Core Real Estate Review

Presented by:

Geoff Nolan

Senior Investment Officer

Jack Bowman

Senior Investment Analyst

August 2024

Contents

Introduction and Objectives

What is Staff seeking to achieve with this analysis?

- **Goal**: Determine whether the Core Real Estate ("CRE") portfolio is meeting its goal/objectives.

- **Process**: Review performance and risk drivers.

- **Next Steps**: Consider strategic alternatives for potential structural improvements to CRE.

Role of a CRE Portfolio

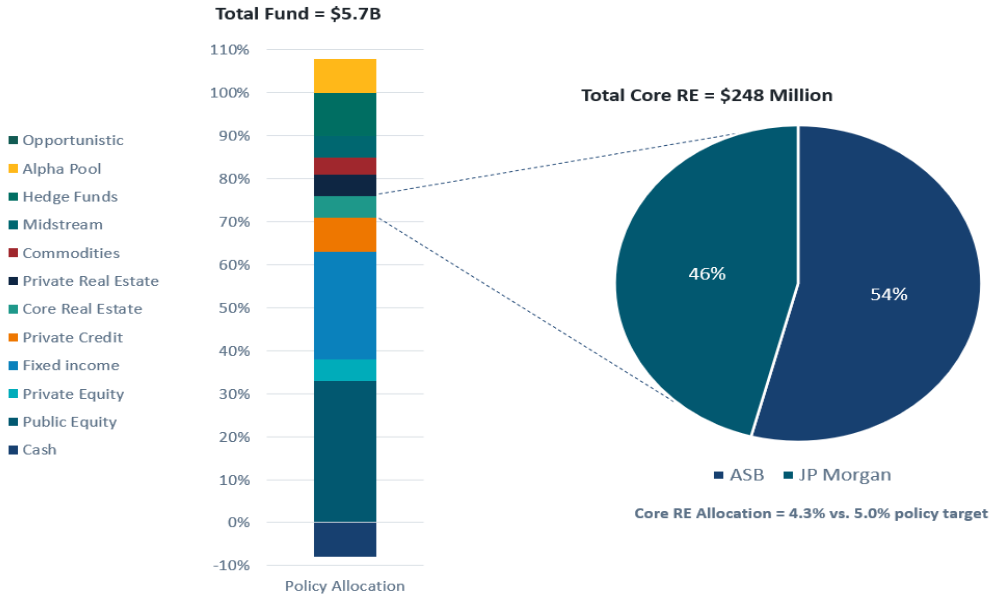
- **Stable income generating cash flows:** Properties often come with long-term leases, providing stable and predictable cash flows.

- **Diversification:** Low correlation with stocks and bonds.

- **Inflation hedge:** Values and rental rates typically increase with inflation.

KCERA's Core Real Estate Portfolio

- KCERA has had real estate exposure for over 30 years. The CRE allocation was established in 2013 and the Plan's current two CRE managers have been in place since 2013 and 2014.
- Over the last 5 years, the CRE portfolio has met its diversification and cash flow objectives but given property value declines it has fallen short on providing an inflation hedge.
- CRE within KCERA Portfolio:



As of March 31, 2024

KCERA’s CRE Manager Fund Overview

- ***JP Morgan’s Strategic Property Fund*** seeks an income-driven rate of return of 100 basis points over the NCREIF Property Index over a full market cycle through asset, geographic and sector selection and active asset management. The Fund invests in high-quality stabilized assets with dominant competitive characteristics in markets with attractive demographics throughout the United States.

- ***ASB Core Fund*** seeks to achieve above-benchmark investment performance through long-term net operating growth by investing in urban markets with strong real estate fundamentals and in assets that have competitive advantages that may drive long-term tenant demand. The Fund seeks to build a portfolio that is diversified by the core property types including office, multi-family, retail and industrial, as well as by maintaining strong geographic diversification across the nation's strongest metropolitan areas.

As of March 31st, 2024. Source: KCERA.

KCERA’s CRE Managers

<u>Similarities:</u>

- Modest leverage (35%-40%).
- Expanding allocations to non-core investments.
- Undertaking a multi-year portfolio allocation shift to reduce office exposure and shift towards both industrial and residential assets.
- KCERA’s managers have fulfilled their mandate to provide an annual cash flow component, annualized at 3+% for the past 5 years.

<u>Differences:</u>

- ASB historically focused on urban markets
- Fund Size:
  - ASB: $4.8 billion Gross Asset Value
  - JPM: $25.7 billion Gross Asset Value

KCERA's CRE Performance Results

	Market Value	% of Portfolio	3 Mo	Fiscal YTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	Fiscal 2023	Fiscal 2022	Fiscal 2021	Fiscal 2020	Fiscal 2019	Inception	Inception Date
Core Real Estate	**247,841,190**	**4.3**	**-6.4**	**-16.8**	**-20.3**	**-2.3**	**-0.3**	**-**	**-12.4**	**24.8**	**5.6**	**1.4**	**5.9**	**4.0**	**Oct-14**
NCREIF ODCE			*-2.4*	*-8.8*	*-11.3*	*3.4*	*3.5*	*-*	*-10.0*	*29.5*	*8.0*	*2.2*	*6.4*	*6.4*	
ASB Allegiance Real Estate Fund	133,800,042	2.3	-6.9	-17.5	-22.7	-3.5	-1.0	3.8	-13.3	23.0	5.4	1.5	6.8	4.2	Sep-13
NCREIF ODCE			*-2.4*	*-8.8*	*-11.3*	*3.4*	*3.5*	*6.8*	*-10.0*	*29.5*	*8.0*	*2.2*	*6.4*	*7.0*	
JPMCB Strategic Property Fund	114,041,148	2.0	-5.7	-15.9	-17.4	-0.7	0.6	-	-11.4	27.9	5.9	1.3	5.0	4.4	Jul-14
NCREIF ODCE			*-2.4*	*-8.8*	*-11.3*	*3.4*	*3.5*	*-*	*-10.0*	*29.5*	*8.0*	*2.2*	*6.4*	*6.6*	

KCERA CRE managers have underperformed the NCREIF ODCE benchmark over 1-, 3-,5-year periods, since inception, as well as every fiscal year since 2019.

As of March 31st, 2024. Source: KCERA.

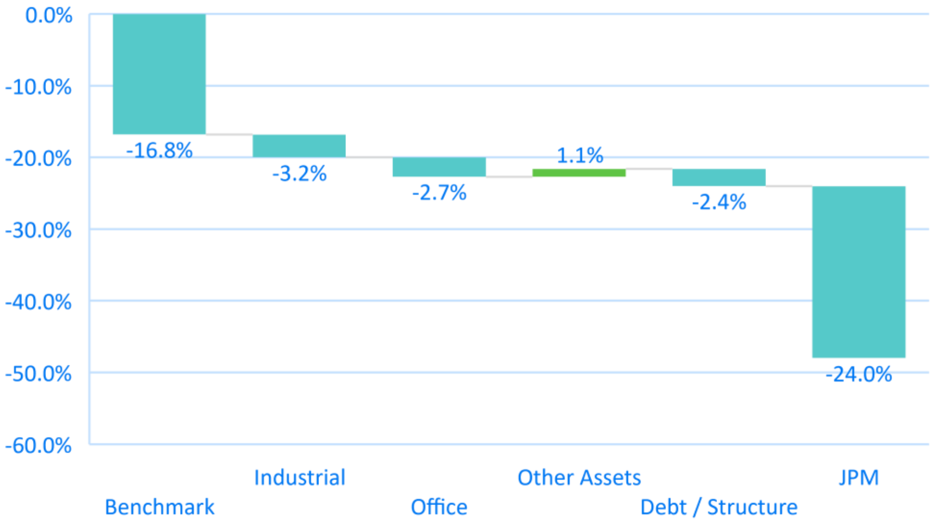
KCERA KERN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

KCERA's CRE Performance Drivers

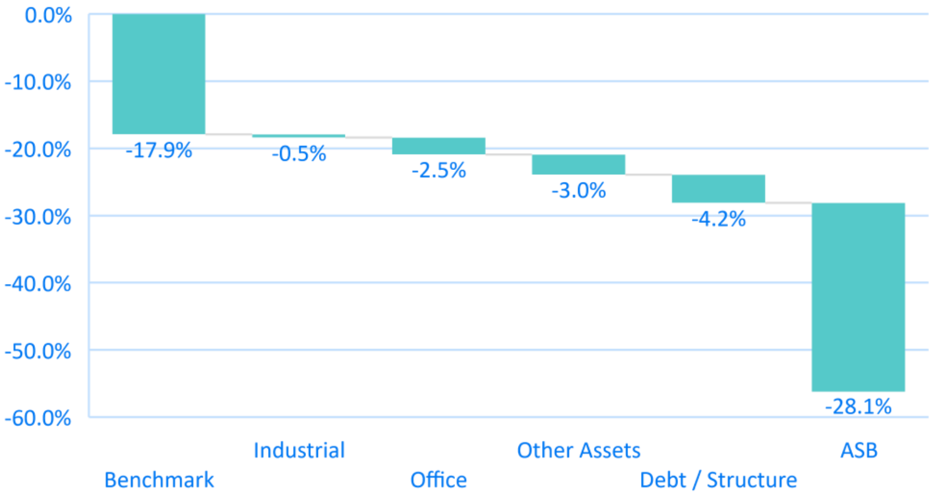
- Underperformance Drivers: overweight office, underweight industrial.
  - COVID & work from home trend negatively impacted office holdings.
  - Strong growth in e-commerce lifted industrial holdings.

- <u>Attribution Walk (2022 Q3 to 2024 Q1):</u>

<u>JP Morgan</u>



<u>ASB</u>



KCERA
KERN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

Core Real Estate Market Update

- Core real estate has experienced ~2 years of negative total returns and weakening fundamentals (rising vacancies, softening growth rates, over-supply in certain markets).
  - Primary drivers: COVID's impact on the office sector, rising interest rates.
- Across the CRE industry, property value declines have been material.
- In addition, managers are facing substantial redemption queue requests.
- Lack of transaction volume due to buyers/sellers not being able to bridge sale price differences in stressed markets has resulted in constrained / restricted liquidity for CRE investors (including KCERA).
- While CRE managers are seeing transactions picking up, additional valuation declines may still be on the horizon.

Next Steps

- Further shift portfolio allocation to a more diversified portfolio that encompasses a CRE segment (office, industrial, retail, residential) along with complementary non-traditional asset classes (e.g., senior housing, outdoor storage, data centers, triple net lease strategies, land bank, REITS, etc.).
    - Considerations:
        - Tracking error vs. current benchmark (NFI-ODCE).
        - Open-end vs. close-end funds.
        - Fund structure liquidity.
- Determine the appropriate level of CRE exposure versus other asset types.
- Determine whether KCERA has the appropriate CRE managers.
- Consider whether to create a Real Assets allocation (i.e., assets with similar characteristics that can meet allocation objectives) of which CRE would be a sub-allocation. Real Assets would allow for exposure to infrastructure, land, etc.

Questions

Appendix

Core Real Estate Policy Benchmark

- The NFI-ODCE index is a capitalization-weighted, gross of fee, time-weighted return index with an inception date of December 31, 1977.
- Open-end fund are generally defined as evergreen / infinite-life vehicles consisting of multiple investors who have the ability to enter or exit the fund on a periodic basis, subject to contribution and/or redemption requests
- The constituents of the NFI-ODCE must meet the following requirements:
    - At least 80% of the fund's gross assets are invested in private equity direct real estate assets.
    - At least 95% of the fund's aggregate properties gross market value must be invested in the United States.
    - At least 75% of the fund's aggregate gross market value at effective ownership share are invested in office, industrial, apartment, and retail property types
    - At least 75% of the fund's gross assets are invested in private equity direct real estate properties that are 75% or more leased
    - No more than 35% Tier 1 leverage as defined tin the NCREIF PREA Reporting Standards
    - No more than 60% (+- for market forces) of the gross market value of real estate in one property type, and must be invested in three of the four main property types, with a minimum of 5% in each the three types. No more than 65% (+- for market forces) of real estate gross market value in one region.

Kern County Employees' Retirement Association

www.kcera.org

11125 River Run Blvd. Bakersfield, CA 93311

Verus

PERSPECTIVES
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SUCCESS

AUGUST 2024

Core Real Estate Review

Kern County Employees’ Retirement Association

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I. Real estate refresher

The case for commercial real estate

Investing in commercial real estate offers several strategic benefits to institutional investors, such as:

— **Diversification:** Real estate has a low correlation with most other asset classes like stocks and bonds, which can help diversify risk in an investment portfolio

— **Stable Cash Flows:** Commercial properties often come with long-term leases, providing stable and predictable cash flows compared to more volatile assets

— **Inflation Hedge:** Real estate values and rental income typically increase with inflation, making commercial real estate a good hedge against inflation

— **Capital Appreciation:** Over time, commercial properties typically appreciate in value, offering the potential for capital gains in addition to steady income from rents

Real estate's role in a diversified portfolio

	RETURN ROLES				DIVERSIFICATION & VOLATILITY ROLES			HOW MACRO OUTLOOK/GDP AFFECTS ROLE	
	Benefit from GDP Growth	Earn Risk Premium	Produce Stable Income	Hedge Against Inflation	Low Absolute Volatility	Low Corr. To Other Assets	Reduce Portfolio Volatility	Elements of Return for Asset Class	Sensitivity to GDP
Public Equities	●	◕	◔	◑	○	○	○	PEs, Dividends, Earnings Growth	●
Private Equity	●	●	○	◑	○	◔	○	PEs (exits), Financing, Opportunity Set	●
Fixed Income (Rates)	○	○	●	◔	●	●	●	Direct Link to Yields	◑
Fixed Income (Credit)	◑	◑	●	◔	◕	◑	◕	Direct Link to Yields, Credit Spreads	◕
Real Estate	●	◑	◕	●	◔	◑	◑	Unemployment, Vacancies, Cap Rates	●

MAGNITUDE	●	◕	◑	◔	○
	High	Med-High	Medium	Low	None

Real estate across market environments

GROWTH

INFLATION

Rising growth
Falling inflation

Equities, corporate bonds, emerging market debt, infrastructure, mortgages, government bonds, real estate, commodities

Rising growth
Rising inflation

Commodities, infrastructure, real estate, equities, corporate bonds, emerging market debt

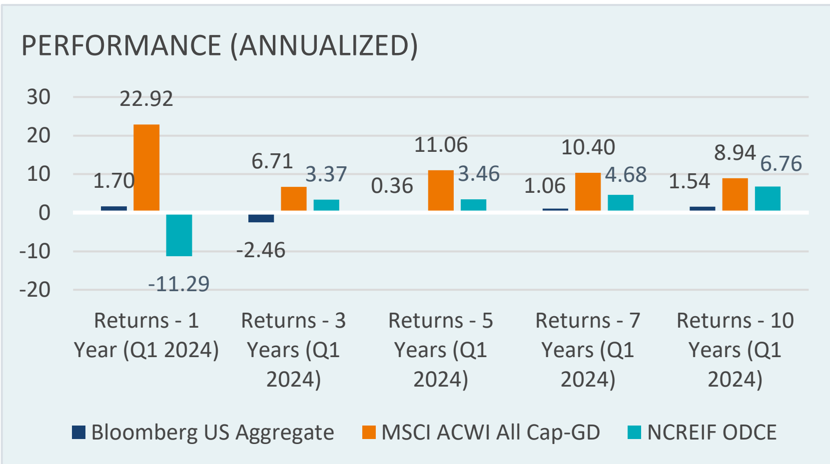
Falling growth
Falling inflation

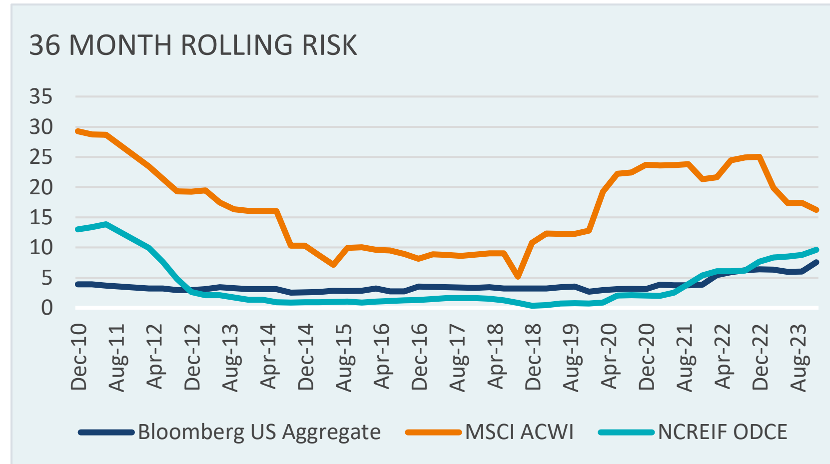
Government bonds, corporate bonds, emerging market debt, inflation linked bonds

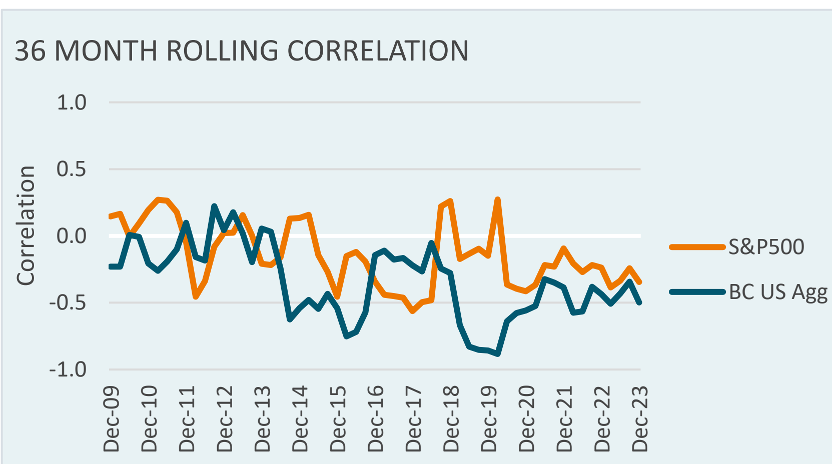
Falling growth
Rising inflation

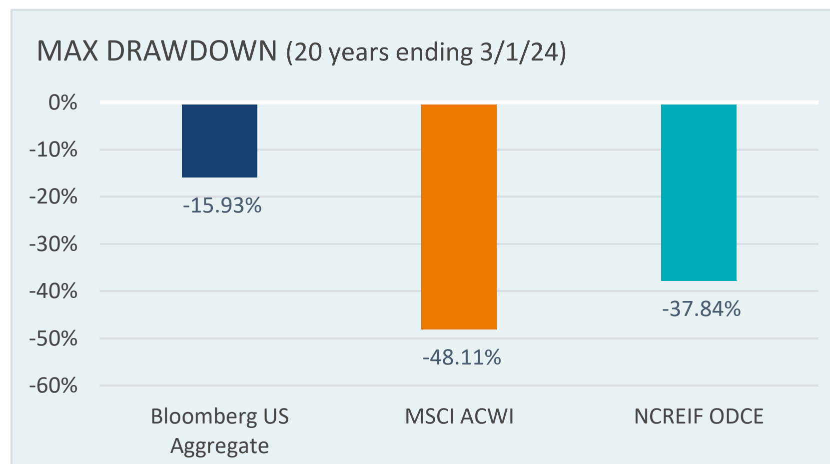
Inflation linked bonds, commodities, infrastructure, real estate

Real estate in an institutional portfolio









Note: Real estate represented by the NCREIF ODCE Index, data as of March 31, 2024.

Real estate market dimensions

Investors considering an investment in real estate face a range of decisions about the type of strategy, property type, location, and quality of the property they wish to invest in, as well as whether they prefer a private investment or to access real estate through the public markets.

Strategy

- Core
- Core+
- Value-Add
- Opportunistic
- Debt

Property Type

Core
Multi-Family
Retail
Office
Industrial

Core+
Multi-Family
Retail
Office
Industrial
Some Non-Core

Non-Core
Hotel/Lodging
Healthcare
Senior Housing
Self Storage
Other

Location

Primary
Top 10 cities

Secondary
< 10 – 25 cities

Tertiary
Below top 25 cities

Quality

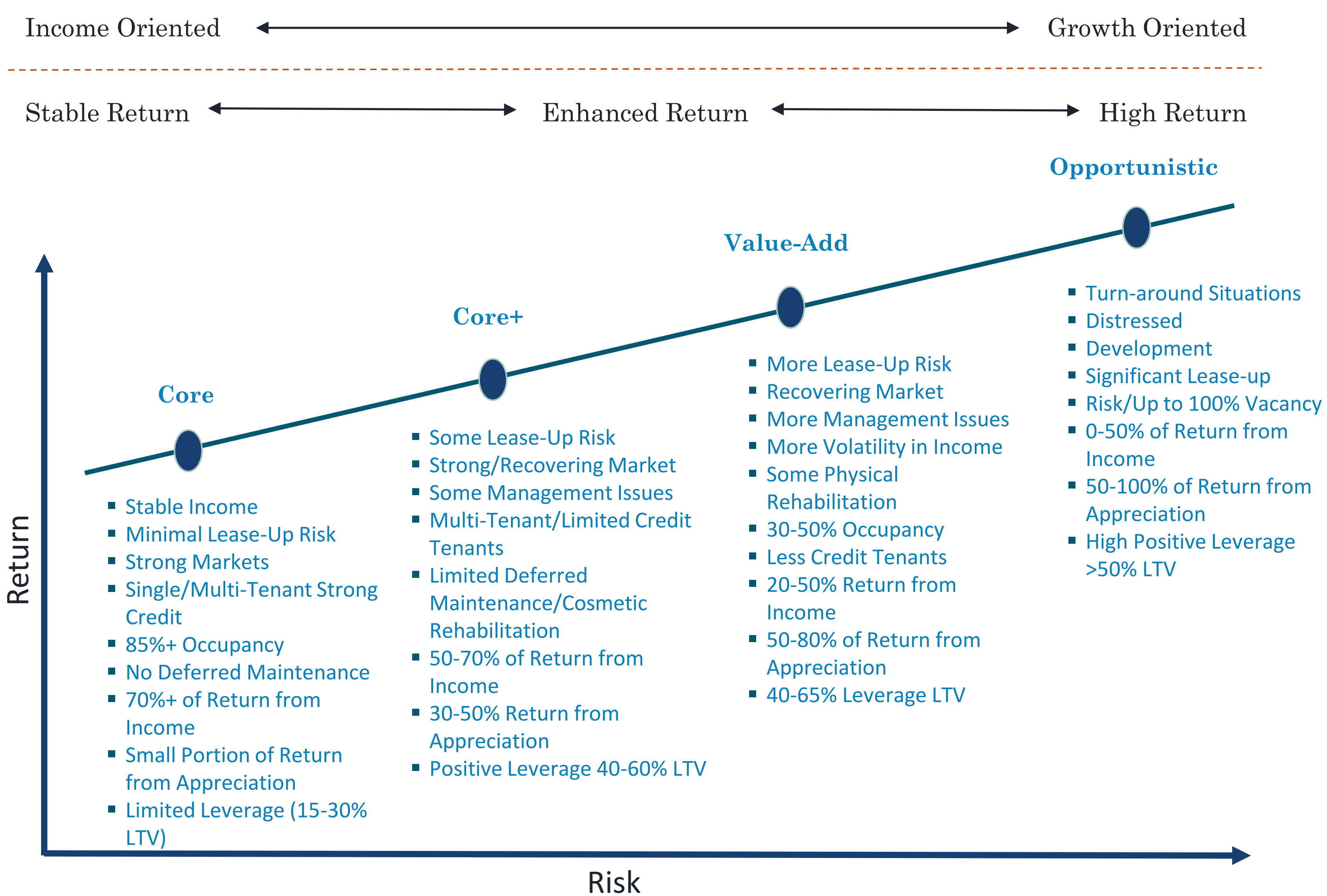
- Class A
- Class B
- Class C

Vehicle

Private Real Estate
Open End
Closed End

Public Real Estate
Equity REIT
Mortgage REIT

Real estate equity risk & return



Core real estate focuses on high quality tenants and properties, while Value-Added and Opportunistic strategies take more risk with under-leased properties or development projects and also use more leverage.

Return drivers by property type

Multi-Family
- Economic Activity
- Demographic Trends
- Supply and Demand

Office
- Economic Activity
- Location / Accessibility
- WFH / Migration Trends

Industrial
- Economic Activity
- Transportation Infrastructure
- Technology

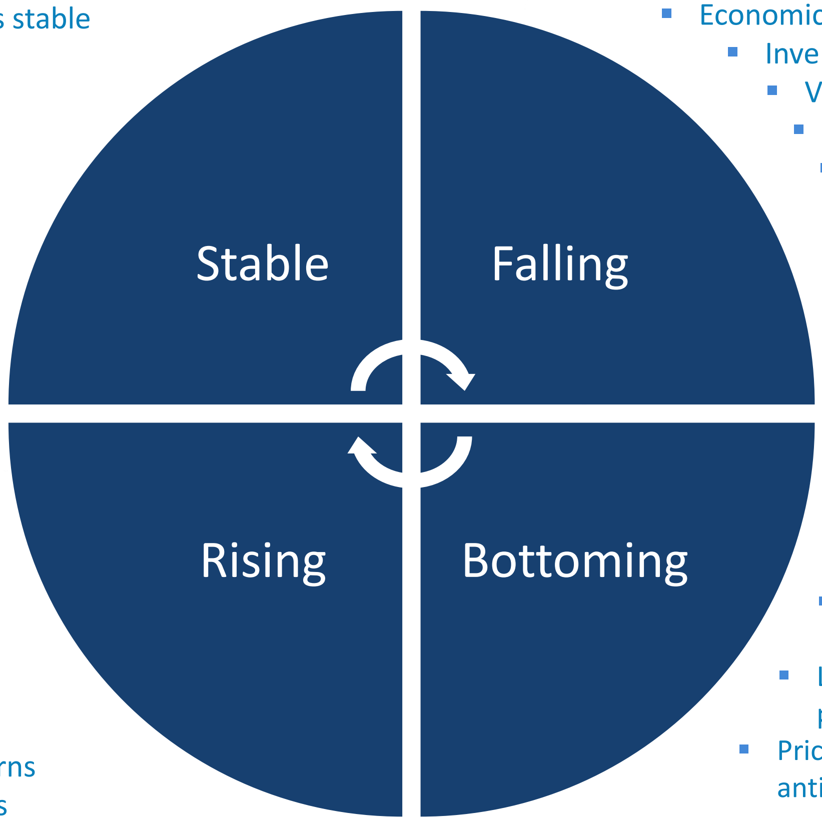
Retail
- Economic Activity
- Consumer Spending
- Adaptability

Non-Core
- Economic Activity
- Varies depending on property type and positioning

Typical real estate market cycle

- Economic growth and interest rates stable
- New Inventory = Demand
- Maximum rents
- High prices and low cap rates

- Economic growth slowing and interest rates rising
  - Inventory growth exceeds demand
    - Vacancy rates rise
      - Softening rents
        - Contracting property values
          - Rising rates and falling property values reduces ability to refinance properties
            - Opportunities for distressed investors begin to appear



- Economic growth rising, interest rates low
- Increasing occupancy
- Rents increasing faster than expenses
- Rising property values and decreasing cap rates
- Core attractive
- As cycle matures, price growth slows and rents become a bigger portion of total returns
- Demand rising faster than inventory creates opportunity
- to add value by repositioning properties

- Interest rates falling and economic growth turning positive
- Low occupancy rates, flat rents, low property prices and high cap rates
- Prices begin to rise ahead of rents on anticipation of recovery in fundamentals

Open-end vs. Closed-end

	Closed-end Fund	Open-end Fund
Pros	— Pure exposure. All clients in a fund enter and exit at the same time experiencing 100% of each asset's performance — Objective nature of valuation process – the ultimate performance is cash flow based rather than appraisal estimates	— Quarterly Liquidity Available. — Better vintage year and property life cycle diversification, which reduces the J-Curve — Flat management fee in some (no incentive fee), which results in a lower percentage fee when returns are high — Easier to maintain desired asset class exposure without dealing with capital calls and distributions
Cons	— Long term lock-up (minimum 7 years) — Early fund life J-Curve effect — Incentive fees reduce investor net returns — Predefined timing of purchases and sales may lead to selling at sub-optimal levels, depending on market conditions	— Large cash flows to/from investors can affect strategy performance — Values are appraisal based, which may lag in volatile markets and could affect NAV entry and exit accuracy — Manager has ability to restrict redemptions during times of stress

Public vs. private

	Public (REITS)	Private (Open-end)
Volatility	— Shares of public REITs are daily valued and subject to market fluctuations	— Private investment funds are valued quarterly and therefore experience much lower volatility
Liquidity	— REITs offer high liquidity, as shares can be bought and sold on the stock market during trading hours	— Private real estate investments have narrower liquidation windows and can experience liquidity gates in distressed market environments
Management Fees	— REITS typically have lower fee structures, and very-low-fee passive options are available	— Higher management fees and operational costs are typical due to more active portfolio management
Performance	— Because REITS are daily valued, price performance is reflective of current market conditions; this also leads to higher correlation with public market equity returns	— Valuation delays cause performance to lag market conditions

II. Current market dynamics

Outlook summary

Strategy	Current Environment	Potential Risks	Outlook/Implementation	View
Core real estate	Core real estate has experienced six straight quarters of negative total returns as valuations have been steadily adjusting downward. The NFI ODCE was down 12% in 2023 and is down over 18% over the last six quarters (through 1Q'24). The primary reason has been adjusting to the higher interest rate environment; however, fundamentals have softened with rising vacancy rates, declining growth rates, higher costs of debt, and an over-supply in certain markets and property types.	— Cap rates have not yet fully adjusted to the new higher interest rate environment and we expect more to come in 2024, especially in the office sector. — Core real estate returns tend to have high correlation to overall GDP growth. There are risks to weakening fundamentals if a recession materializes.	We recommend clients continue to rebalance/ take liquidity from core ODCE funds where possible, although redemption exit queues continue to pay only modest liquidity. We recommend continued diversification into alternative property types to reduce existing exposures to office, which may face longer term challenges.	Negative
Value-add real estate	Transaction levels remain subdued for value-add investments. The costs of leverage remains elevated making it difficult for strategies historically reliant upon leverage to made deals pencil out. Sellers remain reluctant to trade at discounted pricing, with the exception of deals where a catalyst exists such as the inability to refinance/restructure debt creates a need for rescue capital. Many assets are facing an equity gap when refinancing is due and preferred equity structures are becoming more prevalent. Entry pricing is much more favorable on a go-forward basis.	— Higher interest rates and borrowing costs has challenged high leverage value-add strategies, pressuring total returns. — Slowing rent growth in a cooling economy has the potential to further reduce forecasted returns	We continue to favor strategies with limited focus on high leverage and those with strong asset management capabilities to add value as cap rate compression and market growth will be less reliable sources of return.	Neutral
Opportunistic real estate	The steep rise in interest rates that began in 2022 has created pockets of stress and distress in the real estate market. Many asset owners in need of refinancing face a gap in their capital stack as values have declined and credit standards have tightened. Borrowers will be forced to get creative with financing as they often lack fresh equity capital and want to minimize their dilution. Preferred equity financing, structured solutions and investments in debt may see attractive opportunities.	— Higher interest rates and borrowing costs has challenged high leverage opportunistic strategies, pressuring total returns — Competition could be a challenge as large sums of capital have been raised waiting for this opportunity to emerge. — Increasing construction costs due to materials and labor may pressure development strategies.	Non-core funds with vintage years during periods of economic stress tend to be some of the best performing vintages. The impact from higher rates will likely create more attractive entry points. Loans coming due at higher borrowing costs and at higher loan-to-values sets the stage for opportunities to provide rescue capital. GPs with experience in distressed situations and those able to be flexible up and down the cap stack are viewed favorably.	Positive
Real estate debt	Lending rates have increased, both from floating rate base rates as well as spreads. Traditional lending sources (banks and insurance companies) are retreating from writing loans as they continue to reduce risk across their balance sheets. The wall of maturities coming due over the next few years will need refinancing and private lenders are well positioned to take advantage of the opportunity.	— Rising rates, while generally positive for lending strategies, could also decrease transaction volumes and therefore increase competition for deals. — Loan defaults are also on the horizon so having capabilities to structure workouts will be important	Senior lending strategies look attractive as borrowing costs have risen, both in base rates and spreads. Private capital providers look attractive as there will be less competition from traditional lending sources.	Positive

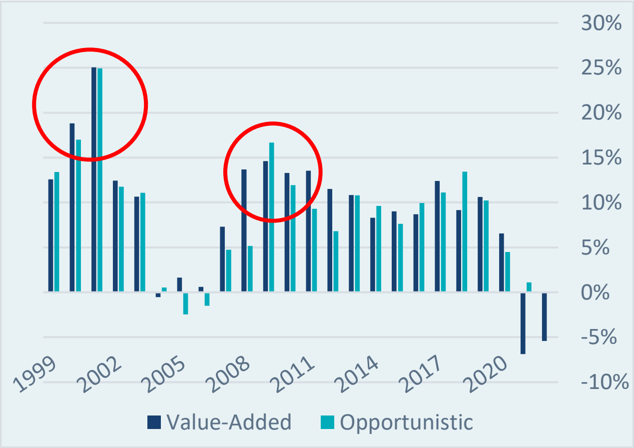
Real estate performance – recent history

- Core real estate was negative in 2023. The unlevered NPI Index was down 7.9% with the levered NFI-ODCE Index was down 12.0%. 1st quarter of 2024 was also negative for both indices at -1.0% and -2.4%, respectively.
- Since late 2022, core real estate has experienced six consecutive quarters of write-downs, totaling negative 11.3% for the unlevered NPI Index and negative 18.4% for the levered NFI-ODCE Index.
- In 2023, every core sector was negative, ranging from office at -17.6%, while retail posted a modest -0.9%.
- Non-core real estate vintage funds have historically outperformed during recessionary years and early recovery periods (e.g., 2000-2003 and 2009-2011) as market dislocations created attractive entry valuations. Given the recent stress in the market, current non-core vintages could be attractive, especially opportunistic strategies with a focus on distress.

NCREIF PROPERTY INDEX RETURNS (CORE)

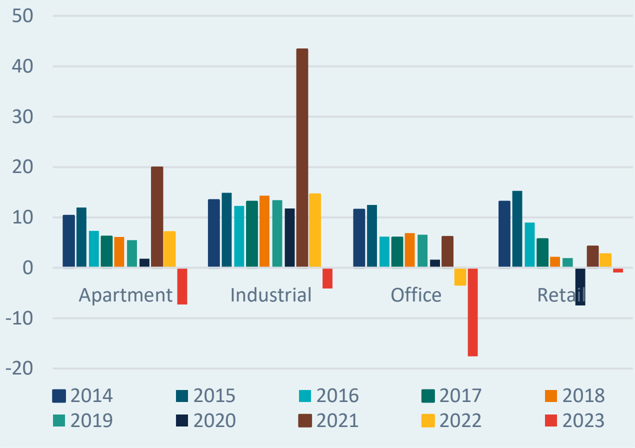
Source: NCREIF, as of 12/31/23

VINTAGE YEAR MEDIAN RETURN (%) NON-CORE REAL ESTATE



Source: Refinitiv, as of 9/30/23

CORE SECTOR ANNUAL RETURNS (%)



Source: NCREIF, as of 12/31/23

Real estate fundamentals

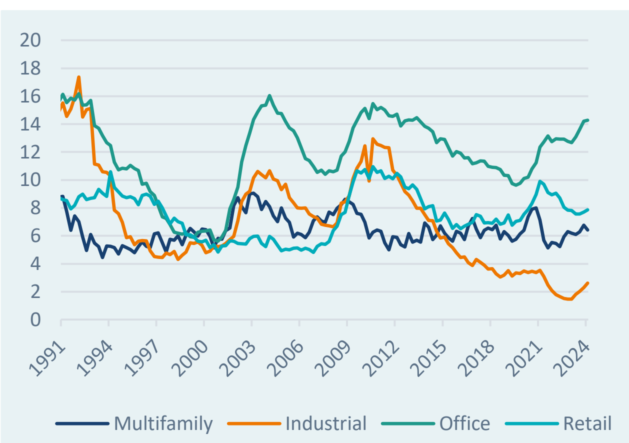
— Private real estate fundamentals have generally weakened over the last year with vacancy rates ticking upward and net operating income trending downward.

— Cap rates spreads, however, have been range bound below 1% for the past couple of years, as they have not fully adjusted to the higher interest rate environment. While cap rates and interest rates do not trade in lock step over shorter time periods, they generally correlate over the long run. Since mid 2022, interest rates have climbed 3%, while appraisal cap rates have climbed only 1%. The valuation process lags, and we expect continued pressure on cap rates, likely through 2024.

— Vacancy rates have been ticking upward for all sectors with the exception of retail, which has trended down recently due to lack of new retail supply and finally seeing positive net absorption.

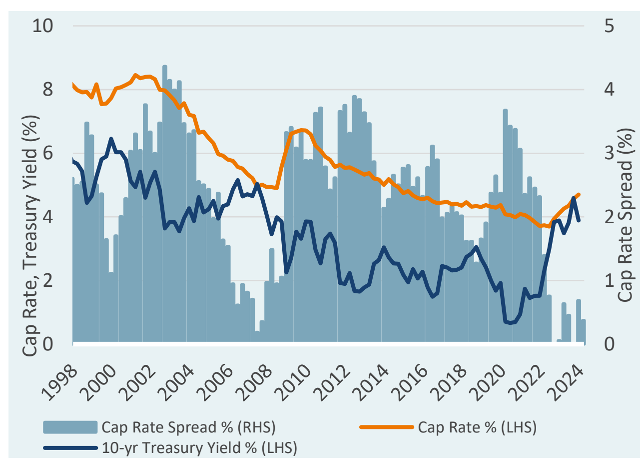
— NOI growth has come down from the highs of 2021 and early 2022 but remain positive for all sectors including office, although office has been bouncing around zero.

VACANCY BY PROPERTY TYPE



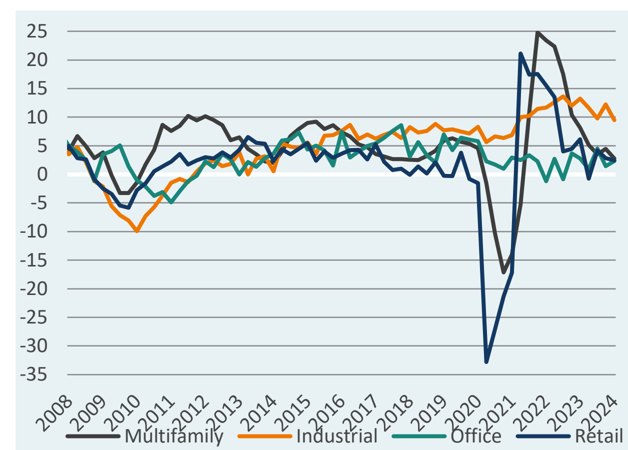
Source: NCREIF, as of 3/31/24

CAP RATE SPREADS



Source: FRED, NCREIF, as of 3/31/24

4-QTR ROLLING NOI GROWTH (%) BY PROPERTY TYPE

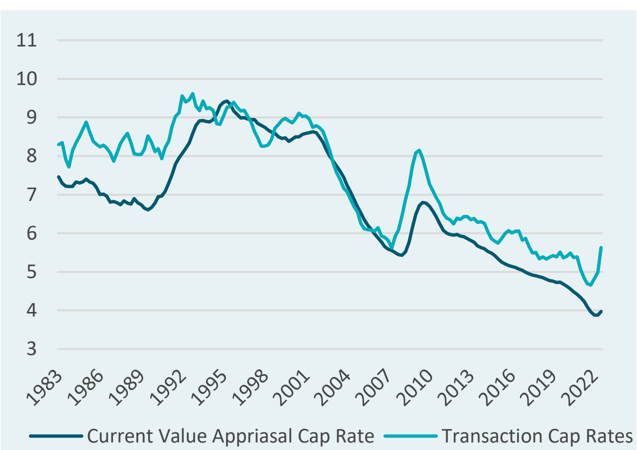


Source: NCREIF, as of 3/31/24

Cap rates

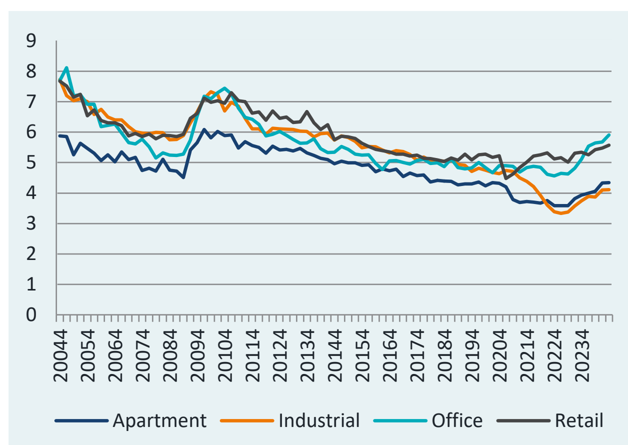
- Private real estate appraisal cap rates have been slower to react to the rising interest rate environment. This is not atypical, as the appraisal process generally lags when there is a decline in transaction volumes and fewer comparable sales or "comps" for appraisers to use as a data set.
- For transactions that are taking place, there is a continued widening gap with appraised values indicated there is more downside to come in private valuations as they adjust to "market".
- We have also seen a widening gap over the last several years between property types as industrial and multifamily have been more in favor with investors versus office and retail. Private market cap rates have come up 0.7% over the last 2 years (through the end of '23)
- We can also look to the public real estate markets for an idea of where cap rates are heading. Implied cap rates in the REIT market have moved up more quickly as indicated in the chart on the bottom right. Implied cap rates are more volatile but can be a leading indicator directionally as they are quicker to respond than the appraisal process.

PRIVATE CAP RATES (4-QTR MOVING AVERAGES)



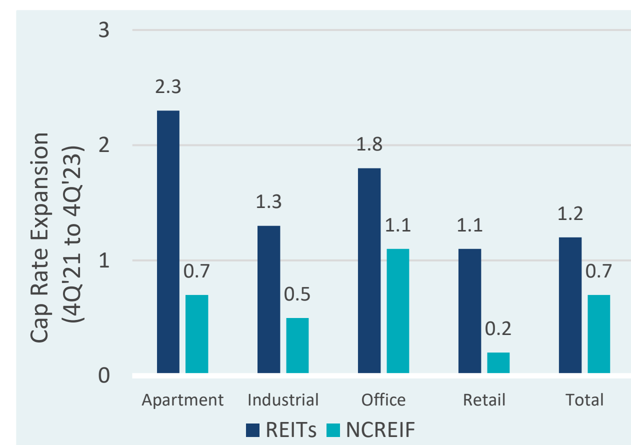
Source: NCREIF, 3/31/2024

CURRENT VALUE CAP RATES BY PROPERTY TYPE



Source: NCREIF, 3/31/2024

PRIVATE CAP RATES VS REIT IMPLIED CAP RATES



Source: NCREIF, NAREIT, 12/31/23

Real estate – new supply and absorption

Demand has declined recently while new completions remains elevated.

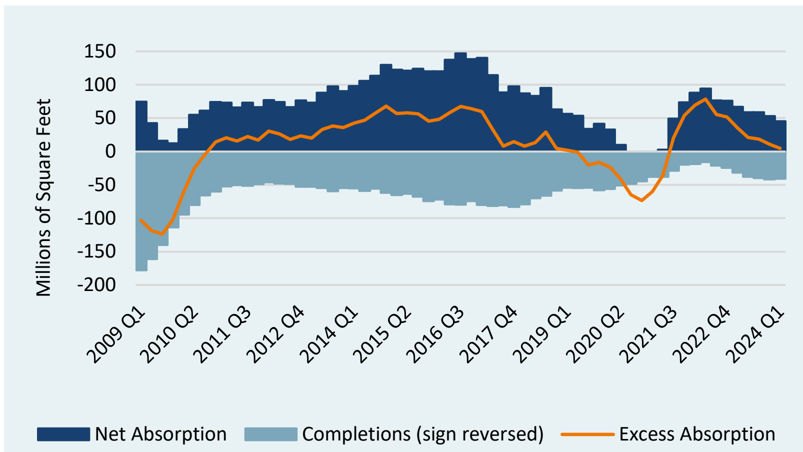
Demand has generally been declining across most segments of CRE markets.

Excess net absorption has been negative (with the exception of retail) as higher levels of new construction began prior to dislocation continues to deliver.

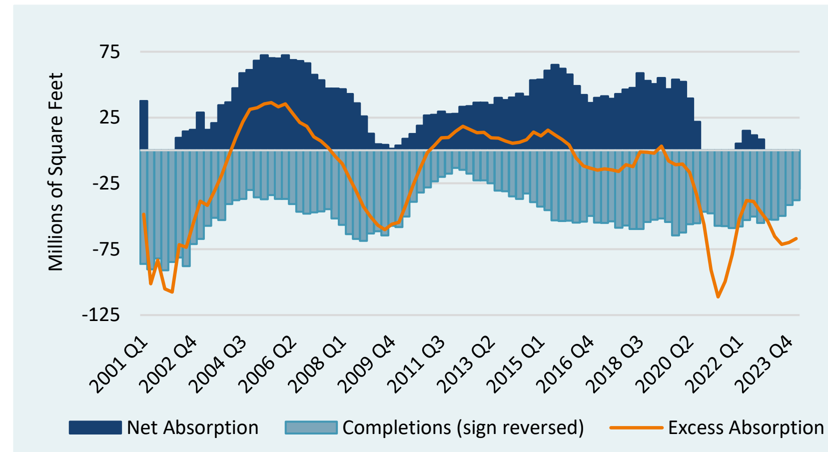
Given higher construction costs and availability of debt, new permitting has declined, indicating new supply may begin to trend back down.

Retail is the one bright spot for this metric, as new completions remain muted .

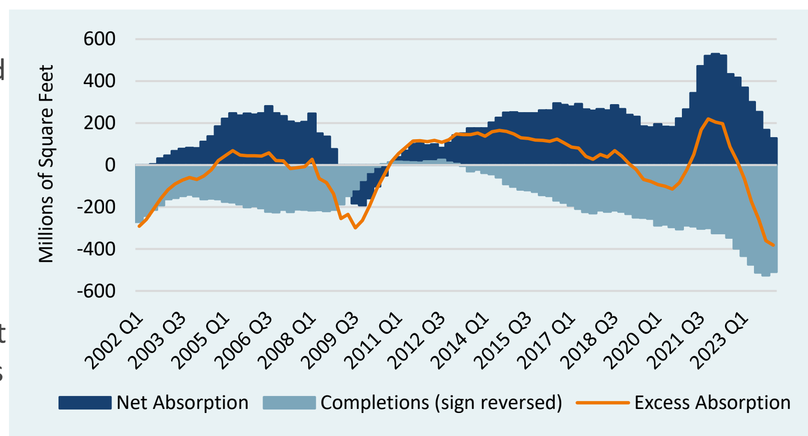
RETAIL



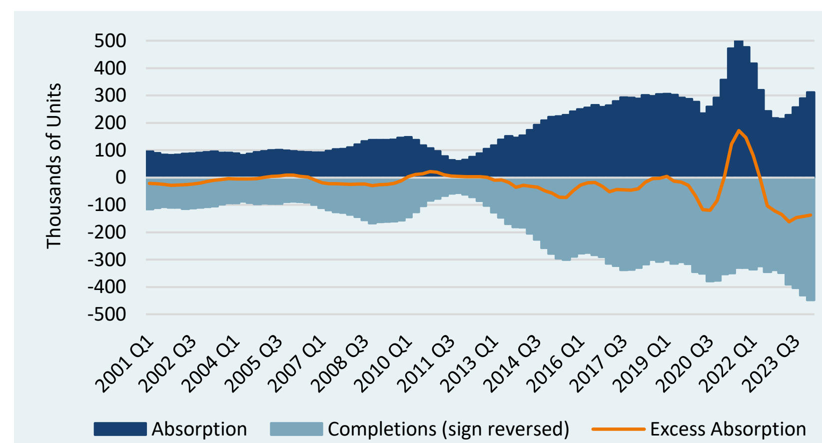
OFFICE



INDUSTRIAL



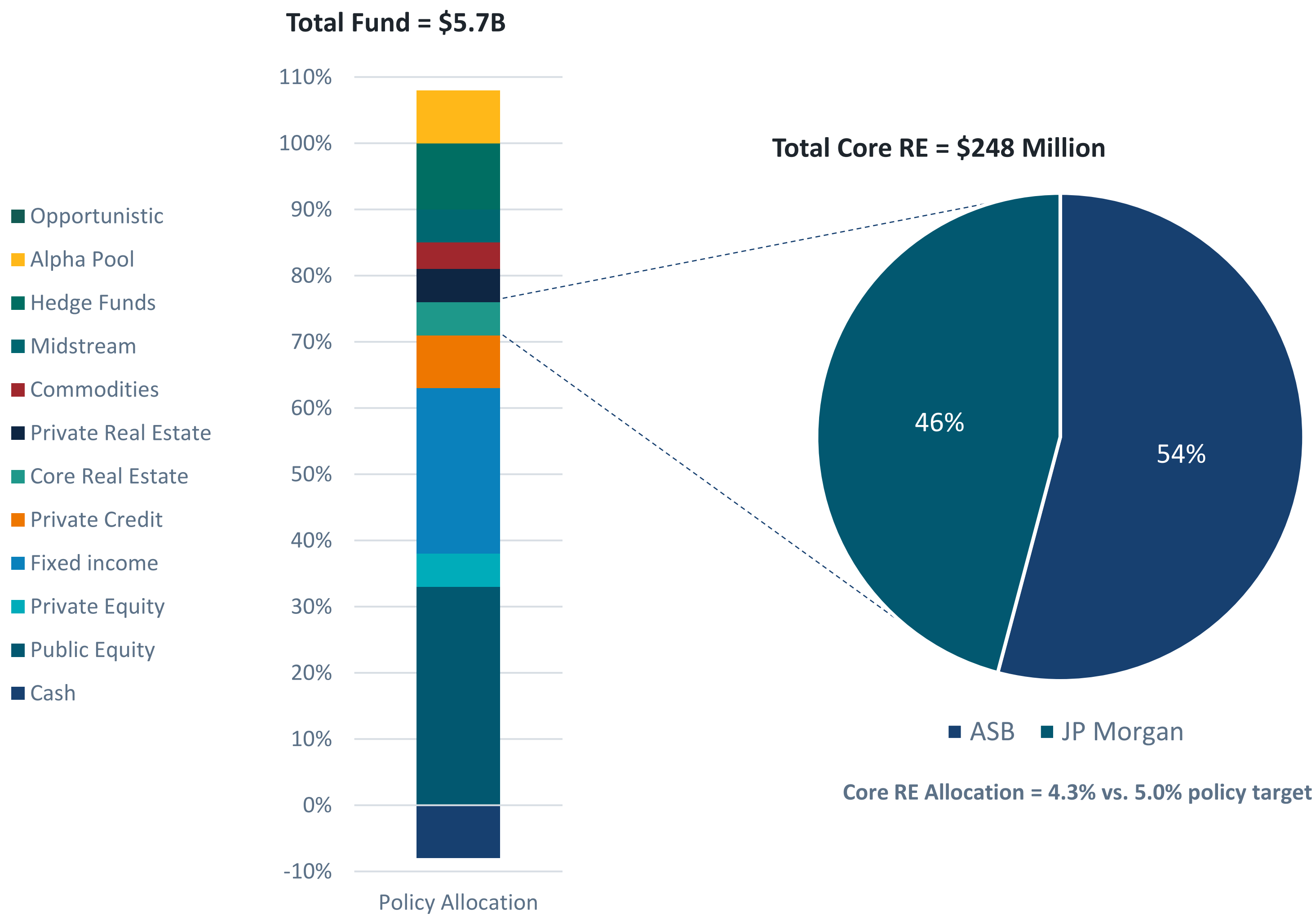
MULTIFAMILY



Source: American Realty Advisors utilizing CoStar data as of 12/31/23

III. KCERA portfolio

Real estate holdings

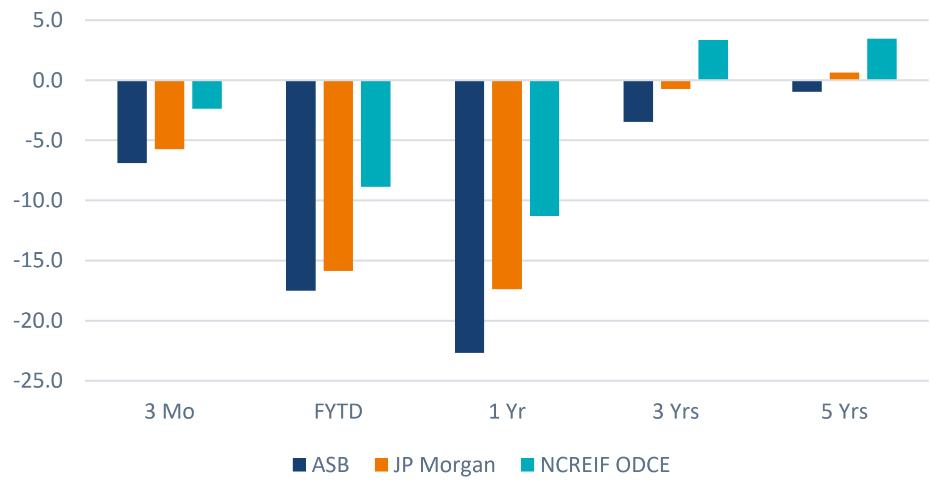


As of March 31, 2024

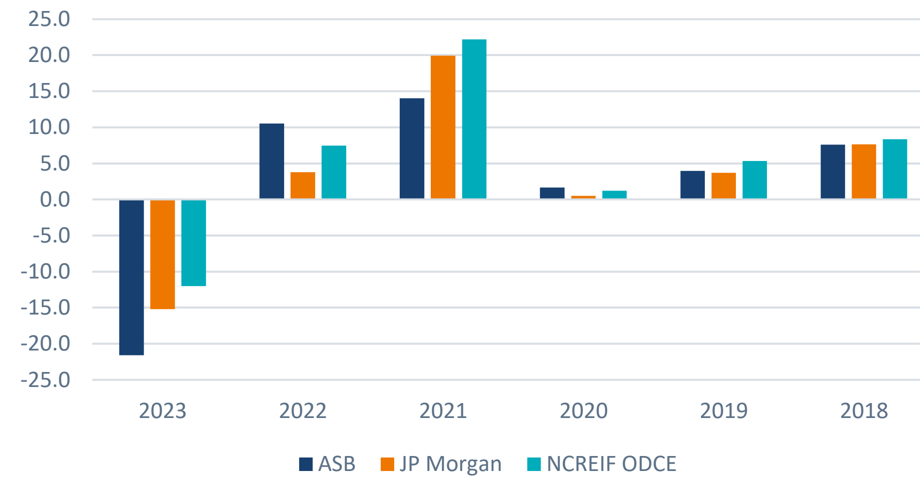
Performance by manager

	3 Mo	FYTD	1 Yr	3 Yrs	5 Yrs	10 Yrs	2023	2022	2021	2020	2019	2018	Inception	Inception Date
Core Real Estate	-6.4	-16.8	-20.3	-2.3	-0.3	-	-18.8	7.3	16.5	1.1	3.8	7.6	4.0	Oct-14
ASB Allegiance Real Estate Fund	-6.9	-17.5	-22.7	-3.5	-1.0	3.8	-21.6	10.5	14.0	1.6	4.0	7.6	4.2	Sep-13
JPMCB Strategic Property Fund	-5.7	-15.9	-17.4	-0.7	0.6	-	-15.2	3.8	19.9	0.5	3.7	7.6	4.4	Jul-14
NCREIF ODCE	-2.4	-8.8	-11.3	3.4	3.5	-	-12.0	7.5	22.2	1.2	5.3	8.3	6.6	

ANNUALIZED PERFORMANCE



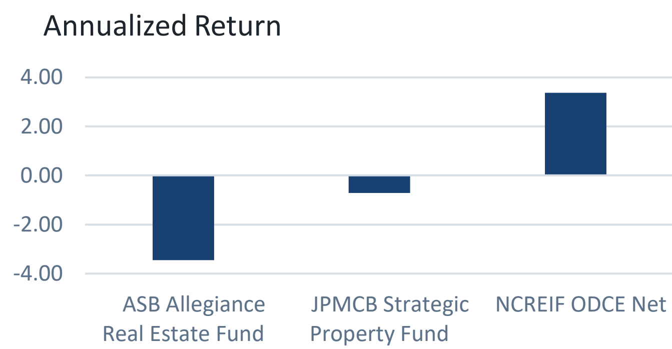
CALENDAR YEAR PERFORMANCE

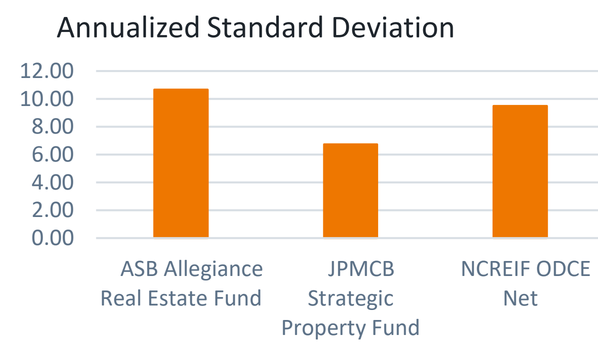


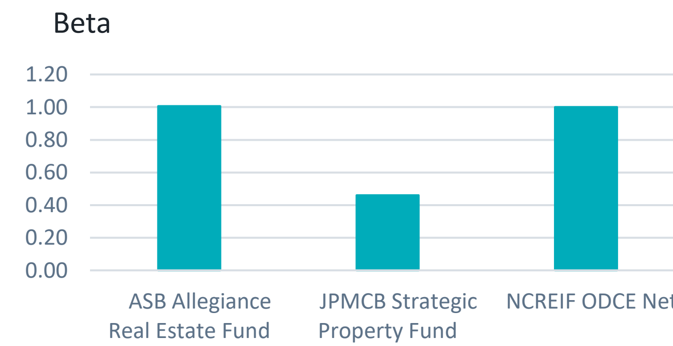
Notes:
Net-of-fee
Period ending 3/31/24

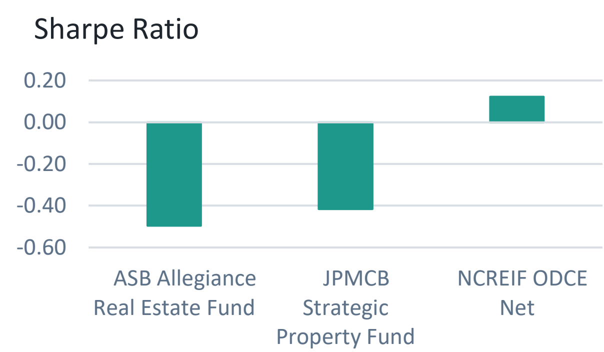
Other summary statistics

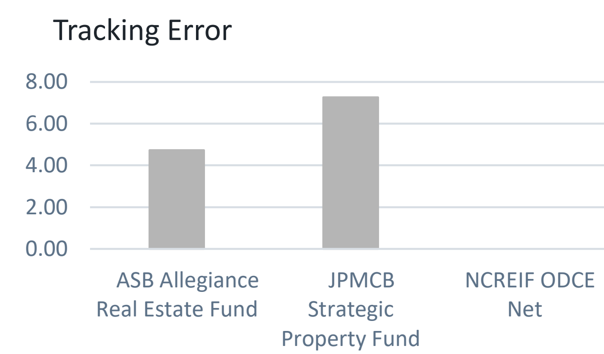
	Annualized Return	Annualized Standard Deviation	Beta	Sharpe Ratio	Tracking Error
Core Real Estate	-2.32	8.16	0.76	-0.53	4.38
ASB Allegiance Real Estate Fund	-3.45	10.67	1.01	-0.50	4.73
JPMCB Strategic Property Fund	-0.71	6.74	0.46	-0.42	7.26
NCREIF ODCE Net	3.37	9.51	1.00	0.12	0.00











Notes:
Net-of-fee
3-year period ending 3/31/24

ASB Real Estate

Strategy Inception: Sept 2013
Fee: 105 bps

STRATEGY DESCRIPTION

The Fund seeks to achieve above-benchmark investment performance through long-term net operating growth by investing in urban markets with strong real estate fundamentals and in assets that have competitive advantages that may drive long-term tenant demand. The Fund's investment strategy is characterized by a tenant-centric approach to asset selection that considers where tenants want to be and how they use space. The Fund seeks to achieve investment performance within the risk parameters appropriate for a core real estate investment fund by maintaining a portfolio that is well diversified by the core property types including office, multi-family, retail and industrial, as well as by maintaining strong geographic diversification across the nation's strongest metropolitan areas.

PERFORMANCE

- Returned -6.9% net for the quarter.
- Underperformed the NCREIF ODCE Index by 450 bps (-6.9% vs -2.4%)
- Gross return of -6.82% for the quarter, comprised of:
  - income of 82 bps
  - appreciation of -760 bps.
- Persistently high interest rates and a struggling office market continued to result in negative appreciation in real estate performance during the first quarter.
- The Fund registered quarter-over-quarter increases in NOI absorption, driven by gains in the industrial portfolio as well as improvements in multifamily and retail.
- Leasing activity spurred occupancy to edge higher across all sectors and write-downs eased except in the Fund's urban-centered office and retail portfolios.
- Portfolio occupancy increased modestly to 90.6% as of March 31st up from 89.9% at year-end 2023.
- More than 671,000 square feet of commercial leases were signed or renewed during the quarter in the commercial portfolio.

PROFESSIONAL TURNOVER (LAST 3 YEARS)

	Acquisitions		Dispositions		Property Management		Portfolio Management	
	Gained	Lost	Gained	Lost	Gained	Lost	Gained	Lost
2021	5	5	n/a	n/a	n/a	n/a	1	1
2022	2	(3)	n/a	n/a	n/a	n/a	0	(1)
2023	4	(4)	n/a	n/a	n/a	n/a	1	0
YTD 2024	0	(1)	n/a	n/a	n/a	n/a	0	0

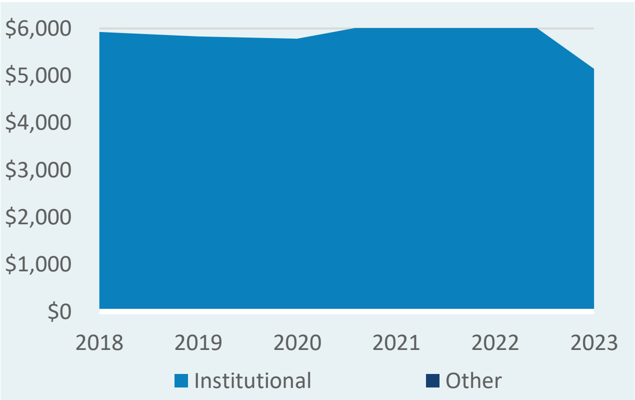
As of 2021, Dispositions and Property Management is included in Acquisitions

CLIENT TURNOVER (LAST 3 YEARS)

	Assets ($MM)			Accounts		
	Gained	Lost	Net	Gained	Lost	Net
2021	$186	($629)	($443)	0	0	0
2022	$218	($335)	($117)	3	(14)	(11)
2023	$9	($84)	($75)	4	0	4
YTD 2024	$0.4	($21)	($21)	0	0	0

Assets gained includes capital from new clients, existing clients, and reinvested dividends

ASSET GROWTH ($MM)



COMMENTS / CONCERNS

N/A

Source: ASB, Verus
As of March 31, 2024

Verus

JP Morgan Strategic Property Fund

Strategy Inception: Jul 2014
Fee: 100 bps

STRATEGY DESCRIPTION

Strategic Property Fund is an actively managed diversified, core, open-end commingled pension trust fund. It seeks an income-driven rate of return of 100 basis points over the NCREIF Property Index over a full market cycle (three-to-five-year horizon) through asset, geographic and sector selection and active asset management. The Fund invests in high-quality stabilized assets with dominant competitive characteristics in markets with attractive demographics throughout the United States.

PERFORMANCE

- Returned -5.7% net for the quarter,
- Underperformed the NCREIF ODCE by 330 bps (-5.7% vs -2.4%).
- Gross return was -5.5% for the quarter, comprised of:
  - income of 93 bps
  - property depreciation of 643 bps
  - debt mark-to-market depreciation of 11 bps.
- Quarterly valuation of real estate investments resulted in an overall value decrease of 630 bps.
- The office sector was the primary detractor for the quarter with depreciation of 437 bps due to capital market adjustments across the portfolio.
- The industrial sector was the second largest detractor for the quarter primarily driven by higher capital market assumptions at various California holdings.
- The residential portfolio recognized depreciation of 64 bps as a result of decreased market rents in Seattle, WA and increased capital market assumptions Sunnyvale, CA.
- The retail portfolio continues to be the most resilient sector in the Fund during this period of re-pricing as operational outperformance and tempered valuations have mitigated the impact of cap rate expansion.
- Disposition activity included a transaction that was among the largest retail sales completed in the post-COVID era.

Source: JP Morgan, Verus

As of March 31, 2024

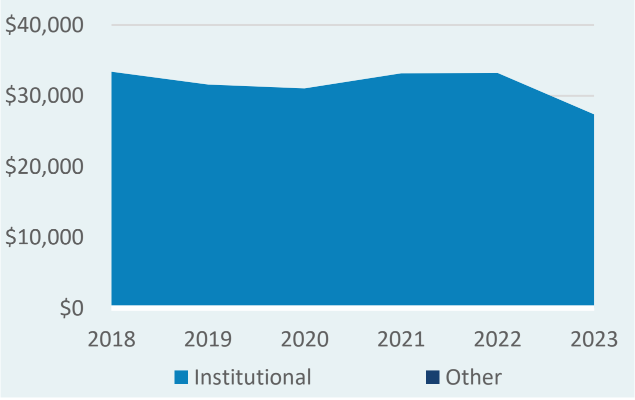
PROFESSIONAL TURNOVER[1] (LAST 3 YEARS)

	Acquisitions		Dispositions		Property Management[2]		Portfolio Management	
	Gained	Lost	Gained	Lost	Gained	Lost	Gained	Lost
2021	2	(4)	0	0	0	(3)	0	(1)
2022	0	0	0	0	7	(7)	0	(2)
2023	0	0	0	0	14	0	0	(1)
YTD 2024	0	0	0	0	2	0	0	(5)

CLIENT TURNOVER (LAST 3 YEARS)

	Assets ($MM)[3]			Accounts[3]		
	Gained	Lost	Net	Gained	Lost	Net
2021	$1,780	($5,479)	($996)	11	(72)	10
2022	$1,088	($2,584)	($3,699)	11	(9)	(61)
2023	$2	($1,210)	($1,208)	2	0	2
YTD 2024	$176	($300)	($124)	8	0	8

ASSET GROWTH[4] ($MM)



COMMENTS / CONCERNS

1 - Includes U.S. Real Estate investment professionals, Vice President and above. It excludes promotions

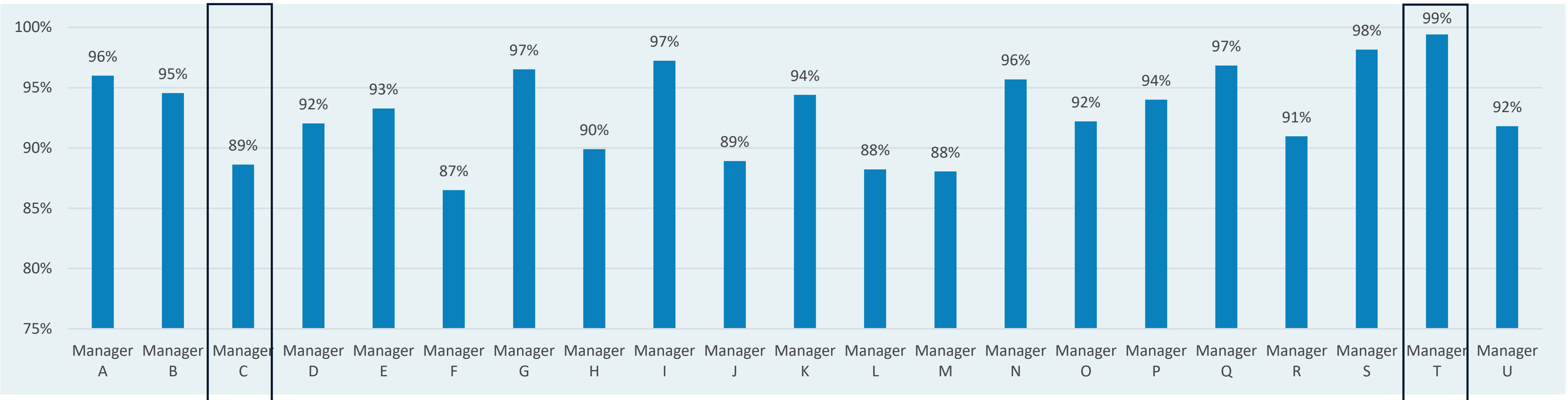
2- Property Management represents Asset Management

3- Assets gained and lost represent complete as well as partial contribution and redemptions during the year whereas # of Accounts gained and lost represent fully redeemed and new accounts.

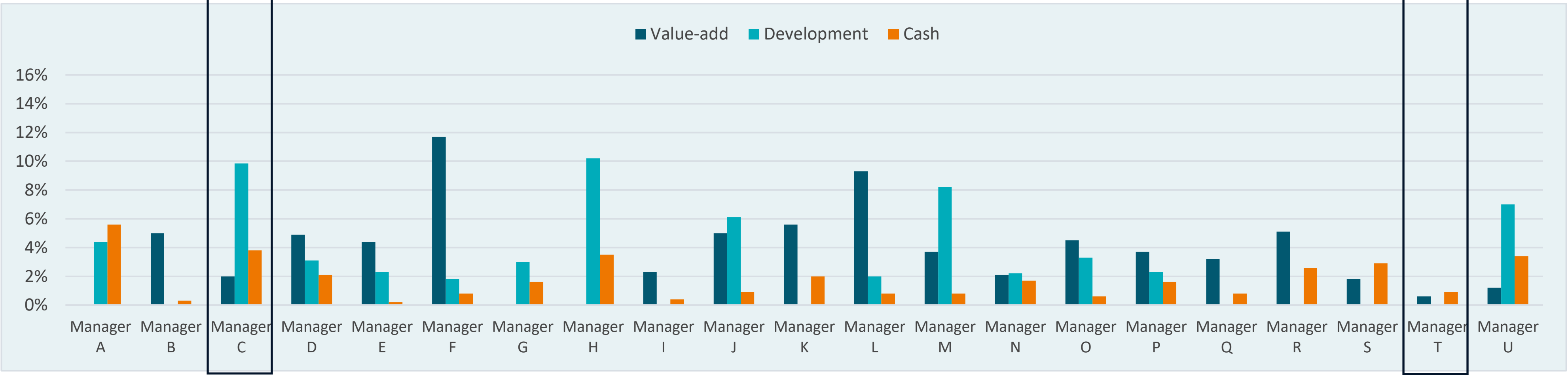
4- Total product assets represent AUM of the fund.

Core and non-core exposures

CORE REAL ESTATE EXPOSURES



NON-CORE EXPOSURES AND CASH



Source: Verus Annual Survey 2024. Data collected through 12/31/23.

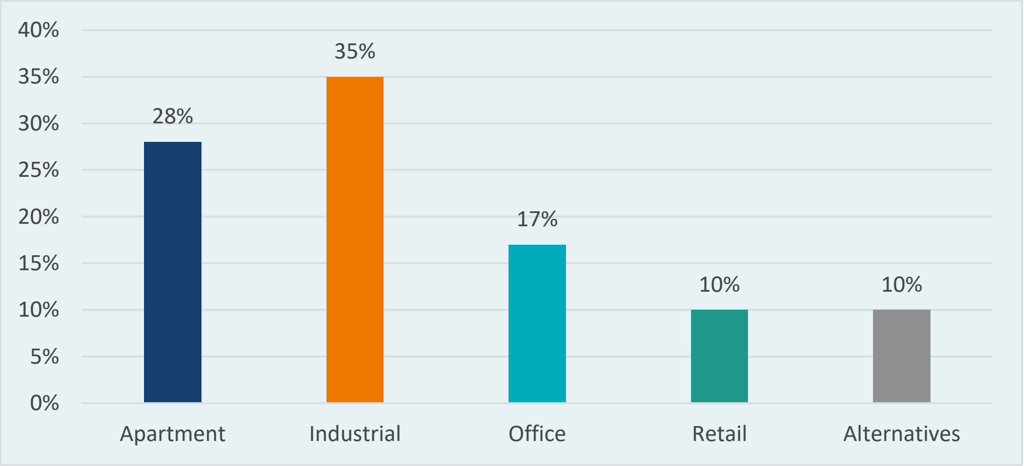
Primary sector exposures

– Total office exposure as a percentage of fund assets have been cut in half over the last two years as valuations have declined the most in this sector and funds have looked to shed office where they can. Average office exposure is down to 17%, which is down from 21% last year and 35% two years ago.

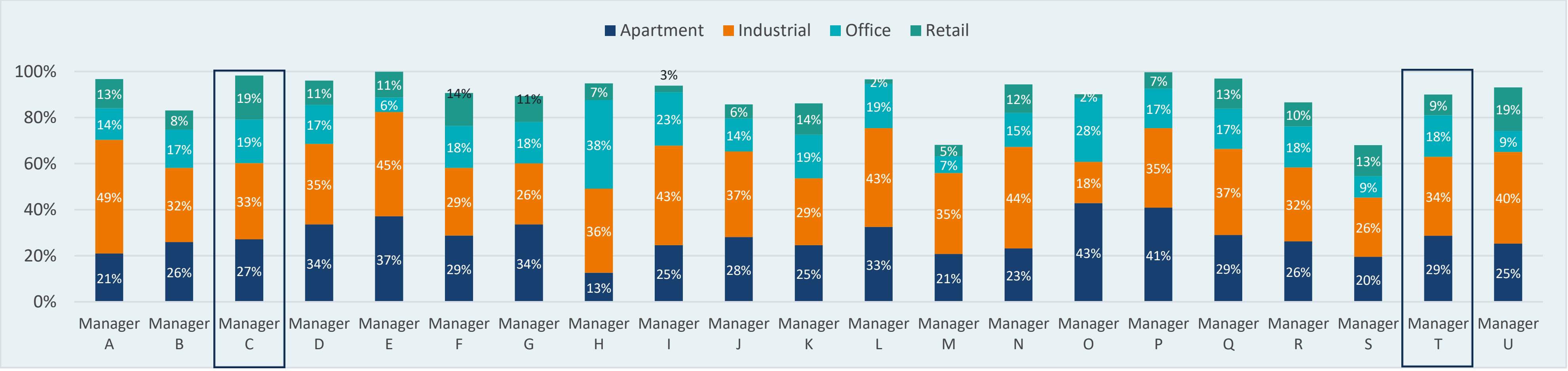
– Concern within office is higher for aging, multi-tenant CBD assets, versus suburban or offices in high growth markets.

– Alternative property types are now up to 10%, which has continued to see increases as a percentage of fund assets (see page 6).

AVERAGE MANAGER WEIGHTS IN PRIMARY REAL ESTATE SECTORS



PRIMARY REAL ESTATE SECTORS

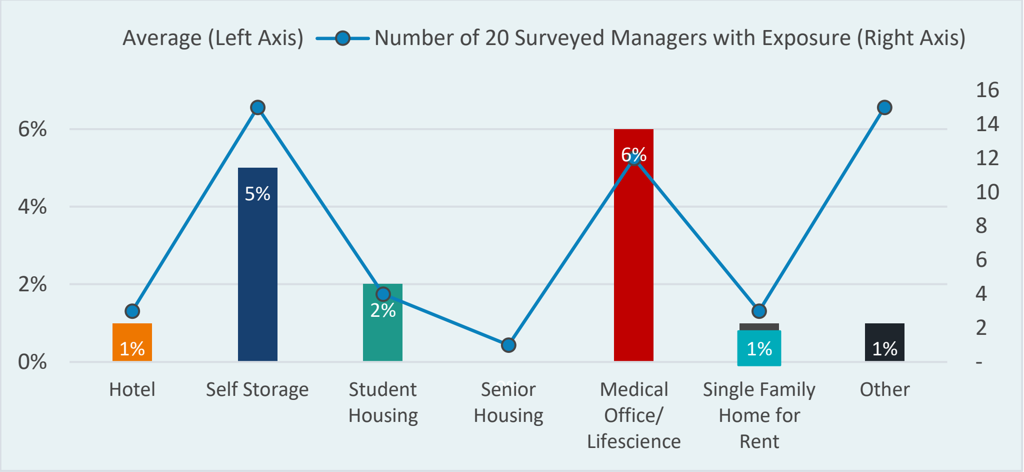


Source: Verus Annual Survey 2024. Data collected through 12/31/23.

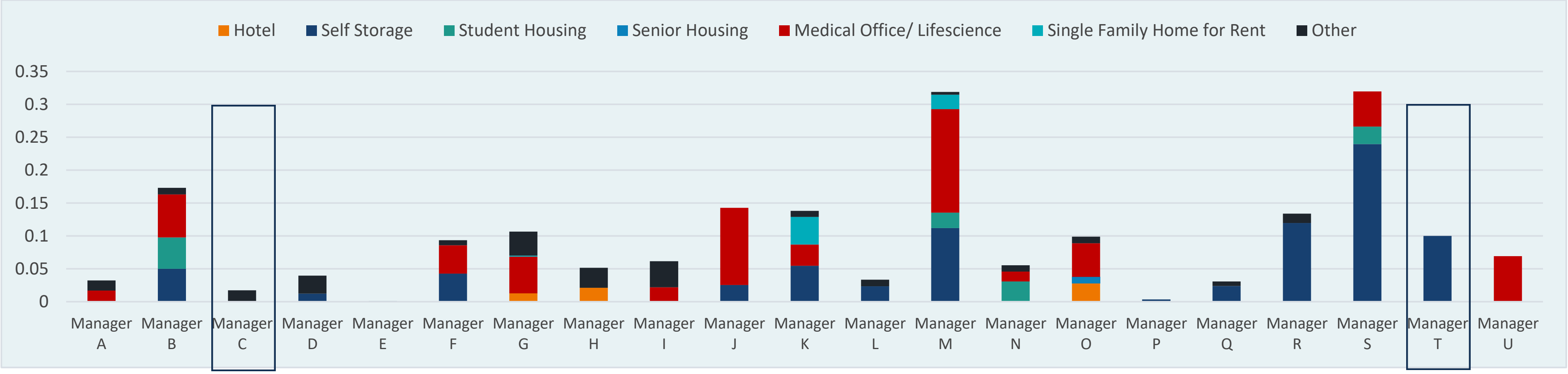
Alternative sector exposures

- Alternative property types or “other” (self storage, senior/student housing, life science, single family rentals) comprise 10% of total core fund allocations, up from 4% two years ago.
- Many funds hold less than 5%, meaning these sectors continue to be underrepresented in many portfolios.
- We expect core funds to increasingly move allocations lower for office and grow exposure to alternative property types, shifting the definition of what are “Core” sectors

OTHER SECTOR AVERAGES (FOR THOSE MANAGERS WITH EXPOSURE)



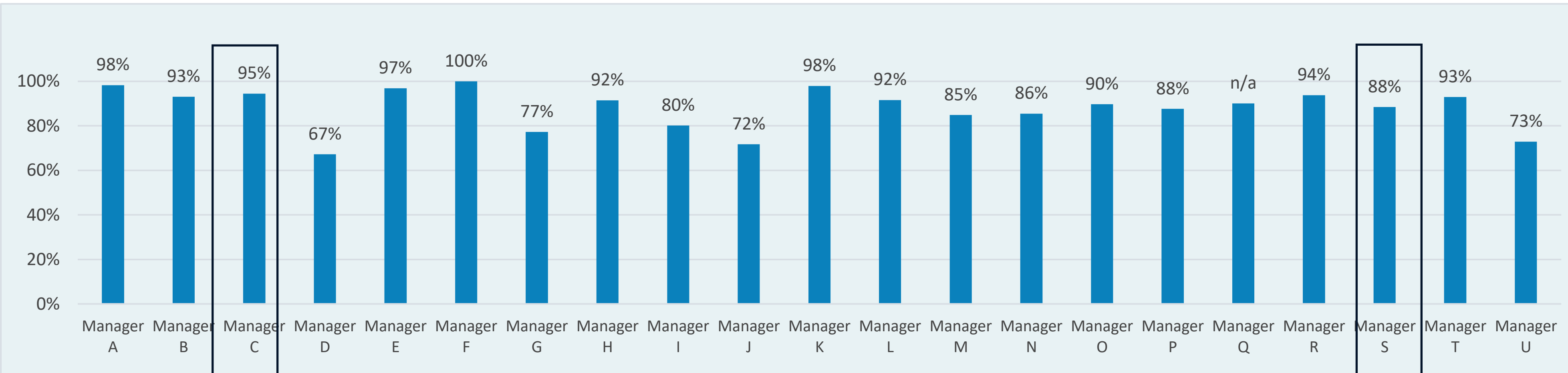
OTHER REAL ESTATE SECTORS



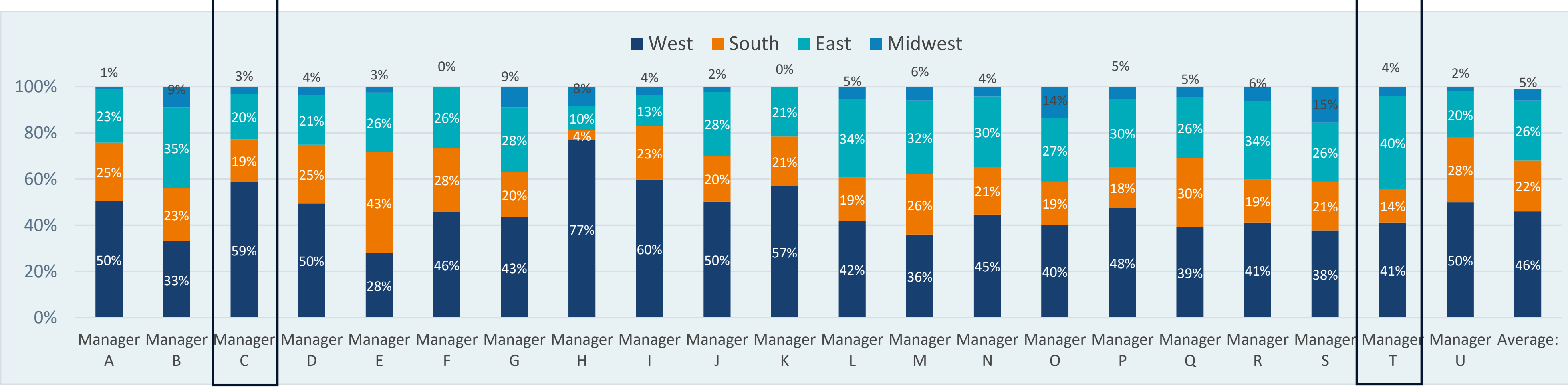
Source: Verus Annual Survey 2024. Data collected through 12/31/23.

Top MSA and regional exposures

TOP 20 METROPOLITAN STATISTICAL AREA (MSA)



REGIONAL EXPOSURE

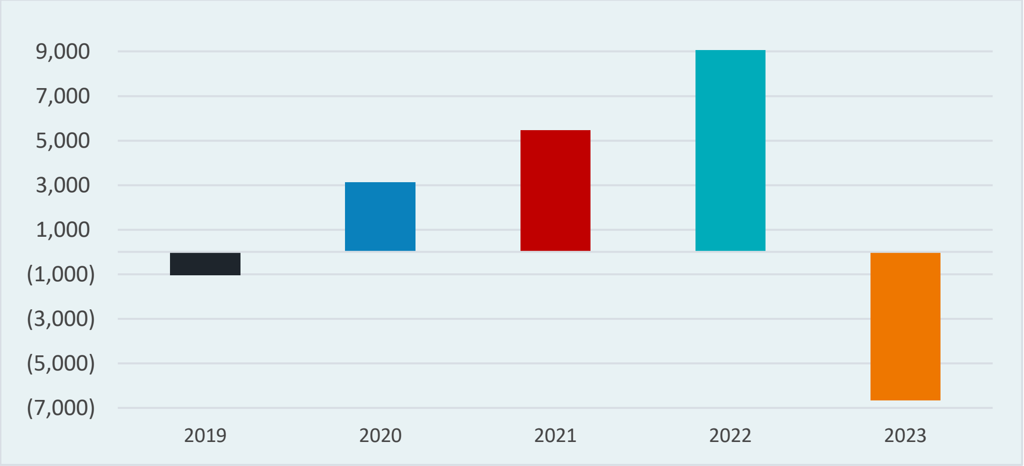


Source: Verus Annual Survey 2024. Data collected through 12/31/23.

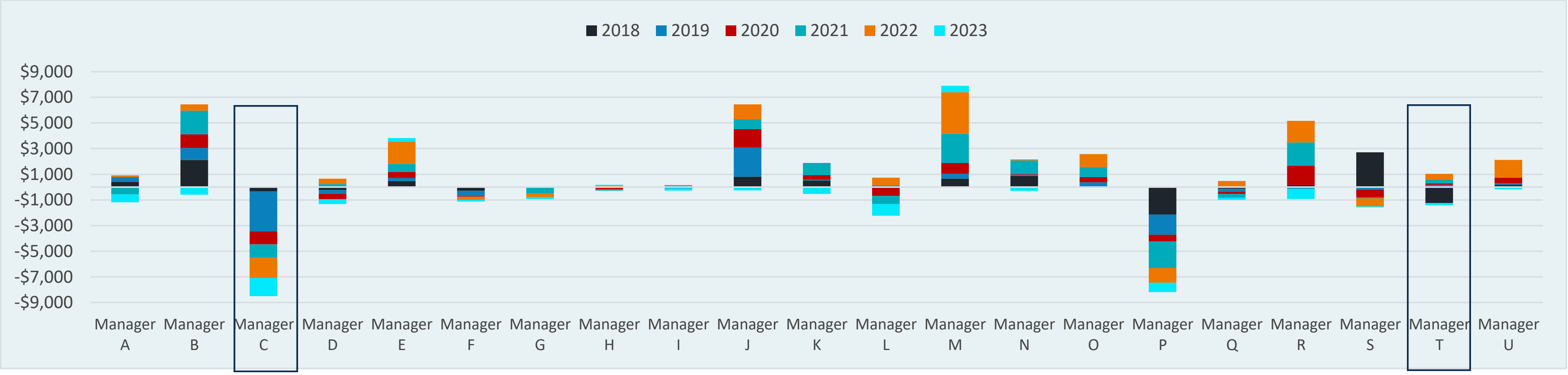
Transaction activity

- The charts on this page provide a high-level net view of purchases and sales activity.
- In aggregate, funds sold more than they purchased for the first time since 2019, driven by the growing redemption queues in the funds.
- Transaction activity across the entire real estate market fell off sharply in 3Q'22 and has remained low through 2023 as the market has been repricing to higher interest rates.
- Much of the sales in recent years have come from large funds with large redemption queues.
- Additional individual fund details can be found on p. 18.

TOTAL NET VALUE OF PROPERTIES PURCHASED MINUS SOLD ($MM)



NET VALUE OF PROPERTIES PURCHASED MINUS SOLD ($MM) BY MANAGER



Source: Verus Annual Survey 2024. Data collected through 12/31/23.

Core Real Estate Entry/Exit Queues

- Redemption queues have continued to increase dramatically. Exit queues were at $10 billion at the end of 2021, rose to $33 billion by the end of 2022 and were over $39 billion at the end of 2023.
- The average fund has a redemption queue of 17% of NAV currently. This is up from 13% at the end of 2022.
- Redemption payments slowed significantly as the transaction market was essentially shut down. In the calendar year 2023, only $5.7 billion was paid out, which was less than 15% of the redemption queues.
- The average time expected to make full payments is over a year from this point, with several funds expecting to take multiple years to fully pay redemptions.

		Investment Queue			Redemption Queue			
Manager	NAV ($mm) 4Q'23	Current Inv. Queue 4Q'23	% of NAV	Est. time for calling new commitments	Redemptions paid out 2023	Redemption Queue 4Q'23	% of NAV	Est. time for making full payments
Manager A	$5-$10B	$2	0%	3 Months	$162	$890	13%	12 Months
Manager B	>$20B	$1	0%	N/A	N/A	$5,293	17%	N/A
Manager C	>$20B	$831	3%	1-3 Months	$1,210	$6,200	23%	N/A
Manager D	$5-$10B	$597	7%	3-6 Months	$125	$1,351	15%	0-3 Months
Manager E	$5-$10B	$347	6%	3-6 Months	$145	$352	6%	N/A
Manager F	$1B-$5B	$0	0%	0-3 Months	$30	$604	29%	12-18 Months
Manager G	$1B-$5B	$213	5%	6-9 Months	$60	$626	14%	N/A
Manager H	$1B-$5B	$0	0%	0 Months	$31	$3	0%	12 Months
Manager I	$1B-$5B	$0	0%	0-3 Months	$56	$84	5%	12 Months
Manager J	$10B-$20B	$0	0%	N/A	$1,094	$3,284	24%	N/A
Manager K	$10B-$20B	$0	0%	3 Months	$200	$2,521	23%	N/A
Manager L	$5-$10B	$0	0%	0 Months	$111	$1,540	28%	12 Months
Manager M	$5-$10B	$0	0%	0-6 Months	$145	$690	9%	6-18 Months
Manager N	$10B-$20B	$0	0%	N/A	$622	$1,463	11%	1-2 Months
Manager O	$5-$10B	$326	4%	3-6 Months	$40	$1,015	12%	1-3 Months
Manager P	$10B-$20B	$0	0%	3 Months	$225	$6,519	60%	24-36 Months
Manager Q	$5-$10B	$25	0%	0-3 Months	$170	$753	14%	3-6 Months
Manager R	>$20B	$34	0%	3 Months	$1,152	$3,160	13%	N/A
Manager S	$5-$10B	$60	1%	3-6 Months	$0	$1,678	19%	24 Months
Manager T	$5-$10B	$0	0%	3-6 Months	$84	$885	17%	9-12 Months
Manager U	$1B-$5B	$69	2%	6-12 Months	$81	$374	11%	12-24 Months
Total:	$208,728	$2,505			$5,743	$39,286		
Average:	$9,939	$119	1%	4 Months		$1,871	17%	12 Months

Source: Verus Annual Survey 2024. Data collected through 12/31/23.

Summary

ASB

- Mid Size ODCE Fund
- Positive track record over the very long term, but has had several recent years of underperformance reducing trailing returns
  - Underperformance has been driven by positioning going into Covid, with higher office exposure than peers and lower industrial exposure than peers, along with higher leverage
  - The fund has worked to transition from these areas and is currently more neutral weight No changes in personnel driving performance. The same team generated returns that were top of ODCE for 10 years post GFC
- Strong labor policy and responsible contractor policies.
- Loyal client base
- Redemption queue is $880M (17% of NAV), equal to average among peers
- Sector exposures right on ODCE weights. Office exposure at 18% (average is 17%). Alternative property types make up 10% of portfolio (all self-storage)
- Leverage is higher than peers at 31%
- Medium conviction strategy going forward

JP MORGAN

- One of the largest core funds with a 40+ year track record
- Typically holds larger assets; major metro focus
- Has had recent and intermediate performance issues
  - 10 year (6.3% vs 7.3% ODCE) -1.0% relative
  - 3 years (2.7% vs 4.9% ODCE) -2.2% relative
    - Higher leverage than peers at 30% now (27% is avg)
    - Higher office exposure historically – although has come down to 19% (vs. 17% avg.)
- Retail is much higher than peers at 19% (vs. 10% avg.); They own several large A-quality supermalls
- Some recent PM turnover, but very deep and experienced team and firm resources overall
- Redemption queue is one of the largest in the ODCE at $6.2B (23% of NAV), higher than peers on $ and %.
  - Will take long time to clear given the size
  - Fund will likely be more on defensive with little ability to acquire opportunistically.
- Lower conviction strategy going forward
  - Large redemption queue (23% of NAV vs. 17% peer average).
  - Recent PM change.

IV. Potential improvement opportunities

Considerations

Question	Response
Is the CRE portfolio meeting its objectives?	Yes. Despite a significant decline last year due to rising rates and an impaired office sector resulting from an increase in work-from-home trends, KCERA's core real estate allocation has acted as a good diversifier to the overall portfolio over the past 5 years
Is CRE SAA exposure appropriate for KCERA?	We believer the strategic allocation is currently appropriate. We would not recommend a target weight below 5% and may consider an allocation up to 10% as the asset class begins to recover.
Does KCERA need two core managers; are there alternative structures that may work better?	JPMorgan and ASB were hired as complementary managers with different investment styles and approaches that were expected to provide alpha (excess return) diversification. These expectations have not been met through the last market cycle, and a broadly diversified approach, described below, is suggested.

A broadly diversified approach

DESCRIPTION

- **Diversification:** This strategy aims to diversify risk by mixing lower-risk, stable assets with higher-risk, potentially higher-return investments. By doing so, it seeks to achieve a more favorable risk/return profile than investing solely in either high-risk or low-risk properties.

- **Flexibility and Exposure:** It allows investors to explore new opportunities and sectors without significantly altering the risk profile of their overall portfolio. For example, an investor might add a satellite position in a high-growth urban retail space or in a new residential development project.

- **Efficiency:** A broadly diversified approach can also be efficient in terms of management and transaction costs. The core properties, being stable and less management-intensive, help keep overall costs down, while the satellites allow for targeted positions to take advantage of specific trends or market sectors.

POTENTIAL SATELLITE POSITIONS

- Non-Traditional Core Sectors, e.g.:
  - Senior Housing
  - Student Housing
  - Manufactured Housing
  - Medical Office
  - Life Sciences
  - Outdoor Storage
  - Parking
  - Data Centers
  - Triple Net Lease Strategies*
- Other:
  - Land bank
  - Cell towers
  - Public REITs
  - Infrastructure
  - Real Estate Debt

A broadly diversified approach in core real estate investing can be used to effectively balance risk and return by combining a large "core" segment of the portfolio with one or more smaller "satellite" investments

**A commitment has been made to a Triple Net Leasing Strategy, which will be funded over the next few years*

Potential next steps

- Conduct market survey to ensure best core manager(s) is/are utilized
- Conduct ongoing investigation of diversifying opportunities

Date: August 2, 2024

To: Trustees, Investment Committee

From: Daryn Miller, CFA, Chief Investment Officer
Geoff Nolan, Senior Investment Officer
Jack Bowman, Senior Investment Officer

Subject: **Core Real Estate Recommendation**

RECOMMENDATION

Staff recommends a $50 million commitment to TPG AG's Essential Housing Financing Fund III ("Fund"). This commitment will be part of KCERA's ("Plan") core real estate asset allocation.

CORE REAL ALLOCATION

As stated in the Plan's Investment Policy Statement ("IPS"), "The primary goals of the core real estate allocation are income generation, positive correlation to inflation, and diversification."

As of March 31, 2024, the Plan had $248 million dollars allocated to two different managers in the core real estate allocation, which represents a 4.3% allocation with a policy target allocation of 5% and an adjusted policy target allocation of 6.3%.

TPG ANGELO GORDON

Angelo Gordon is a leading alternative investment firm, specializing in credit and real estate strategies. Founded in 1988, the firm has a global presence with offices in Europe, Asia, and North America. The firm has more than 650 employees and $74 billion in assets under management ("AUM"). In May of 2023, TPG acquired Angelo Gordon in a cash and equity transaction valued at $2.7 billion. The combined organization currently manages over $220 billion in AUM and has over 1,800 employees spread across 31 offices globally.

BACKGROUND

The Essential Housing Fund ("EHF") was launched in 2020. The Fund was formed around one of the largest investment grade homebuilders in the United States, Lennar Corporation, and subsequent funds were launched at a greater scale with the addition of more homebuilders due to its success. EHF is a transformative vehicle that provides homebuilders flexibility with capital efficient off-balance-sheet financing for short duration, close-to-production land inventory. Essential Housing Funds 1 and 2 have generated a net IRR greater than 11%. EHF 3 will continue their partnerships with the 11 established homebuilders with a targeted net return of 13-15%, higher than the returns for EHF I and EHF II due to higher base rates.

ANALYSIS

Market Opportunity

EHF provides homebuilders flexibility with capital efficient off-balance-sheet financing for close-to-production land inventory. Homebuilders benefit from:

- Capital light source of financing
  - Creating capital efficiency and improved earnings without capitalization changes.
- Positive credit ratings impact: rating agencies prefer land purchase options given their ability to (1) limit downside, and (2) allow homebuilders to avoid utilizing existing debt facility capacity thus limiting added leverage.

Structure

EHF deals are structured as contractual repurchase obligations between the homebuilder and the Fund for the contractual repurchase of the asset (land) at cost (which includes improvements) plus a required yield. The land assets plus improvements serve as collateral. Should the builder not perform under their option agreement, both the undeveloped land and, in particular, the developed land, are valuable assets. These assets are in the homebuilder's better communities and can be monetized quickly, thus reducing downside risk for EHF.

Investment Thesis

The underlying thesis is a unique capital solution (i.e., a "land bank") that takes advantage of the constrained housing supply.

Development of new homes has been depressed since the Global Financial Crisis ("GFC") and a housing stock shortage persists today. With lessons learned from the GFC, homebuilders have better matched their sales pacing with the supply of new homes. Supply constraints also limit how much new supply can be added to the market.

Additionally, the available supply of resale homes remains constrained due to the rise in mortgage rates, diverting that demand towards the new home market. This further exacerbates the existing new home supply/demand imbalance.

Finally, the housing industry has shifted to utilize land banks as it recognizes the capital structure advantages. EHF has been the leader in this space and offers attractive investment characteristics.

Essential Housing Fund Investment Characteristics:

- Direct ownership of land collateral
  - No foreclosure required.
  - EHF finances homebuilders' assets at a discount to fair value:
    - Land basis: Public builders can purchase land for better pricing, often receiving discounts due to larger scale purchases and certainty of close.
    - Value added development: Horizontal site improvements completed by the homebuilder to create a fully improved lot ready for vertical constructions requiring operating expertise and is a value-add process.
    - Builder deposit: Builder at-risk deposit is 19.9%.

- Short tenor
  - No option agreement longer than 40 months.
  - EHF retains the right to accept new projects on a rolling basis.
- Amortization
  - Monthly payments consist of amortized principal plus yield.
  - Amortization causes rapid de-risking.
    - Reducing the breakeven of an average project to ~14 months.
  - Monthly payments typically commence within six months and continue throughout the life of the project.
- Custom built portfolio
  - EHF has complete control over the selection of projects.
- Yield enhancement from prepayment
  - Homebuilders are permitted to accelerate repayment but are subject to a minimum MOIC.
- No risk of structural / temporal subordination
  - EHF does not share its collateral with any other creditors.
- Proprietary access to deal flow
  - Contractual exclusivity with Lennar / otherwise “functional exclusivity” through price – builders is economically motivated to show EHF a project first as they are generally the lowest cost of capital.

Risks and Considerations
Essential Housing Fund’s risks can be summarized as counterparty risk, key man risk and market risk. EHF has structural considerations in place to mitigate these risks and protect capital.

- Counter party credit risk – Homebuilders cannot meet their contractual obligations
  - 19.9% downpayment from the homebuilder.
  - Diversified geographic locations and partners.
  - Enhanced value of assets through land improvements.
- Key Man risk – There are three individuals that are key to the operation: Ryan Mollett (Portfolio Manager), Bryan Rush (Portfolio Manager), and Steve Benson (Head of Asset Management Team). All have extensive tenures with the strategy.
  - Key man risk is mitigated through non-compete clauses as well as consideration of external solutions in the event of Steven Benson’s absence.
- Market risk – Potential for housing demand to dwindle due to economic factors
  - The fund has “Pause Provisions” in place
    - In the event of a significant market decline, instead of termination, builder and EHF may mutually agree to designate a Pause Provision for a period not to exceed six months following the last completed takedown.

Vehicle and Terms
The Fund has a draw-down structure, similar to our other Private Market investments, where the manager calls capital, and the fund has a set end date.

The Fund has a target size of $3 billion, of which TPG AG is committing $500 million. The Fund’s investment period is 30 months, with one 3-month extension at General Partners’ discretion plus one 3-month extension with LP approval. The Fund’s harvest period is 24-36 months.

Fund terms include, a) 0.50% management fee (calculated on total assets including leverage), and b) 15% carried interest over a 7.5% preferred return with an 80/20 GP/LP catch-up.

Consultant Recommendation
Verus, our general consultant, has provided a recommendation memo.

<u>CONCLUSION</u>
This is an attractive investment opportunity with an institutional quality manager that should be a positive addition to the core real estate allocation.

Memorandum

To:	Investment Committee, Kern County Employees' Retirement Association
cc:	KCERA Investment Staff
From:	Scott J. Whalen, CFA, CAIA, Managing Director|Senior Consultant
Date:	August 2, 2024
RE:	TPG AG Essential Housing Fund III

Background

KCERA's investment strategy includes a policy allocation to core real estate of 5% with a current allocation of 4.2% or approximately $244 million (as of June 30, 2024). Core real estate has traditionally been characterized as an investment in an open-ended commingled fund that invests in office, multi-family housing (apartment), retail, and light industrial (warehouse) properties. Most of the return in a core fund comes from stable rental income in fully-leased or nearly fully-leased properties. More recently, property types included in the "core" sector have expanded into other building types such as medical office, self-storage facilities, and student and senior housing.

KCERA's current allocation to core real estate is invested in two separate strategies managed by ASB and JP Morgan, respectively. Both managers invest largely in traditional core property types, and both, like many other core strategies, have been hurt by the pandemic-induced downturn in office properties and the impact of rising interest rates on valuations.

Given the recent performance challenges, KCERA Investment Staff launched a research initiative to explore the idea of investing in strategies that extend beyond traditional core real estate to identify ways to increase risk-adjusted returns. One such strategy is a triple-net lease fund that was recently approved by the Board and is currently being added to the portfolio. The TPG AG Essential Housing Fund III ("the Fund") is also a strategy that resides outside the traditional definition of core real estate but is being included in the allocation as a diversifier with the expectation it will complement and improve the risk/return profile of KCERA's current holdings.

This memo describes the investment thesis behind the Fund, outlines its expected return and risk profiles, and provides our view on its merits.

Strategy Description

Overview

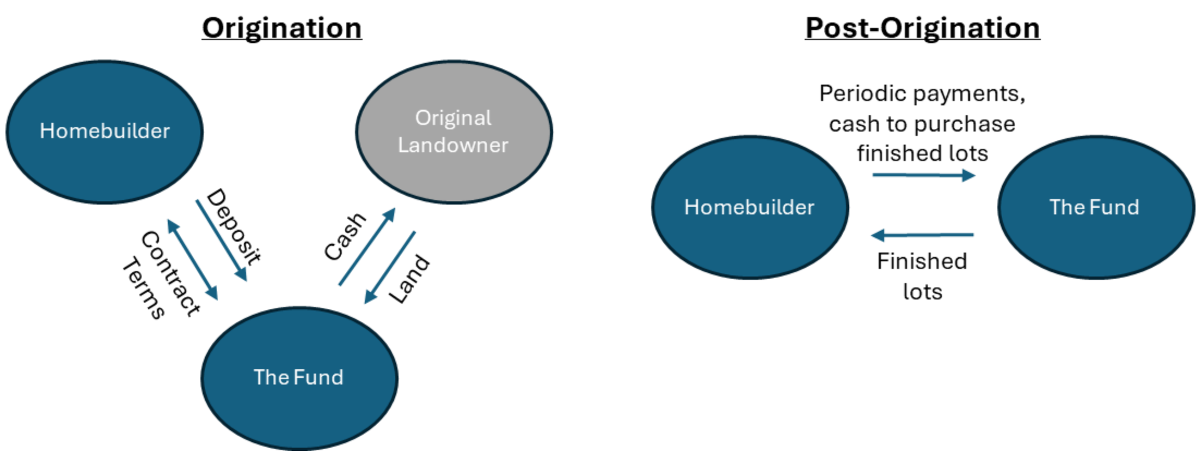
The TPG AG Essential Housing Fund III is a real estate debt fund designed to take advantage of an ongoing strategic shift in the homebuilding industry, i.e., removing raw land from company balance sheets. This "asset light" approach was pioneered by NCR, the fourth largest residential real estate developer in the nation and resulted from the firm's near bankruptcy in the early 1990s. Historically, homebuilders purchased tracts of raw land and held them on their balance sheet while they prepared the land for development. This tied up capital and also led to operational volatility as the residential real estate market was impacted by broader economic cycles. Moving the land off balance sheet allows a homebuilder to focus on its core competencies of constructing and selling new homes. Other significant benefits to the homebuilder include:

- Lower capital requirements;
- Lower exposure to market economic risks;
- Improved credit rating; and
- Increased operational flexibility.

Mechanics

This off-balance sheet objective is achieved through a structure that is akin to an option-based repurchase agreement, resulting from the following process. First, the homebuilder identifies a plot of land on which it would like to build. The Fund then steps in and buys the land on behalf of the homebuilder. At the same time the homebuilder acquires an option to repurchase the land from the Fund at a future date in exchange for reimbursement of the original cost of the land plus a pre-specified yield (it is this structure that leads to the return characteristics of a debt investment). Once the land is acquired, the homebuilder prepares it for development (e.g., grading, sewage, roads), while at the same time making a series of payments to the Fund to maintain the purchase option. Once the buildable lots are finished, the option is exercised, and the construction-ready land is delivered to the homebuilder.

The graphic below describes the process at a high-level through the transaction stages.



Fund History

The fund under consideration is the third fund in the Essential Housing Fund series. The first fund was initiated in 2020 and was considered a "proof of concept", working with just one homebuilder, Lennar (the second largest homebuilder in the U.S.). The first fund is currently in the harvest phase of the investment cycle and has so far achieved a 12.2% net IRR, compared to a 12-13% targeted return. The second fund expanded the number of participants in the fund from one to 11 homebuilders. It is currently entering the harvest phase and has so far achieved a return of 11.5% return with a 12-13% life-of-fund target. Fund III is in the portfolio construction phase and is targeting a net IRR of 13-15%

Risk and Risk Mitigation

The biggest risk associated with this investment is that the counterparties (homebuilders) are not able to meet their contractual obligations, most probably due to a downturn in the economy leading to falling home prices. There are multiple layers of protection built into the structure of the Fund to reduce the risks associated with this scenario, including:

- Selection of high-quality projects with strong forecasted economics
- 19.9% upfront option fee (down payment)
- Land improvements enhance value of collateral throughout the process
- Geographic diversification

Manager analysis estimates capital loss to Fund investors would require a sustained nationwide decline in the average sales price ("ASP") of a home of 20-25%. For context, the ASP during the Global Financial Crisis was 24%.

Verus Position

Verus agrees with the approach of diversifying KCERA's core real estate fund exposure, and we further believe the TPG AG Essential Housing Fund III will help achieve this and also improve the expected return of the overall core real estate asset allocation.