ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM
BOARD OF RETIREMENT
2223 E. WELLINGTON AVENUE, SUITE 100
SANTA ANA, CALIFORNIA

INVESTMENT MANAGER MONITORING
SUBCOMMITTEE MEETING
February 2, 2017
9:00 A.M.

MINUTES

The Chair called the meeting to order at 9:05 a.m. and read the opening statement into the record. Attendance was as follows:

Present: Frank Eley, Chair; Russell Baldwin and Charles Packard

Absence: Thomas Flanigan, Vice Chair

Also present: Steve Delaney, Chief Executive Officer; David Beeson, Investment Officer; Adam Cheng, CFA, Investment Officer; Stina Walander-Sarkin, Investment Analyst; Anthony Beltran, Visual Technician; and Julius Cuaresma, Recording Secretary

A. INDIVIDUAL MANAGER PRESENTATIONS

Mr. Beeson introduced True North and its Real Estate Fund III. He noted that this real estate debt manager recently presented to the Committee in May 2016, but staff decided to bring in the manager off-cycle so that the manager could discuss a current labor union issue they are facing. He stated that OCERS committed $50 million in June 2014 and committed an additional $50 million in July 2015.

Mr. Packard asked if staff expected the manager to have concentration in the office sector, presently over 70% of the portfolio.

Mr. Beeson responded that this amount of concentration is unexpected, but in the context of the entire OCERS real estate portfolio, staff does not have a concern.

Mr. Packard asked if staff has any concerns regarding the manager's geographical exposure.

Mr. Beeson responded that staff does not have any present concerns, but True North does tend to focus on secondary cities, which is a diversifier relative to the rest of OCERS' real estate managers.

Mr. Baldwin requested research on the long-term sustainability of investing in union versus non-union businesses.

TRUE NORTH MANAGEMENT GROUP
Presentation by Paul Turovsky & Brent Morris

The key highlights of the presentation were:

Firm update: True North's Real Estate Fund III had its final close in July 2015 with $548 million. Fund III is the only active investment vehicle, thus it is the sole focus for the principals and the team. True North had the following changes in staff: Craig Perrotta joined in October 2015 as CFO, replacing Desmond McGowan. Desmond's departure was mutually agreed upon and amicable. True North also added a senior controller and assistant controller to augment their accounting resources and four new analysts to support the senior deal captains.

Market Overview/Outlook for 2017: True North has called down 46% of OCERS' commitments, with 10-15% that is imminently pending to be called. This leaves approximately 40% left of OCERS' commitment, with 18 months of the investment period remaining.

Portfolio Strategy: True North looks for transitional assets (temporarily troubled or undervalued assets) where performance has suffered from excessive financing, undercapitalized owners, and/or operational mismanagement). The manager seeks to improve these mispriced assets and then sell at a premium to their original investment and improvement costs.

Performance: Thus far, Fund III has made 25 investments and has sold two investments. The portfolio does not have any underperforming assets at this point. As of September 30, 2016, the fund has generated a 13.5% net IRR with a 1.11 multiple since inception.

Mr. Eley expressed his concern with True North's investment in a Phoenix Hilton property, which has a labor union dispute with Unite Here, a hotel employee union. He noted that approximately 70-80% of OCERS' members are in unions. He asked for the manager's pending timeline as it relates to resolving this labor issue.

Mr. Turovksy responded that True North is not anti-union, as a posture or policy or as a firm. He explained that True North as a firm does not have much experience with unions. Historically, about 10 years ago, they had an issue with a union (which was subsequently resolved), but as a lender, which differs in this case where True North is an equity holder.

Mr. Baldwin questioned True North's hiring of legal firm Jackson Lewis; he noted this firm is known as a specialized "union-buster" or anti-union legal firm.

Mr. Turovsky responded that True North is the financial partner and that the operating partner, HB Hospitality Ventures, hired Jackson Lewis. He reported that True North recently hired Prospect Hotel Advisors, who are considered to be knowledgeable about unions, and from what he understands, has a respectable relationship with Unite Here. True North has a much higher sensitivity to these issues; he explained that he expects a turning point in this issue and that all relevant parties will meet in the near future.

Mr. Baldwin observed that it seems as if True North is dragging their feet, as this issue has been lingering for quite a bit of time. He questioned if the manager has a hard date or something more compelling in the process or timeline going forward.

Mr. Turovsky replied, understanding OCERS' sensitivity, and assured that they will keep OCERS' staff updated and apprised as developments occur.

Mr. Eley observed that True North works with troubled assets, so this situation should not have been a surprise.

Mr. Turovsky explained that a public REIT owned the property, with Hilton as the manager. Prior to investment, True North knew that there were unresolved issues on-site. True North stepped into the investment with the expectation that there were good employee compensation and benefit plans.

Mr. Eley asked, observing that True North has a large concentration in the office sector, for the percent of their office portfolio that is union versus non-union.

Mr. Turovsky responded that he does not have that number offhand. He explained, however, most of their office investments are in smaller cities or in suburbs, which tend to be less unionized.

Mr. Eley asked if True North and/or the industry have done any sort of IRR analysis on investments that are union versus non-union. Additionally, Mr. Baldwin asked how True North evaluates properties, union versus non-union.

Mr. Turovsky responded that a number of factors affect an investment's IRR, primarily: 1. Different wage rates; 2. Different work rules; and 3. What's the perception in the marketplace. True North has not done the specifically questioned IRR work, but does not believe there is a standard. There is a potential for an economic impact of union versus non-union, but they understand that certain factors and circumstances play a part in the IRR. He reported that the property is not in strife and it is operating.

Mr. Morris added that True North would not necessarily avoid properties just because it is unionized, describing that in their due diligence process, union versus non-union is something that is factored and underwritten when they invest.

Mr. Weintrobski, Mission Viejo, addressed the Committee about the labor union dispute issue and the manager's timeline.

Mr. Baldwin asked about the CFO's departure and whether True North knew about his pending departure when OCERS made its additional commitment in July 2015. Discussing key man risk and if there is a formal succession plan, he also asked if the manager has learned anything from his departure and if there is a focus on retaining their senior staff so as to ensure the firm's stability.

Mr. Turovsky responded that Desmond McGowan did not leave until after Fund III closed. He noted that this was similarly discussed at the Manager Monitoring Subcommittee Meeting in May 2016: he views this departure positively, as new eyes and ears were brought into look at their business operations. New knowledge of the industry is refreshing. He outlined True North's history of very little personnel turnover – particularly since many of their senior people have also worked with each other at Bankers Trust and Deutsche Bank. He reported that McGowan left amicably and that ultimately McGowan wanted to move to the next level above CFO and run his own business. He also explained that they are strengthening their back-up levels, with the addition of the senior and assistant controllers. Regarding a True North succession plan, he reported that they are working on it, and expect to move on it shortly.

Mr. Beeson asked True North to discuss the rest of Fund III's investment period and the expected build out, particularly as it relates to their concentration in the office sector.

Mr. Turovsky responded and described a number of newer transactions outside of the office sector, including multi-family investments. He outlined that they are still simultaneously looking at mispriced and unique office opportunities.

Mr. Morris explained that, in this market, True North has to underwrite to imperfection: they have to finalize such transactions immediately and then sell at all-time highs. However, he noted that True North, at their present asset size, they are still nimble and can capitalize on these one-off opportunities.

Mr. Baldwin asked about True North's geographical concentration, observing that about 45% of the portfolio is in the southeast.

Mr. Turovsky responded that, given their background, one would think that True North would naturally invest in the northeast. That said, he described that the northeast opportunity set is fractured: New York differs from New Jersey, which differs from Connecticut. He reported that New York City has attractive offices, but there is an abundance of new construction. Prices and valuations are in excess of their ideal entry points. That in mind, they are seeing concessions for the first time in recent history, i.e., first month free, which suggest that prospectively, this area could be interesting. He also observed that commercial financing markets have been sloppy (except for West Los Angeles and San Francisco). Setting political views aside, he remarked that long-term True North is not sure what the new administration and deregulation could do to their portfolio; but potential deregulation efforts in the short-term would likely be constructive for True North from a selling standpoint.

The Committee recessed at 10:13 a.m.

The Committee reconvened at 10:21 a.m.

MESIROW FINANCIAL
Presentation by Bob Debolt

Mr. Beeson introduced Mesirow Financial, one of OCERS' private equity (PE) fund-of-fund (FoF) managers. He stated that OCERS' relationship dates back to 2006, when OCERS committed $60 million to their Private Equity Fund IV. OCERS presently has $180 million in commitments to Funds IV - VI. More recently in January 2017, Mesirow held its first close on their co-investment vehicle, Fund VII-B in which OCERS committed $40 million as part of the 2016 commitments.

Mr. Eley asked for a comparison of Mesirow's returns relative to OCERS' other PE FoF.

Mr. Beeson responded that a fair comparison is difficult to make because Adams and Abbott have annual funds, versus Mesirow's multi-year funds. Overall, however, he noted that performance has generally been strong, with Fund IV in the top quartile and Fund V in the second quartile.

The key highlights of the presentation were:

Firm update: Mesirow, an alternative asset manager (with some traditional assets) based in Chicago, now has 650 employees, with $32 billion in assets under management. The firm has benefited from low staff turnover.

Market Overview/Outlook for 2017: The PE fundraising environment was a crowded space in 2016 and is generally expected to be crowded in 2017 as well. The best PE funds continue to be quickly oversubscribed – Limited Partner (LP) access to such constrained General Partner (GP) capacity is more important than ever. Top quartile access is contingent upon existing relationships that GPs have cultivated over a number of years with the underlying PE operators. PE performance has been strong and is expected to continue to be so; further, significant amounts of distributions have been returned to LPs. The U.S. buyout market saw diminished deals year-over-year, as public equity market indices pushed price multiples higher. Venture capital firms, with more cautious market perspectives, have begun to counsel their underlying invested companies to moderate their spending. The secondary market, due to a supply-demand imbalance, looks frothy: excessive capital is chasing secondary offerings. Accordingly, Mesirow continues to stand on the sidelines, picking spots, as they wait for the next crack in the markets. Opportunistically, they are permitted between 5-15% in secondaries, but there is no obligation to do so.

Portfolio Strategy: Mesirow typically invests over 4 years in an effort to capture multiple points over a cycle. The manager selectively only invests around 8-12 partnerships per year (versus their competitors, who use a different model, investing in up to 30-50 partnerships per year).

Performance: The manager described the following characteristics for its funds:

- Fund IV: 2006 vintage with a loss rate less than 1%;
- Fund V: 2009 vintage that generated a 14.8% net IRR vs. 11.8% for the Median Private Equity FoF Benchmark;
- Fund VI: currently 86% committed; they have lined up about 6 likely investments such that the portfolio should be fully committed by April or May of 2017;
- Fund VII: co-investment vehicle that is in the beginning of its life cycle; the fund term and its investment period will start with the closing of its 1st investment in the 1st quarter of 2017.
    - The manager's co-investment portfolio is a more focused and more selective approach, with about 6-8 investments alongside PE managers that Mesirow has strong relationships with. Mesirow selects the best ideas of these PE managers and offers this co-investment vehicle at a significantly lower cost, as there are no FoF fees.

Mr. Packard asked about Mesirow's non-U.S. geographic allocations.

Mr. Debolt responded that Mesirow does have some Western European buyout funds. As a firm, they are generally more conservative outside of the U.S., so they have limited emerging market (including China, India, and Latin America overall) exposure.

Mr. Baldwin asked about the new administration in Washington, D.C. and the potential impact it could have on Mesirow's portfolios.

Mr. Debolt responded that their portfolio's duration covers many market cycles, investing/exiting over a number of years. He remarked that PE thrives in changing, transitional periods. Further, he observed the inherent difficulty in picking the best vintage year – therefore, Mesirow emphasizes a portfolio that has time diversification.

Mr. Eley suggested to the Committee that they remind themselves that some of the best investments years occurred in 2008 - 9. He noted the importance for the Committee to remember this, such that OCERS is already committed and ready to deploy. Citing his long tenure on the Committee and his experience through market cycles, he observed that PE investing needs consistent allocations, where there are investments in every vintage cycle. He emphasized that if one tries to market time PE, they will likely have missed the opportunity.

Mr. Debolt agreed as PE is a particular market not to be timed and as such, Mesirow diversifies by time as much as possible.

Mr. Eley recalled that Mesirow actually and impressively delivered their target returns. He noted his appreciation, recalling a number of successful products that the underlying PE managers funded.

Mr.Baldwin and Mr. Eley remarked that Environment, Social and Governance (ESG) investing, while typically a longer investment game, may be more profitable.

Mr. DeBolt responded that there is some evidence that there are higher returns. He described that one of Mesirow's first screens is for respectable and reputable firms – he stated that is how Mesirow keeps and maintains their top quartile relationships that lead to access to the next great transaction.

A **motion** was made by Mr. Baldwin and **seconded** by Mr. Packard to receive and file the manager presentations. The **motion carried unanimously.**

PUBLIC COMMENTS:
None

COMMITTEE MEMBER COMMENTS:
None

CHIEF EXECUTIVE OFFICER/STAFF COMMENTS:
Mr. Beeson reported that Meketa, at the February Investment Committee Meeting, will have their first review of the OCERS' PE allocation.

COUNSEL COMMENTS:
None

ADJOURNMENT:
The Chair adjourned the meeting at 11:12 a.m.

Submitted by:	Approved by:
Steve Delaney Secretary to the Committee	Frank Eley Chair