Municipal Police Employees' Retirement System
Minutes of the Meeting of the Investment Committee
October 18, 2023

The Investment Committee of the Municipal Police Employees' Retirement System held a Regular Meeting on Wednesday, October 18, 2023.

A. Call to Order

The meeting was called to order by Major (Retired) Kelly Gibson at 10:44 a.m.

B. Roll Call

Members Present

Major (Retired) Kelly Gibson, Chair
Chief Edwin Bergeron, Jr., MPERS Board member
Asst. Chief Jason DiMarco, MPERS Board member
Lt. (Retired) Chad King, MPERS Board member
Mayor Gerard Landry
Mr. Rick McGimsey, Commissioner of Administration designee
Mr. Julius Roberson
Lt. Tyrone Warren, MPERS Board member
Chief Beth Westlake, MPERS Board member
Chief Christopher Wilrye

Members Absent

Major Raymond Burkart, Jr.
Mayor Greg Cromer

Others Present

Mr. Benjamin Huxen II, MPERS Executive Director and General Counsel
Ms. Taylor Camp, MPERS, Chief Financial Officer
Ms. Emily Thurston, Accountant
Ms. Melissa Frazier, MPERS, Benefits Administrator
Mr. David Barnes, NEPC, Investment Consultant
Ms. Sheri Morris - Daigle, Fisse, & Kessenich
Mr. Greg Curran - Curran Actuarial Consulting, Actuary
Mr. Nate Bishop - HarbourVest, Managing Director
Mr. Ed Powers - HarbourVest, Managing Director
Mr. Darren Kleis - Principal, Managing Director
Mr. Bill Grayson, Principal, Managing Director
Mr. Greg Pittenger – Principal, Investment Advisor Representative
Ms. Ashlee McNeely, Executive Management Officer (virtual)
Mr. Matt McCue, FIN news, Managing Director
Mr. Claude Schlesinger, retired NOPD

C. Public Comment

Major (Retired) Gibson called for public comments. There were no public comments.

D. Approval of the July 19, 2023 Committee Meeting Minutes

Motion by Chief Wilrye, seconded by Lt. (Retired) Chad King, to approve the minutes of the meeting held July 19, 2023. Without objection, the motion carried.

E. New Business

1. Discussion and Action Regarding NEPC Report on Investments (Qualifies as Investment Training)

Mr. Barnes notified the committee that they would be hearing from two investment managers. He then reviewed the current market conditions and reviewed the September flash report. September was a difficult month with nowhere to hide except in cash. The fact that the Federal Reserve appears to be holding interest rates higher for longer has weighed on markets. Stocks were down across the board. Bond markets were also down. High yield bonds were down. The leveraged loan portfolio was the one piece of the portfolio that had appreciated.

The total fund ended the month at $2,466,376,652 with investment losses of $75.5 million. The rate of return for the month of September was -3%. The Fiscal Year to Date return for the first three months of the new fiscal year was -2.7%. Value stocks lost less than growth stocks in the month of September. The system's value managers outperformed markets while its growth managers underperformed. Within the international equity portfolio, KBI underperformed their benchmark but outperformed the broad market.
The system's bond portfolio outperformed the policy index. Overall, September was a tough month for investors. The returns for October through October 17th provided some relief with U.S. large cap stocks up with other stock segments down.

Mr. Barnes then turned his attention to the second quarter of 2023 NEPC Private Equity Report. He stated that the Private Equity portfolio still has a lot of good news. Throughout the history of the Private Equity investing program the system has committed $452.9 million and has had $128 million returned in distributions. Mr. Barnes stated that the money weighted rate of return for the portfolio has been about 15.8% annually.

Mr. Barnes informed the committee that HarbourVest, the money manager that manages the system's Fund of One, would be making a presentation on their portfolio. He directed the committee members to lines 3 and 4 of the Private Equity report. He stated that lines labeled "Tranche I-1" were the investments made by HarbourVest while those labeled "Tranche L" were the legacy investments currently being handled by HarbourVest. Returns for those funds were 17.2% for the legacy funds, and 17.53% for the new investments.

2. NEPC Private Markets Education (Qualifies as Investment Training)

Next, Mr. Barnes discussed the Private Markets Investment Education document prepared by NEPC. He stated that private markets are significantly different than the public market investments. Private market investments involve providing capital in the form of equity capital or debt capital to companies in the private market.

For the most part, publicly traded stocks and bonds offer daily liquidity. This is not the case in the private market portfolio. Invested capital in the private markets is typically locked up for 10 to 12 years. These investments involve an expected return premium over public markets and have been used as a return enhancer. Private investments must be invested over time for diversification. This requires Boards to make a commitment where committed funds are called as the money manager finds investment opportunities. It may take up to 5 years for money managers to call the full commitment. By that time, the portfolio will have returned capital from the early investments. Therefore, if the system commits $20 million, even at the peak of the fund, they may only have $15 million invested.

For these investments, managers must use an appraisal to determine a value for invested capital. Such portfolios do not have valuations available daily like public markets. Public investors are typically passive owners of a company, but private investors buy a company and are more involved in helping the company succeed. Within private investment portfolios, fees are more complex and are higher than fees in public markets. It is typical for investment management fees to be 1.5% to 2% of committed capital. This means that investors pay a management fee on the committed amount even before they call the entire commitment. After the investment period is over there is a fee on money invested. There is also typically a carried interest (a profit share with the money manager). The industry standard for carried interest is around 20% of the realized investment gain to the money manager with 80% going to the investor. Typically, the 80/20 split is assessed on returns above a preferred level of return like 8%. This means that the money manager doesn't typically get their 20% carried interest share until after earning the preferred return. Mr. Barnes stated that returns in the report are net of those fees. Net of fees, these investments have shown an historical premium over public stock markets.

The presentation described several different strategies in private equity and private debt. Among these strategies were venture capital, growth equity, buyouts, special situations, mezzanine, opportunistic credit, direct lending, distressed debt, and secondaries.

Venture capital represents higher risk private investments at the early stage of startup companies. Mr. Barnes stated that MPERS does not have a specific allocation to Venture Capital. Growth Equity represents capital for small, growing established businesses. Buyouts involved typically buying interest in well established companies. Special Situations could be a turnaround opportunity. On the debt side, there were investment categories from Mezzanine down to Distressed Debt. Opportunistic Credit could be industry specific opportunities or used to maneuver between different strategies. MPERS' private debt investment is focused on the Direct Lending side. Typically, direct lending involves high yield debt and a floating rate. Direct lending involved providing lending for a Private Equity company to buy another company.

Distressed debt may be companies with some balance sheet issues. Secondaries involve buying another investor's interest in a Private Equity or Private Debt fund. Secondaries focused on buying seasoned investments that were already returning capital. Secondaries would be purchased at a discount.

Mr. Barnes stated that among the NEPC client base, the average client currently has a 10% allocation to private markets. These clients invest in private markets because of the higher expected returns. Mr. Barnes reviewed a picture representing common flows related to a private investment fund. Such funds tend to fundraise for 0-2 years, have an investment period that is typically 1 – 5 years (where after that period, they cannot invest in new companies), go into a harvesting phase (years 4 -8), and finally enter a liquidating phase (years 7 - 12). Mr. Barnes then discussed J curve issues where an investor pays fees on committed capital in the beginning of the investment. In the first few years such investments do not typically record increasing valuations but have high fees. Negative early cash flows typically flatten out in years 3 through 5 and then returns spike in years 5 through 10.

On average these investments only have 70 to 75% of the commitment put to work at their peak. Therefore, NEPC does planning by forecasting out plan growth, what is expected related to capital call pacing and distributed capital pacing along with expected returns for the portfolio. With this modeling, NEPC determines how much the system needs to commit over the next few years to get to the target allocation.

In the case of HarbourVest, NEPC forecasted the upcoming four years and gave all of the necessary funds to HarbourVest to make the individual fund selections. Mr. Barnes stated that in the upcoming year, they would be looking at how we are doing with the pacing.

3. Presentation By HarbourVest on HarbourVest Frenchmen Street Fund, L.P. (Qualifies as Investment Training)

Nate Bishop, the head of investor relations, and Ed Powers, a leader in the Fund of One area presented for HarbourVest. Mr. Powers reviewed the Executive Summary describing HarbourVest as managing a fund with multiple Private Equity and Private Credit strategies for MPERS. The portfolio is made up of primary fund investments plus commingled fund commitments. Since inception, the fund has drawn down about $83 million with $9.2 million distributed through September 30, 2023.

He then discussed diversification by type of investment broken down by Primary, Senior Credit, Co-Investment fund, and Secondary fund. Most of the invested capital is deployed in the primary buyout and most in North America.

Mr. Powers stated that the investment is on schedule and compared the tactical plan to the actual investments. He stated that the goal would be to capture potential outperformance by picking a diversified set of strategies.

Within the presentation, Mr. Powers discussed portfolio progress by reviewing the list of primary fund managers chosen for MPERS. These managers were displayed in order of oldest investment to youngest investment with no one investment too large versus the total.

They then discussed the performance for Tranche-I which is a mixture of four separate strategies, Dover Street, Direct Lending, Co-Investment, and primary funds. The Dover Street portion is already generating distributions and is driving returns. The secondary exposure is driving the portfolio early where the other areas will drive performance later.

He then reviewed the HarbourVest Direct Lending I portfolio. With recent increases in yields, the portfolio has found deals with yields around 11%. There has been a healthy deal flow, but the deal flow is down due to higher yields. There have been low default rates in this environment. There is a potential for a small increase in default rates, but the portfolio has seen only modest defaults. The total value to paid in capital is currently 1.1x with a net internal rate of return of 8.8%.

The Co-Investment Fund just started investing in 2021 and has recently seen realized gains from a couple of deals. The Secondary program, Dover Street, began investing in 2019, with commitments through 2022. It represents the most mature area of the investment, where the portfolio is already starting to see distributions with a 1.6x multiple and a 36.9% return level. The fund has called about 65% by June 2023 and about 68% to date. The portfolio has been extremely diversified with 3,000 to 4,000 companies in it.

The Legacy Co-Investment Fund IV has distributed 100% of the capital committed to the fund. It is a mature and fully invested fund and any future capital calls will likely be offset by distributions. In the Co-Investment Fund V, there have been distributions equal to about 30% of capital and 80% of the capital has been called.

The committee thanked HarbourVest for their presentation.

4. Presentation By Principal Global Investors (Qualifies as Investment Training)

Bill Grayson and Darren Kleis made a presentation related to the Principal US Property Account. Bill Grayson stated that MPERS had been invested with Principal for about 20 years, which makes MPERS one of Principal's longest standing clients. Bill Grayson stated he has been with the Board annually since 2003 but notified the Board that he was retiring at the end of the year. He introduced his replacement, Greg Pittenger, and Darren Kleis Managing Director.

In the 20 years invested in the Principal portfolio, MPERS has experienced two negative years, including 2023. During 2023, the portfolio is recognizing some declines in value. The Federal Reserve policy of higher interest rates for longer really affects real estate. It is still a very challenging environment for real estate. How the firm executes the strategy is very important.

Mr. Grayson gave an update on the investment team. He stated that MPERS had originally invested $55 million in the fund, has added $47 million in additional investment over 20 years, has taken out almost $60 million in distributions, and now has an account value of $192 million.

Mr. Kleis stated that at the end of June 2023 the portfolio had an occupancy rate of 94.2% and a one-year net absorption of 894,006 square feet representing areas occupied today that were not there a year ago. He stated that Principal was in the business of being a landlord and that they managed 159 investments throughout the country in the U.S. Property Account.

He discussed the fact that they were taking a little more of a defensive posture since they were a little cautious about their investment strategy. The team was monitoring and mitigating risk. He stated that as investors they could not control interest rates, but that they could control the management of leases and costs.

Rick McGimsey asked how they have avoided occupancy rate reductions and discussed how hybrid work and Covid had impacted office buildings. Mr. Kleis stated that in every other category in the portfolio occupancies are very high.

Occupancies are almost 100% in industrial and apartments, and the portfolio had almost no retail occupancy issues. Regarding the office portfolio, about 82% was leased as of June 30th. He stated that they were seeing a flight to quality in the office sector, where tenants are moving to higher quality buildings. Overall, 19% of the portfolio is in the office sector with almost 70% in multifamily and industrial.

He reviewed a test case in the industrial sector that was just built at the Port of Houston which is already leased.

In the Residential sector the portfolio had student housing and manufactured housing including an RV park near Orlando. The portfolio also owns 176 single family homes in growth markets as well. Principal had started selling office buildings when the cost of putting tenants in place increased. Most of that portfolio was sold pre-Covid and they have continued reducing the allocation.

Within the retail sector the portfolio owns no malls. They usually look to have a dominant grocer in their retail developments.

The portfolio currently has about a 12% allocation to alternative property sectors like student housing, manufactured housing, age restricted housing and self-storage. They would like to increase that allocation to about 25%.

The portfolio derives more of its return from income than the index and has a track record of growing income at a faster pace than the market.

Mr. Barnes asked about how Principal was managing their withdrawal queue. Mr. Kleis stated that much of the queue came in the 4th quarter of 2022. The reasons for asking for a distribution varied by client from being overallocated to real estate to an effort to avoid write-downs. He stated that they expected a number of these investors to rescind their requests which occurred in the past. Principal made $125 million available in the 3rd quarter of 2023. In addition, they have a large inbound queue of almost $600 million.

Mr. Kleis stated that they have sold some properties and that they have some for sale. The reason for limitations on withdrawals is the lack of liquidity which has happened before in the 40-year history of the products. Mr. Barnes reminded the Board that they had asked for a $30 million redemption because the real estate portfolio had succeeded when everything else fell and the portion of the portfolio in real estate increased. To date, Principal has paid out a portion of the redemption request – approximately $2.6 million.

The committee thanked Principal for their presentation.

Mr. Roberson asked about whether NEPC has concerns with performance or the management of the Principal fund. Mr. Barnes stated that NEPC had no concerns about Principal as a manager.

Mr. Barnes completed the private market education discussing real assets which includes real estate along with infrastructure. Infrastructure investments include hard assets that support critical functions. They tend to be long-duration assets like toll roads and cell towers with stable cash flows similar to real estate. They tend to operate in a regulated environment that protects the investment.

Mr. Barnes stated that real estate investments have been illiquid in the worst of times and now in the best of times. He added that, for this reason, the system needed to change their perspective on real estate despite its claim of quarterly liquidity. Instead, he suggested considering a diversified portfolio called Real Assets, which would include real estate. NEPC would like to model what it would look like to take some of the Principal fund and put it in a real assets/infrastructure investment. He added that if these assets are going to be illiquid, the system should invest in areas of the market with a higher return profile. He suggested that the Board may want to diversify their portfolio in the real assets area.

Major Gibson asked about fees. Mr. Barnes stated that Principal had low fees at 80 basis points versus an average of 100 basis points for other core managers. Mr. Roberson asked about their returns. Mr. Barnes stated that some managers have been quick to write down assets and some have been slow to do so. Therefore, it's hard to put too much emphasis on their relative performance.

F. Other Business

There was no other business to discuss.

G. Adjourn

A motion was made by Chief Wilrye, seconded by Mr. Roberson, to adjourn the meeting at 12:21 p.m. Without objection, the motion carried.

Next Meeting Date is to be determined.

To the best of my knowledge, the foregoing minutes accurately represent the actions taken at the meeting held October 18, 2023.

Major (Retired) Kelly Gibson, Chairman	Ben Huxen, Executive Director and General Counsel