Minutes of the meeting held on August 29, 2023

Present: Francis Murphy – Chairman, Michael Gardner, Joseph McCann, James Monagle, Michele Kincaid, Ellen Philbin, Rafik Ghazarian and Chris Burns.

Left Early: Nadia Chamblin-Foster (Left following BlackRock presentation)

The meeting was called to order at 11:00 AM. This was a hybrid meeting held in-person at 125 CambridgePark Drive, and via Webex videoconference. The Webex was digitally recorded.

Agenda Item #1 – Segal Marco Advisors
Ghazarian reviewed Segal Marco's written analysis of investment performance for the period ending June 30, 2023. Over the last quarter, US Equities were the best performing sector. Real Estate continues to be a difficult environment, now showing a 10% loss over the trailing twelve months.

Ghazarian reviewed the system's current asset allocation, and he noted that the report reflects the current allocation targets adopted by the Board. Ghazarian stated that he would present a new asset allocation model later in the meeting. The system has completed funding for two new managers, Acadian (International Equity) and RBC (Emerging Markets Equity). Private Equity remains above the target allocation, with most other asset classes slightly underfunded.

Overall, the total fund was valued at $1.676 billion, representing a gain of 2.3% during the quarter. The fund underperformed the policy index return of 2.7%. The holding of Cambridge Bancorp stock has declined 33% over the last year. Ghazarian stated that he felt that this was due to market concerns over small, regional banks in general. He did not feel that this was reflective of any particular concern about Cambridge Bancorp's management. Gardner asked if it would be possible to measure this stock's performance against a benchmark of other small banks.

The Board reviewed an asset allocation study prepared by Segal Marco Advisors. Ghazarian stated that he felt it was important to review the system's strategy due to the increase in interest rates over the last year. This presents an opportunity to shift more money into less risky fixed income assets, while still earning a reasonable return. Another factor is the likelihood of poor returns from core real estate over the foreseeable future. This is almost entirely due to reduced demand for office space in the post-COVID era. Ghazarian noted that residential and industrial real estate was still showing good returns and value-add funds also had the potential for good returns. Ghazarian reviewed three proposed asset mixes. The proposals share several common themes. All proposals increase the allocation to core fixed income to varying degrees. All of them reduce the allocation to core real estate and eliminate the allocation to hedge funds. Some proposals cut the allocation to equities, or increase the allocation to private equity, high yield debt or infrastructure. He noted that Segal does not anticipate that interest rates will remain high over the long term. Their 10-year projection calls for lower rates. The Chairman noted that one option doubles the fixed income allocation, which he felt was too conservative and might lock the system into lower returns. Gardner stated that he agreed that this proposal was too radical change. Gardner moved to adopt the allocation strategy described as "Mix 2" in the Segal report. McCann seconded the motion, and it was voted unanimously. This mix would set the targets at 26% US equity, 10% international equity, 10% emerging markets equity, 12% core fixed income, 3% bank loans, 5% high yield, 3% emerging markets debt, 13% private equity, 6% core real estate, 3% value add real estate, 3% timber, 1% farmland, and 5% infrastructure.

The Board reviewed Segal Marco's analysis of responses to the High Yield RFP. Twenty firms submitted proposals. There were no responses from women/minority owned firms. Segal rated three firms as "highly advantageous". They are Loomis, the incumbent firm; MacKay Shields; and Mesirow. Four other firms were rated "Advantageous" with the others rated "Not Advantageous". Over the last ten years, both Mesirow and MacKay Shields have shown better returns than Loomis. The Mesirow fund is benchmark agnostic, able to buy into any type of high yield debt, and has shown more volatility than the other funds. They also charge a higher management fee. Motion by Gardner, seconded by Monagle to schedule interviews with Loomis, Mesirow and MacKay Shields. Voted unanimously.

Maria Bascetta represented UBS. A written overview of the portfolio was presented to the Board. Over the last twelve months, the fund has significantly underperformed the benchmark, returning -15.46% net of fees, vs. the ODCE at -9.97%. The fund tends to be overweighted to coastal cities, and toward apartment properties. The fund has moved to invest more in Industrial properties, as well as adding some exposure to self-storage and laboratories. Bascetta reported on the ongoing effort to sell properties that have been designated non-strategic. Currently, there are only three properties left to sell, with 40 having been sold. Mario Maturo, who had been leading that process, has now moved to head a value-add fund. Bascetta announced that UBS would hold their annual investor conference in Cambridge this year. Bascetta described the work of redeveloping CambridgeSide. One floor of retail space will be converted to offices. Three new buildings are now under construction on the lot, which now includes apartments and lab space. Bascetta reviewed some specific properties in the portfolio. Apartments in Seattle, San Francisco, Los Angeles and San Diego have seen declining values. Washington, New York and Florida have seen increases. Rising interest rates have been a drag on values as the properties become more difficult to sell. The fund is now 20.4% leveraged, compared to the ODCE at 24.5%. The average interest rate is 4.9%. Bascetta stated that she is comfortable with the current debt level. She noted that the fund had underperformed over the last ten years in large part due to lower leverage. She stated that once rates have stabilized, the fund intends to add more debt.

John Maughan and Lawrence Ostow represented J.P. Morgan Asset Management. A written portfolio report was submitted to the Board. There have been no changes to the portfolio management or strategy over the last year. Ostow stated that Mike Kelly, Head of the Real Estate Americas team, will retire. His successor has not yet been announced. In the last twelve months, the fund returned -10.4%, which underperformed the ODCE index return of -10%. Ostow reviewed the current positioning of the portfolio. He noted that JP Morgan is working to build several industrial properties in urban areas. Infill and port-proximate properties have notably higher rents than more remote locations. Industrial properties remain the biggest driver of performance in the post-COVID environment. The fund has moved to sell several office and retail properties over the last four years. The fund has also moved to sell older industrial properties and is now slightly underweight to industrial vs. the index. Ostow noted that demand for new industrial properties has been softening and vacancies have increased. He stated that he was comfortable with the underweight position. Ostow stated that the fund was among the first to invest significantly in truck terminals, outdoor storage and single-family rentals. The rental property is geared towards affordability, with rents averaging in the 65th percentile within the local markets. He stated that retail has seen a significant rebound over the last year, and that he expects retail to be the best performing sector in 2023. In general. he expects the market to be at its bottom within six months and that it represents an excellent buying opportunity. The portfolio is 27.4% leveraged, with 80% of that as fixed rate debt. The fund currently has a redemption queue of $5.6 billion.

Christopher Rahe represented IFM Investors. A written portfolio review was presented to the Board. There have been no changes to the portfolio management or strategy over the last year. In 2022, IFM launched a new Net Zero Infrastructure Fund, focused on projects to transition to carbon-free energy. This fund has now raised $2 billion and made four acquisitions. IFM has hired Deepa Bhardwaj as Head of Infrastructure Europe. She replaces Christan Seymour following his retirement. In 2022, IFM acquired a 15% interest in Sydney Airport. They also acquired Switch Inc, which operates data centers in the USA. In 2023, the firm sold out of ports in New York and New Jersey. This should result in a substantial distribution later in the year. The firm sold off 25% of M6toll, a toll road in the UK. Finally, IFM sold an oil export facility in Texas. IFM had managed the construction of this facility, which started operating in 2021. The fund has returned 9% over the last year. The portfolio is now 35% leveraged, which Rahe noted is lower than most other infrastructure managers. The fund has an entry queue of $3.1 billion. Rahe noted that this is lower than usual and could be taken up by a single large transaction. He noted, without offering specifics, that the firm was considering acquisition of a European airport and a European data center firm.

Mark Andrew represented Lexington Capital Partners. A written review of the portfolio was presented to the Board. There have been no changes to the portfolio management or strategy over the last year. Earlier in 2023, Lexington completed a $2 billion acquisition from CalPERS. Andrew noted that this was due to liquidity and asset allocation concerns and not due to the performance of the funds that were acquired. The fund is now near to closing Fund X, which has a hard cap of $20 billion. Andrew reviewed the LCP VIII portfolio. Most of the funds are buyout-focused and based in the United States. The fund is well diversified by vintage year. Cambridge committed $20 million in 2015. $18.3 million has been drawn, and Cambridge has received back $18.5 million in distributions. The remaining value of Cambridge's share of the fund is $12 million. The current IRR was calculated at 17%. Ghazarian asked what type of discount the fund negotiated in the CalPERS acquisition. Andrew stated that he did not believe the information was public, but that it was approximately 15%.

Anna Farley, Michael Riccobono and Trey Smith represented BlackRock. A written review of the portfolio was presented to the Board. Lynn Baranski and John Seeg will now be co-heads of PEP. There were no other changes to the portfolio management or strategy over the last year. Riccobono announced that Russ Steenberg will step back into a Chairman role. Cambridge currently has one active investment in DivPEP Fund V, with DivPEP Fund II having closed in June 2022. Gardner noted that he knew John Seeg as a student in a church group. Riccobono described BlackRock's current fund offerings, noting that clients can now invest in multiple strategies and specify the amount to be placed into primaries, secondaries and co-investments. Riccobono reviewed the construction of the DivPEP V portfolio. It is primarily fund-of-funds, but about one-third of the portfolio is direct co-investments, and a smaller amount in secondaries. Fund V is a 2012 vintage fund, now in the harvesting phase. Cambridge has committed $6.5 million and paid in $5.4 million. To date, the fund has returned about $4.7 million to Cambridge. The portfolio has a net IRR of 9.4%. Riccobono stated he did not feel that the firm would have to draw the rest of the uncommitted capital. This fund will wind down in 2026 and BlackRock is considering options for liquidating the fund on the secondary market as was done with Fund II.

Tim D'Arcy and Jackie Rantanen represented Hamilton Lane. A written overview of the portfolio was presented to the Board. There have been no changes to the investment strategy or the management team at Hamilton Lane. Rantanen gave her outlook on the current state of financial markets. There is increasing sentiment that a recession can be avoided and that interest rates have stabilized. Rantanen anticipated increased deal flow in the secondary markets over the next year.

Cambridge has investments in Fund VI and Fund VIII. Cambridge has committed $6.5 million to Fund VIII, which is a 2012 vintage fund. The fund is now fully committed and into the harvesting phase. This fund will not call any additional capital. The portfolio has a net IRR of 7%. This fund is not as heavily weighted toward buyouts, with larger amounts of distressed debt, venture capital, emerging markets and energy. The fund remains short of the S&P 500 return since inception.
Cambridge made a $10 million commitment to fund VI, which is a 2007 vintage fund. The fund has an 8.3% net IRR. The fund is nearing termination. The fund is weighted toward buyouts, and to investments in North America. The portfolio still has some value remaining and continues to make distributions.

The Board reviewed Segal Marco's analysis of responses to the Emerging Markets Debt RFP. Eighteen firms submitted proposals. There were no responses from women/minority owned firms. Segal separated the responses, noting which funds invest in local currency and which use US dollars, as well as funds that do both. For local currency, Segal rated Pictet and PIMCO as "Highly Advantageous" as well as the incumbent, Wellington. For hard currency, Segal rated Marathon and PIMCO as "Highly Advantageous". The incumbent manager, Fidelity was rated as "Advantageous". Ghazarian stated this was due to a change in their Chief Investment Officer a year ago, as well as other staffing changes. Fidelity's returns have also been lower than the highly recommended managers. Ghazarian reminded the Board that Fidelity has offered a very favorable fee due to the Board holding other investments with that manager. Gardner noted that the fee quoted by PIMCO on both portfolios was significantly more than their competitors. Ghazarian stated that PIMCO's performance has been quite strong and that they have a larger investment universe than some of the other managers. The current mandate is for $45 million, which would be split between a local currency manager and a hard currency manager, receiving $22.5 million each.
Gardner stated that he was happy with Wellington's performance and that they were continuing to offer a reasonable management fee. He moved to retain Wellington as the local currency manager. Monagle seconded the motion. The motion carried on a 4-0 vote with Chamblin-Foster absent.
Gardner stated that he would not be comfortable hiring Marathon without an interview and that he would like to give Fidelity the opportunity to discuss their organizational changes. He also said that he would not favor interviewing PIMCO due to their high management fee. Motion by Gardner seconded by McCann to interview Marathon and Fidelity for the hard currency mandate. The motion carried on a 4-0 vote with Chamblin-Foster absent.

Monagle moved to adjourn at 3:00 PM.