



Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 16

MEETING DATE: December 18, 2019

SUBJECT: Alternative Assets Consultant RFP

SUBMITTED FOR: Consent **Deliberation and Action** **Receive and File**

RECOMMENDATION

Staff recommends the Board authorize staff to issue a request for proposals (RFP) for alternative assets investment consulting services.

PURPOSE

This item contributes to the effective management and oversight of investment activities. The Board is responsible for engaging board consultants and service providers, including investment consultants.

BACKGROUND

In February 2011, SCERS hired Cliffwater LLC as its first alternative assets investment consultant. The contract with Cliffwater has since been amended and extended in 2017, and with the extension, the language and terms of the underlying alternative assets investment consultant agreement remained largely unchanged. The current contract with Cliffwater expires June 30, 2020.

The alternative assets investment consultant focuses on the following alternative SCERS asset classes:

- Absolute Return
- Private Equity
- Private Credit
- Real Assets

Specific duties and scope of service of the alternative assets investment consultant include:

- Development of long-term and annual strategic plans, and portfolio construction, across SCERS' alternative asset classes.
- Providing access to a broad range of alternative investment managers and conducting initial and ongoing investment and operations due diligence of alternative asset managers.
- Investment performance and risk monitoring, measurement, and analytics.

- Development and maintenance of cash flow, liquidity, and pacing projections of SCERS' alternative asset classes.
- Collaborative work with SCERS' Staff, SCERS' Board, and SCERS' other consultants and advisors.
- Review of investment manager fund documents and assisting SCERS in interpreting and negotiating key terms in contracts and manager fees.
- Creation of appropriate benchmarks to monitor performance.
- Board education.

DISCUSSION

Cliffwater represented SCERS' first dedicated alternative assets consultant when it was hired in 2011 to help SCERS increase its exposure to alternative assets. The reason was to enhance returns and increase diversification for SCERS' total portfolio. SCERS also made the decision at that time to transition away from fund of funds (FOFs) within the alternative asset classes and toward making direct investments with alternative asset managers. Investing directly into alternative asset funds also was expected to produce higher returns than using a FOFs approach. Alternative asset classes have historically demonstrated a meaningful dispersion of returns between top performing and median/bottom performing managers, so manager selection becomes paramount.

In order to effectively implement these revised alternative asset objectives, SCERS determined it was necessary to hire a dedicated alternative assets consultant. Using an alternative assets consultant also reduced the extra layers of fees charged by a FoF manager, which are significantly higher than the cost of an alternative assets consultant.

Subsequent to hiring Cliffwater as its alternative assets consultant, SCERS also hired a dedicated real estate consultant, given the idiosyncrasies of investing in real estate. The Townsend Group was hired as SCERS' real estate consultant in 2012.

SCERS' Alternative Assets Growth

When Cliffwater was hired, SCERS was at the early stages of investing in alternative asset classes. Since then, SCERS has accomplished the following within the alternative asset classes:

Absolute Return/Hedge Funds:

- Moved from a 5% equity long/short only approach to a 10% allocation diversified across a wide suite of absolute return strategies
 - Equity long/short; credit; event driven; global macro; market neutral; relative value; multi-strategy
- Moved from a FoF approach to a mostly direct approach
 - Maintained diversified FoF exposure through Grosvenor Capital Management as a complement to the direct program
- Divided the Absolute Return portfolio between growth and diversifying strategies within different asset categories of SCERS' portfolio

- Generated aggregate returns of 3.9% since inception versus the HFRI Fund of Funds Composite Index return of 3.0%

Private Equity:

- Increased from a 5% allocation to a 9% allocation
- Moved from a FoF approach to a direct approach across buyouts, venture capital, and distressed debt
- Fully implemented at a 9.2% allocation as of September 30, 2019
- Generated a since inception net IRR of 15.5% (as of September 30, 2019) and a 1.56x net Total Value to Paid in Capital (TVPI), exceeding the policy benchmark return of 13.0%

Real Assets:

- Created a 7% real assets allocation to provide an inflation hedge, increase cash flows, and add another layer of diversification across infrastructure, energy, and agriculture strategies
- Meaningfully implemented at a 5.4% allocation as of September 30, 2019
- Generated a since inception net IRR of 13.7% (as of September 30, 2019) and a 1.25x net TVPI, exceeding the policy benchmark return of 6.8%

Private Credit:

- Added a 4% private credit allocation in 2017, made up of direct lending and opportunistic credit allocations
- On the path toward implementation at a 1.8% allocation as of September 30, 2019
- Early results show a since inception net IRR of 8.1% (as of September 30, 2019) and a 1.11x net TVPI, exceeding the policy benchmark return of 7.1%

Looking Ahead

While Cliffwater has been a successful and effective partner to SCERS over the past eight years, SCERS has not issued an RFP in the alternative assets consulting space since 2011. There are reasons for an institutional investor like SCERS to periodically issue an RFP for investment consultants, with specific considerations related to alternative assets consulting including:

- Institutional investing within alternative asset classes continues to evolve, with an increasing number of alternative asset classes, a variety of approaches to implementation, and a greater number of investment managers to underwrite.
- SCERS' alternative asset classes are maturing, and there are several considerations for implementation going forward, including:
 - Decisions between follow-on investments with existing general partners (GPs) and new investments with new GP relationships;
 - The number of underlying funds in SCERS' portfolio and managing against fund and manager proliferation;
 - Use of co-investments and secondary investments to complement primary investments; and,
 - Use of strategic partnerships to have greater control of the investment guidelines and better fee alignment.

- Evolving technology systems and software allow for more dynamic monitoring, performance attribution, fee and expense aggregation, and increased frequency of reporting.

Issuing an alternative assets RFP will allow SCERS to compare Cliffwater to other alternative assets consultants in the following areas: (1) consulting approach; (2) firm resources; (3) the number of clients it serves; (4) the universe of managers it performs due diligence on; (5) reporting and risk management systems; and (6) performance.

Staff views issuing an alternative assets consulting RFP as a way to gauge the current market for alternative assets consultants, and not necessarily as a signal that Cliffwater should be replaced. Cliffwater has been a valuable partner for SCERS over many years. The RFP process will assist SCERS in determining if Cliffwater represents the best consulting partner going forward, or if other consulting options should be considered.

Evaluation Process

Below are the steps toward issuing a RFP, reviewing responses, and evaluating consultant candidates within the alternative assets consulting universe:

- Staff will create a RFP that contains categories to evaluate the capabilities of alternative assets consultant candidates, such as organization, conflicts of interest, client information, client servicing team, consulting services, manager research, operational due diligence, risk management, performance, client access to fund managers, performance reporting and monitoring, and fees.
- Staff will send the RFP to a group of alternative assets consultants that Staff has identified as strong candidates. The RFP will also be posted to the SCERS website.
- Interested alternative assets consultants will provide responses to the RFP.
- Staff will conduct an initial review and evaluation of responses, which is expected to be based less on a rigid/scoring system, but rather, a combination of a qualitative and quantitative assessment of consulting firm responses across the various categories.
- Staff will identify semifinalist candidates to be invited to SCERS' office for interviews. The semi-finalist meetings will allow SCERS to drill deeper into not only the firm's capabilities, but also to better gauge the fit/compatibility of the firm with the Board, Staff, SCERS' other investment consultants, and SCERS' organizational culture.
- Staff will then identify up to three firms that are best qualified for the assignment. Those firms would be invited to make a finals presentation to the Board.
- If the Board prefers, it has the option to assign a Board member(s) to the evaluation process.
- The Board will select and approve the consultant.
- The objective is to conclude the evaluation/selection process prior to the conclusion of Cliffwater's contract at the end of June 2020.

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