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 JSH
Executive Director

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

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

Victoria Owens - CFA VO
Senior Portfolio Manager, Public Fixed Income

Dennis Esselsagoe
Security Analyst

Date: May 8, 2019

Agenda Item:
Recommendation to terminate the allocation to AFL-CIO Housing Investment Trust 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 the AFL-CIO Housing Investment Trust.

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 AFL-CIO Housing Investment Trust

---

Overview:

Investment Staff ("Staff") is recommending terminating the allocation to AFL-CIO Housing Investment Trust. SFERS had $50 million invested in this strategy as of February 28, 2019.

This recommendation is part of Staff's ongoing efforts to to meet 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:

AFL-CIO Housing Investment Trust ("AFL-CIO HIT") is a mutual fund with about $6.1 billion in assets under management as of March 31, 2019. The strategy has been managed with a consistent approach for over 30 years. With an emphasis on high quality multifamily mortgage backed securities, the portfolio seeks to generate greater income with less credit risk than the Bloomberg Barclays US Aggregate benchmark.

This recommendation is based on the need to significantly reduce the Liquid Credit portfolio to meet the asset allocation targets established by the Retirement Board and to reconstitute the portfolio to fulfill the strategic investment plan for Public Fixed Income. The recommendation to terminate the allocation to AFL-CIO HIT considers the strategy's investment characteristics as well as an evaluation of the fund's long-term fit with the objectives for Liquid Credit detailed below.

SFERS Investment in AFL-CIO Housing Investment Trust:

San Francisco Employees' Retirement System has been invested in AFL-CIO HIT since September 1, 1996.

Performance:
Since the inception of SFERS' account through 2/28/2019, the strategy has posted net annualized returns of 5.09% compared to 5.11% for the Bloomberg Barclays US Aggregate Bond Index. AFL-CIO HIT was placed "Under Review" as of 2Q 2017 for performance reasons. As shown below, AFL-CIO HIT underperformed the Bloomberg Barclays US Aggregate Bond Index over the trailing 3-year and 5-year periods ended 2/28/2019:

Annualized Returns (%) as of 2/28/2019:

	3 Months	1 Year	3 Years	5 Years	10 Years	Since Inception
AFL-CIO HIT	2.26	2.62	1.25	2.21	3.43	5.09
Bloomberg Barclays US Agg	2.86	3.17	1.69	2.32	3.71	5.11
Over/Under	-0.60	-0.55	-0.44	-0.10	-0.28	-0.02

The portfolio's lack of corporate bond exposure (vs. a weighting of about 24% in corporate bonds for the benchmark as of 12/31/2018) created a significant hurdle in both 2016 and 2017. However, the portfolio outperformed in 2018 when corporate bonds lagged. Calendar year to date as of 2/28/2019 the portfolio returned 0.67% vs. 1.00% for the index.

Organizational Changes:
Stephen Coyle, who served as Chief Executive Officer since 1992, retired in September 2018. Chang Suh was named CEO effective September 28, 2018. Mr. Suh was promoted from the role of Senior Executive Vice President/Chief Portfolio Manager of the AFL-CIO HIT and has been with the organization since 1998. Given Mr. Suh's new responsibilities, Michael Cook, CFA, FRM was appointed Co-Chief Portfolio Manager. He has been with the team since 2003. In addition, other recent changes include a reorganization plan that resulted in reductions in the number of employees. AFL-CIO HIT's anticipated operating budget for 2019 is materially lower than for 2018.

Recent Reductions to the allocation to AFL-CIO HIT:
With the necessary reductions to SFERS' Liquid Credit portfolio to fund additions to Treasuries as well as areas outside of Public Fixed Income, the allocation to AFL-CIO HIT was reduced by $120 million in early May 2018.

Role in SFERS Portfolio:

The recommendation to terminate SFERS' allocation to AFL-CIO HIT stems in large part from portfolio construction and liquidity considerations for the overall Liquid Credit 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%

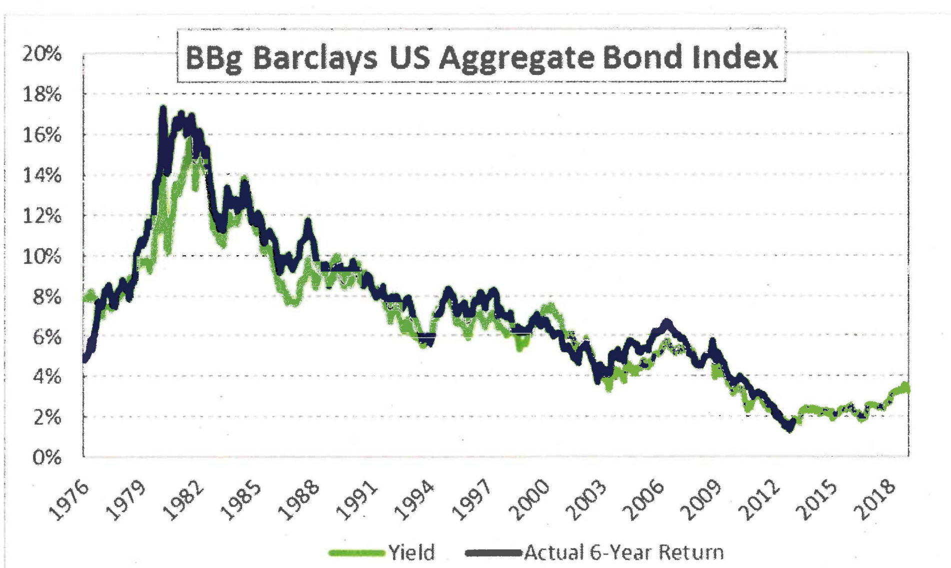
Liquid Credit and Treasuries composites were established 1/1/2018. 2017 weights are estimated using the strategy classifications subsequently employed for the construction of each composite.

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 AFL-CIO HIT 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 of the 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 AFL-CIO Housing Investment Trust'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
AFL-CIO Housing Investment Trust	3.5%
SFERS Liquid Credit Composite	5.5%
Bloomberg Barclays US Aggregate Bond Index	3.3%

AFL-CIO HIT's emphasis on multi-family mortgage backed securities means that it also offers less diversification than some lower-yielding managers that invest in a blend of fixed income sectors such as investment grade corporate, securitized, and government bonds. In addition, the AFL-CIO HIT portfolio offers liquidity only on a monthly basis. By prospectus, the strategy allows monthly redemptions with notice on a business day at least 15 days before the last business day of the month. The time required to realize liquidity for the portfolio could therefore range from about 15 days to about 1.5 months depending on when notice is provided.

Given the portfolio's yield, diversification, and liquidity characteristics, the AFL-CIO HIT strategy is not 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.