



Investment Program

MANAGER DUE DILIGENCE – PRIVATE MARKETS

Police and Fire Investment Committee

California Government Code - GOV § 6254.26

(a) Notwithstanding any provision of this chapter or other law, the following records regarding alternative investments in which public investment funds invest shall not be subject to disclosure pursuant to this chapter, unless the information has already been publicly released by the keeper of the information:

- (1) Due diligence materials that are proprietary to the public investment fund or the alternative investment vehicle.*
- (2) Quarterly and annual financial statements of alternative investment vehicles.*
- (3) Meeting materials of alternative investment vehicles.*
- (4) Records containing information regarding the portfolio positions in which alternative investment funds invest.*
- (5) Capital call and distribution notices.*
- (6) Alternative investment agreements and all related documents.*

Recent Private Markets Discussions

Private Markets Strategy

Overview of program including objectives, constraints, and philosophy.

Presented in Oct 2020

Pacing Plan

Annual recommendation of commitment amounts to implement asset allocation.

Presented in Apr/May 2021

Performance Reporting

Quarterly presentations by consultants on portfolios and investments.

Presented in Jun 2021

Asset Class Reviews

In depth updates on specific private markets asset classes.

Scheduled for Dec 2021

Key Elements of Strategy

1. **Ensure beta exposure above all else.**

Failure to execute the pacing plan guarantees not meeting objectives envisioned within the asset allocation.

Implication is that consistent commitments and vintage diversification matter more than anything else, including manager selection.

2. **Alpha is an outcome of process.**

The plans can achieve their objectives without alpha, but alpha is likely required to justify the Private Markets allocation.

Sources of alpha can be choosing: better sub-sectors (beta timing), managers who are better at choosing the right investments (security selection), manager who operate more effectively (value creation), capital structure optimization (risk decomposition).

Consistently harvesting alpha from those sources requires a competitive advantage relative to all sources of private capital, which must be deliberately developed and maintained.

3. **Alignment of interests can overwhelm most other investment factors.**

Agency conflicts increase with (a) distance from the asset and (b) dispersion of ownership.

Fees are the result of a buy-versus-build decision and market forces.

Constraints

Most constraints on the plan are deliberate governance and resource decisions, but one critical constraint is immutable.

California Public Pension Status

California public pension plans have transparency requirements in accordance California government code. These requirements are limiting to the extent that (a) certain investment managers do not want to be subject to such disclosures; and (b) Board and staff risk appetites are altered by non-economic forces, such as headline risk.

Governance

- Investment Policy Statement
- Minimum qualifications – registered under Advisor’s Act or similar, fiduciary standard consistent with law, size and nature of mandate consistent with asset allocation, concentration limits;
- Concentration limits –
 - Max 15% with any private fund manager
 - Total asset class commitments max 150% of approved annual pacing plan
 - Per primary fund commitments max 2% of plan assets (first allocation to a manager) or 3% of plan assets (follow-on)
 - Per secondary fund investment max 1% of plan assets
 - Co-investments must be approved by Board

Resources

The availability and reliability of resources has the largest impact on strategy and execution, and includes:

- Time – the only resource that cannot be enhanced;
- Capabilities – personnel, external advisors, technology;
- Budget – the constraint on enhancing capabilities.

Pacing Plan

Federated

(in \$ mm)






	FY 20-21		Pacing Plan				
	<u>Pacing Plan</u>	<u>Actual</u>	<u>FY 21-22</u>	<u>FY 22-23</u>	<u>FY 23-24</u>	<u>FY 24-25</u>	<u>FY 25-26</u>
<i>Private Markets</i>	107	79	162	162	187	193	178
Buyout	13	13	50	50	75	75	60
Venture	30	15	30	30	28	28	28
Private Debt	24	16	28	28	28	32	32
Private Real Estate	20	16	28	28	28	30	30
Private Real Assets	20	20	26	26	28	28	28

Police & Fire

(in \$ mm)

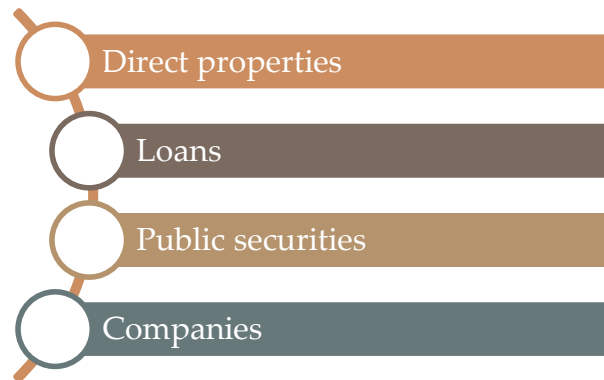
	FY 20-21		Pacing Plan				
	<u>Pacing Plan</u>	<u>Actual</u>	<u>FY 21-22</u>	<u>FY 22-23</u>	<u>FY 23-24</u>	<u>FY 24-25</u>	<u>FY 25-26</u>
<i>Private Markets</i>	156	125	189	243	243	272	277
Buyout	13	13	25	75	75	100	100
Venture	32	29	40	40	35	35	35
Private Debt	48	28	48	48	48	50	50
Private Real Estate	30	24	40	40	45	45	50
Private Real Assets	33	32	36	40	40	42	42

Private Markets Asset Classes

Buyout		<ul style="list-style-type: none"> • Large Buyout • Small-/Mid- Buyout • Special Situations • Other 	<p>Equity investments in growing, established, and mature companies, with enterprise values generally ranging from \$20mm to \$20bn.</p>
Venture		<ul style="list-style-type: none"> • Fund-of-funds • Direct funds • Co-investments 	<p>Primarily equity investments in start-ups and high growth companies.</p>
Debt		<ul style="list-style-type: none"> • Par Credit • Securitized • Stress/Distress • Other 	<p>Debt investments include credit expected to pay back original principal and interest (par credit), loans and bonds that have been packaged into special purpose vehicles (securitized), securities where the obligor is in a stressed or distressed financial situation (stress/distress), and unique strategies that have some or all the characteristics of debt investments.</p>
Real Estate		<ul style="list-style-type: none"> • Value-Added • Opportunistic • Real Estate Debt • Other 	<p>Equity and debt investments in operating companies and physical properties where the economic value is derived primarily through real estate-related activities. Value-added and opportunistic are distinguished by the level of risk associated with an investment.</p>
Real Assets		<ul style="list-style-type: none"> • Infrastructure • Energy • Natural Resources • Other 	<p>Investments in operating companies and physical assets where the economic value is derived primarily from the development, production, transport, or processing of natural resources, and the facilities supporting their downstream progress.</p>

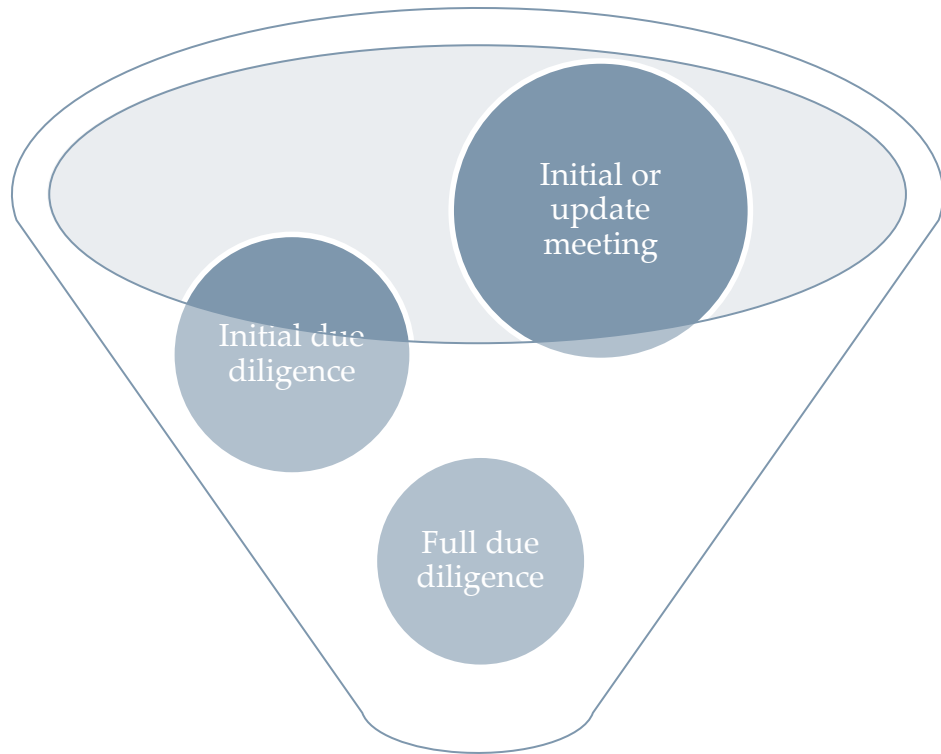
Due Diligence – Desired Exposures

- Sector
- Geography
- Risk level
- Investment types



Due Diligence – Sourcing

- Relationships
- Unsolicited introductions
- Consultants
- Peers
- Industry publications
- Pitchbook
- eVestment



Due Diligence – Evaluation

- Using information advantages
- ILPA due diligence tools
- Supplemental data requests
- Performance appraisal
- Commitment sizing
- Managing scoring

	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Manager A															
Manager B															
Manager C															
Manager D															
Manager E															
Manager F															
Manager G															
Manager H															
Manager I															
Manager J															
Manager K															
<i>Cambridge US</i>															
<i>Opp RE - Med</i>	8.2%	12.2%	19.4%	16.1%	14.3%	8.9%	11.0%	11.1%	7.5%	9.1%	2.8%	-5.6%	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>

Scoring Matrix	Weaker					Stronger
Investment	1	2	3	4	5	
Team	1	2	3	4	5	
Timing	1	2	3	4	5	
Risk	1	2	3	4	5	
Terms	1	2	3	4	5	
Fees	1	2	3	4	5	
Transparency	1	2	3	4	5	
Control	1	2	3	4	5	

Appendix

IPS – Delegated Authority

A. The CIO's authority to select and terminate investment managers shall be subject to the following general constraints and parameters:

1. Investment managers shall meet the following minimum qualifications to be selected to manage any assets of the fund:

a. Be registered as an investment advisor under the Investment Advisor's Act of 1940 or comparable legislation, unless the manager represent and warrants that it is exempt from such registration under applicable law.

b. Agree to enter into a contract with the Plan requiring them to perform their services consistent with the fiduciary services established under

(a) the Investment Advisor's Act of 1940;

(b) California law applicable to fiduciaries of public employee retirement systems, which includes the California State Constitution, Art. XVI sec. 17 and the San Jose Municipal Code and/or (c) terms and conditions substantially comparable to the foregoing that are satisfactory to the Plan.

2. The nature and size of the manager's mandate shall be consistent with:

a. The asset allocation policy of the Plan;

b. Applicable constraints (e.g. manager or strategy concentrations) contained in this Investment Policy Statement; and the total Plan active risk limit(s)¹ contained in the risk section of this IPS.

3. Notwithstanding paragraph 2) b) above, the CIO shall not approve the selection of an investment management firm for mandates that exceed the following limits:

Basis*	Description	Management Firm Concentration Limit ²
Vehicle	Separately managed accounts (active)	15%
	Commingled funds and SMAs (public, passive)	No limit ³
	Commingled funds (public, active)	15%
	Commingled funds (hedge funds)	15%
	Commingled funds (private strategies)	15% ⁴
Public Markets ⁵	Passive strategies	No limit
	Active strategies (excluding hedge funds)	10%
	Hedge funds	10%
Private Markets (excluding venture capital)		Transaction Limit⁶
	Total \$ commitment to asset class (e.g. Private Debt)	150% of Board-approved pacing plan (cumulative) ⁷
	Primary fund commitment (1st allocation to mgr.)	2%**
	Primary fund commitment (follow-on)	3%**
	Secondary fund investment	1%**

IPS – Manager Selection Process

A. The process used to select an investment manager shall, at a minimum, include the following elements:

- 1. Imposition of a Quiet Period/No Contact policy. Board members and staff shall not have contact with individuals or entities who are seeking engagement by the Plan in response to an RFP, RFI, purchase order, or other solicitation or contracting process, except in accordance with the published terms of the contracting process or except for, and limited to, contact necessary in connection with ongoing Plan business with an individual or entity. The Plan's RFPs, RFIs, and other contract solicitations shall include notice that a "quiet period" will be in place from the beginning of the contracting process until the selection of the successful party such that these communications shall not occur, except as provided above. As part of the contracting process, potential contracting parties shall be required to disclose potential conflicts of interest. Board members and staff shall not use or attempt to use influence, outside of the individual authority to cause the organization to enter into a contract with any individual or entity. Board members and staff may refer individuals or entities for consideration for contracting to the appropriate Plan staff member(s) responsible for the particular procurement or contract process.*
- 2. Identification of a mandate to implement the Board's SAA Policy Portfolio.*
- 3. Comprehensive operational due diligence performed by the investment staff, qualified investment consultant, or qualified quasi-discretionary investment manager;*
- 4. In the case of private markets, comprehensive operational due diligence performed by the investment staff, qualified investment consultant, or qualified quasi-discretionary investment manager;*
- 5. Legal review by qualified investment counsel of the manager agreement and related documentation;*
- 6. An internal meeting of investment officers, including the CIO and the officer responsible for the asset class in question, during which staff's due diligence analysis is reviewed and debated and a staff recommendation is made;*
- 7. Approval by the CIO;*
- 8. Concurrence by a qualified investment consultant or quasi-discretionary investment manager as to the reasonableness of the selection decision; and*
- 9. Written affirmation to the Investment Committee by the CIO that the process used to select the manager complied with applicable policies and the Procedures. Such affirmation shall be submitted to the Investment Committee at the next regularly scheduled Investment Committee meeting following the selection of the manager.*

IPS – Manager Selection Process, cont'd

- B. The Procedures shall include any checklists and templates to be used in the due diligence process. Such Procedures shall be presented to the Investment Committee for review and input at least every three years, or sooner upon request of the Investment Committee or any member of the Board.*
- C. Whenever amendments are made to the Procedures, a copy shall be provided to the Investment Committee at its next regularly scheduled meeting.*
- D. Should any Investment Officer responsible for performing manager due diligence and preparing manager selection and termination recommendations to the CIO cease to be employed by the City for any reason, the CIO shall inform the Investment Committee immediately.*
- E. The selection of an investment manager that would contravene a provision of this policy or the Procedures shall require Investment Committee approval.*
- F. A file or files shall be established to serve as a permanent record of the due diligence process for each investment manager hired and shall contain a summary of the due diligence information and analysis generated during the search process, as well as the legal documentation.*
- G. The internal audit plan of the internal auditor shall include a review of a random sample of investment manager selection decisions at least once per year to confirm compliance with this policy and the Procedures approved by the CIO, the scope of which shall not include the investment performance of such selection decisions. The results of such review shall be reported to the Audit Committee and the Investment Committee.*
- H. A "Watch List" will be established for underperforming managers and managers under extraordinary review for qualitative reasons, and will be maintained by the General Consultant.*
- 1. Quantitative criteria for underperformance which would trigger placement on the Watch List includes manager underperformance versus the appropriate benchmark over a three and/or five year period.*
 - 2. Potential actions resulting from placement on the Watch List include finding appropriate resolution of outstanding issues, renewed confidence in the manager or strategy, or determination that the termination of the manager or strategy is appropriate.*
 - 3. Investment staff will identify underperforming managers in conjunction with consultants.*
 - 4. As necessary, nuanced investment strategies or fund types may require customized review.*
- I. The Plan will seek alignment of interests when negotiating fees while pursuing the best net of fees performance results. Investment costs shall be monitored, controlled, and whenever possible negotiated to ensure cost effectiveness. The Board shall give consideration to the impact of administrative expenses, external management fees and performance fees when establishing the asset mix policy of the Plan. The Board will be provided reports on investment costs of the Plan at least annually.*
- J. The Plan's staff, in coordination with its investment consultants and legal counsel, will negotiate, monitor, and report on fees with investment managers regularly to ensure market competitiveness and appropriateness.*
- K. The Plan will seek to ensure that excessive fees are not being paid for alternative assets by reviewing manager fees at least annually. Fee structures could incorporate fixed fees, performance based fees, high water marks, waterfall, hurdles, floors and caps. The Plan may also incorporate multi-year performance periods with clawbacks as needed.*

Private Markets Due Diligence Checklist

Stage	Due Diligence Process	Action Items/Documentation	Lead	Date				
Stage 1	Manager Search	Identify manager candidates	Pipeline, consultant recommendations, third party marketers					
		Perform initial qualitative due diligence	Manager Marketing Materials					
			Manager Organizational Chart Firm-wide AUM and Returns Disclosure Initial fee estimate					
		Perform initial quantitative due diligence	Returns Stats (Net IRR, Net MOIC, Vintage Quartiles, Loss Ratios)					
		Funding considerations	Check capacity					
			Determine optimal & initial investment size Determine source of funding					
		Conduct initial call with consultant analysts	Check consultant coverage, initial feedbacks					
Stage 2	Investment Due Diligence	Narrow to top candidate(s)	Inform IG of top candidates					
		Perform DD calls & meetings w/ managers	Manager DDQ Supplemental DDQ (ad hoc) ILPA DDQ/PREA DD Guidelines LP List					
			Complete full quantitative due diligence	Historical Fund Returns Historical Strategy AUM and Holdings Historical Sub-strategy Returns and Attribution (if applicable) Historical Risk & Exposure Reports (if applicable) Manager Monthly/Quarterly Strategy Update/Research Manager Current Risk and Exposure Reports (if applicable) Quantitative Analysis - Internal Risk System Fund suitability analysis: expected return, risk, exposure analysis				
				Seek internal and external feedbacks	Consultant investment DD Report Conduct calls with consultant analysts Quantitative Analysis - Consultant Solicit feedback from IOs/CIO			
		Prepare Scoring Matrix & Proposal Memo			Private Fund Scoring Matrix			
		Stage 3		ODD	ODD	Manager ADV Review of Financial Statements (Consultant) Valuation Policy Historical Annual Financial Statements (if applicable) Reference Checks Background checks (if applicable) Operational DD Report (Consultant)		
			Stage 4			Terms Review & Negotiations	Evaluate fees and core terms	Manager Fees/Terms Review Manager standard LPA/PPM/side letter
CIO Review	CIO Meets with manager							
Prepare final documents	Due Diligence Process Review & Checklist w/ Signoff Blackbook							
	Obtain Consultant supporting memo							
Make final fund selection decision	Key Legal Documents (IMA, PPM/OM, LPA, Sub-Docs etc.)							
Stage 5	Approval		CIO Approval			CIO approval form		
Stage 6	Communication	Federated IC notification						
		P&F IC notification						

** Differences to public markets in red text*

CIO Approval Form

Due Diligence: CIO Approval Form		
Firm Name		
Fund Name		
Strategy		
Primary Office Location		
Investment Officer		
Secondary Analyst		
	CIO	
Process Review	Notification	Comments
IDD Results	<input type="checkbox"/>	
ODD Results	<input type="checkbox"/>	
Consultant Support	<input type="checkbox"/>	
Legal Documents	<input type="checkbox"/>	
DD Check List	<input type="checkbox"/>	
Final Decision	CIO Decision	Date
Approve	<input type="checkbox"/>	
Reject	<input type="checkbox"/>	

Manager Decisions 2H 2020

Plan	Asset Class	Manager	Strategy	Strategy Type	Action	AUM (\$MM)	Consistent with IPS?	Date	Meketa Opinion on New Managers
P&F Pension	Venture Capital	Top Tier Capital Partners	Top Tier Capital IX, L.P.	Active	Hire	10	Yes	6/27/2020	N/A
P&F Pension	Private Real Assets	Orion Resource Partners	Orion Mine Finance Fund III, L.P.	Active	Hire	9	Yes	7/27/2020	Supportive
P&F Pension	Private Real Assets	N/A	Energy Services Coinvest 1B, LLC	Active	Hire	1.8	Yes	9/11/2020	N/A
P&F Pension	Venture Capital	Northgate Capital	Northgate Venture Partners IX, L.P.	Active	Hire	10	Yes	9/15/2020	N/A
P&F Pension	Venture Capital	Canvas Ventures	Canvas Ventures 3, L.P.	Active	Hire	5	Yes	11/9/2020	N/A
P&F Pension	Private Debt	HPS Investment Partners	HPS Special Situations Opportunity Fund, L.P.	Active	Hire	12	Yes	11/30/2020	Supportive
P&F Pension	HY Bonds	Columbia HY	High Yield Bonds	Active	Hire	75	Yes	12/2/2020	Supportive
P&F Pension	EMD	Payden & Rygel	EMD	Active	Hire	49.6	Yes	12/9/2020	Supportive
P&F Pension	Core Real Estate	Clarion Partners	Clarion Lion Properties Fund, L.P.	Active	Commitment to Existing Manager	4	Yes	7/1/2020	N/A
P&F Pension	Private Equity	Neuberger Berman	SJPF Private Equity Strategic Partnership, L.P.	Active	Commitment to Existing Manager	27.5	Yes	7/1/2020	N/A
P&F Pension	Core Real Estate	BlackRock	BlackRock U.S. Core Property Fund, L.P.	Active	Commitment to Existing Manager	13	Yes	12/1/2020	N/A
P&F Pension	Public Equity	GQG	Emerging Markets Equity	Active	Additional Allocation	27	Yes	7/1/2020	N/A
P&F Pension	Public Equity	Artisan	Global Opportunities	Active	Partial Redemption	15	Yes	9/17/2020	N/A
P&F Pension	Absolute Return	Hudson Bay CSA	Relative Value	Active	Partial Redemption	39.1	Yes	9/30/2020	N/A

Source: Manager Decisions for Second Half of 2020, Dec 2020