



SFERS

San Francisco Employees' Retirement System


City and County of San Francisco
Employees' Retirement System

RETIREMENT BOARD CALENDAR SHEET

Retirement Board Meeting of May 8, 2019

To: The Retirement Board

Through: Jay Huish 
Executive Director

William Coaker, Jr. – CFA, MBA 
Chief Investment Officer

From: Kurt Braitberg - CFA, CAIA
Managing Director, Public Markets

Victoria Owens - CFA 
Senior Portfolio Manager, Public Fixed Income

Dennis Esselsagee 
Security Analyst

Date: May 8, 2019

Agenda Item:

Recommendation to terminate the allocation to Prima Capital Advisors commercial real estate debt strategy within the Liquid Credit portfolio.

Background:

This recommendation is part of Staff's ongoing efforts to meet the long-term target allocation of 3% of plan assets for Liquid Credit approved by the Retirement Board in 2017, and to reshape the Liquid Credit portfolio as detailed in the May 2018 strategic investment plan for Public Fixed Income.

Recommendation:

Staff recommends the Retirement Board, if it agrees with this recommendation, adopt the following motion:

- Move that the Retirement Board of the San Francisco Employees' Retirement System terminate the allocation to Prima Capital Advisors commercial real estate debt portfolio.

Attachments:


Staff Memorandum



Date: May 8, 2019

To: The Retirement Board

Through: Jay Huish 
Executive Director

William Coaker, Jr. – CFA, MBA 
Chief Investment Officer

From: Kurt Braitberg - CFA, CAIA
Managing Director, Public Markets

Victoria Owens, CFA 
Senior Portfolio Manager, Public Fixed Income

Dennis Esselsagoe
Security Analyst 

Subject: Recommendation to terminate the allocation to Prima Capital Advisors real estate debt

Overview:

Investment Staff (“Staff”) is recommending terminating the allocation to Prima Capital Advisors commercial real estate debt portfolio. SFERS had \$107 million invested in this strategy as of February 28, 2019.

This recommendation is part of Staff’s ongoing efforts to to move toward the long-term target allocation of 3% of plan assets for Liquid Credit approved by the Retirement Board in late 2017 and to reshape the Liquid Credit portfolio as detailed in the May 2018 strategic investment plan for Public Fixed Income.

Background:

Prima Capital Advisors, LLC (“Prima”) is an asset manager focused on commercial real estate debt. The firm managed about \$4.2 billion in assets as of March 2019. Prima focuses on investing in commercial mortgage loans, commercial mortgage backed securities, REIT bonds and other real estate debt instruments.

Prima is a private company with six employees including four investment professionals. The firm’s research process emphasizes evaluation of property characteristics through steps including on-site visits and inspections, cash flow analysis, and assessment of the quality and terms of underlying leases. Investments are allocated across property types such as office, retail, industrial, and multi-family housing.

SFERS Investment in Prima:

Prima Capital Advisors (and prior entities Schroder Mortgage Associates, LP and Conning Asset Management Company) have managed this strategy on behalf of the San Francisco Employees’

Retirement System since September 1, 1995. Since the inception of SFERS' account through 2/28/2019, Prima has achieved annualized net returns of 6.96%. In addition, over the trailing 5-year period Prima's net annualized performance of 4.57% exceeded both the Bloomberg Barclays US CMBS 2 benchmark (3.53%) and the Bloomberg Barclays US Aggregate Bond Index (2.32%) as of 2/28/2019. The recommendation to terminate SFERS' allocation to Prima stems primarily from portfolio construction and liquidity considerations for the overall Liquid Credit portfolio rather than either a concern regarding Prima's investment process or portfolio performance.

Role in SFERS Portfolio:

For the last several quarters, Staff has been working to transition the Public Fixed Income portfolio in keeping with the asset allocation targets approved by the Retirement Board in 2017. The table below illustrates the recent allocation shifts within Public Fixed Income following approval of the revised targets.

| | 12/31/2017 | 6/30/2018 | 12/31/2018 | 2/28/2019 | Long-Term Target |
|-------------------------|------------|-----------|------------|-----------|------------------|
| Liquid Credit Composite | 12.9% | 7.1% | 6.7% | 6.2% | 3% |
| Treasuries Composite | 3.4% | 5.9% | 6.1% | 5.8% | 6% |
| Public Fixed Income | 16.2% | 13.0% | 12.8% | 12.0% | 9% |

Liquid Credit and Treasuries composites were established 1/1/2018. 2017 weights are estimated using the strategy classifications subsequently employed for the construction of each composite.

Liquidity Considerations:

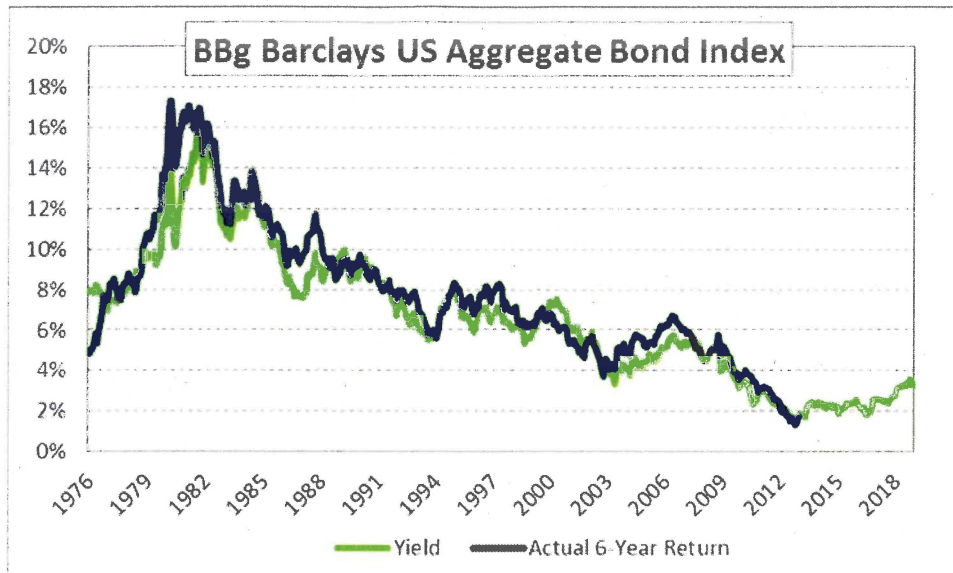
The established target of approximately 6% of plan assets for the Treasuries allocation within Public Fixed Income has been achieved. However, the process of moving toward the 3% target for the Liquid Credit portfolio in which Prima belongs is ongoing and corresponds with the need to raise funds for areas such as private credit. Reductions to date have already been considerable and have contributed to declines in the assets under management for most managers within the Liquid Credit portfolio.

Reductions to Liquid Credit since late 2017 have been achieved through lower allocations to existing managers rather than through manager terminations. However, as Staff anticipates the need to raise further funds, there are a limited number of Liquid Credit managers from which capital may be efficiently drawn.

Portfolio Characteristics and Diversification:

In addition to reducing the size of the Liquid Credit allocation, Staff is also in the process of reshaping the return and risk profile of the overall Public Fixed Income portfolio. As detailed in the May 2018 strategic investment plan, the Public Fixed Income portfolio is expected to transition to a barbell type profile. The intent of this barbell approach is that the 6% allocation to Treasuries for safety and liquidity will be complemented by an emphasis on areas with higher long-term return expectations within the 3% invested in Liquid Credit.

As shown below, the yield of the Bloomberg Barclays US Aggregate Bond Index at a point in time has closely corresponded with realized returns for the index over the subsequent six years.



With the yield for the Bloomberg Barclays US Aggregate Bond Index at about 3.3% as of 12/31/2018, forward looking return expectations for the index are low. Emphasizing higher-yielding strategies within Liquid Credit is intended to improve long-term expected returns.

Staff believes it will be necessary to reduce or terminate some managers with lower yield characteristics within the Liquid Credit portfolio in order to effectively implement the barbell strategy. In addition, for the limited portion of Liquid Credit maintained in lower-yielding strategies, Staff will maintain greater exposure to managers that offer broader diversification across sectors and more liquidity.

Long-Term Fit with SFERS Investment Objectives:

As shown below, while Prima's yield is higher than the Bloomberg Barclays US Aggregate Bond Index it is lower than the overall yield for SFERS Liquid Credit composite.

| 12/31/2018 | Yield to Maturity |
|--|-------------------|
| Prima | 4.9% |
| SFERS Liquid Credit Composite | 5.5% |
| Bloomberg Barclays US Aggregate Bond Index | 3.3% |

Prima's commercial real estate debt focus means that it also offers less diversification than some of the lower-yielding managers that invest in a blend of fixed income sectors such as investment grade corporate, securitized, and government bonds. In addition, the Prima portfolio is less liquid than some of these diversified core strategies, and Staff expects that a full redemption of the Prima portfolio could take two to three months to complete.

Given these considerations, the Prima strategy is no longer a fit with the objectives and requirements of the Liquid Credit portfolio discussed above. Staff is recommending the termination of this allocation as a step toward meeting the target of 3% of plan assets for Liquid Credit approved by the Retirement Board.