INVESTMENT POLICY STATEMENT

MISSION STATEMENT

THE MISSION OF THE SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM IS TO DELIVER ACCURATE AND TIMELY BENEFITS TO ITS PARTICIPANTS AND ENSURE THE TRUST FUND'S SAFETY, INTEGRITY AND GROWTH.

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SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

INVESTMENT POLICY STATEMENT

I. INTRODUCTION

The San Diego City Employees' Retirement System (SDCERS) Trust Fund (Fund) exists for the purpose of providing retirement income, disability income, and death benefits for the employees (and their beneficiaries) of The City of San Diego, The San Diego Unified Port District, and The San Diego County Regional Airport Authority.

This Investment Policy Statement (IPS) encompasses the investment goals, objectives, and policies of the Fund. The purpose of the IPS is to declare the goals and structure of the SDCERS investment portfolio and to guide the Board of Administration (Board), the Investment Committee, and Staff in effectively supervising and monitoring SDCERS' Investment Program consistent with the Board's constitutional fiduciary duties. This IPS addresses the following topics:

- The goals of SDCERS' Investment Program;
- Specific asset allocation, rebalancing policy, and investment policies;
- Performance objectives; and,
- The roles and responsibilities of the parties involved with the oversight and management of the Fund's assets.

The Board establishes this investment policy in accordance with applicable local, state, and federal laws. The Board has been and will continue to be guided by the Prudent Expert standard.

The IPS is designed to provide sufficient flexibility in the management and oversight process recognizing the dynamic nature of the investment environment, while setting forth reasonable parameters to ensure prudence and care in the execution of the investment program in order to assure the competency of the assets of the Fund to timely provide retirement and related benefits to members and their beneficiaries, both now and into the future. The IPS provides broad guidance relating to the oversight and management of SDCERS' assets. Additionally, separate policies and procedures are defined with respect to individual asset classes (for instance, private equity, real estate) and investment-related functions (such as proxy voting, securities lending, etc.).

II. STATEMENT OF INVESTMENT PHILOSOPHY

The Board believes that investment policies, in aggregate, are the most important determinants of investment success. Compliance with investment policies should, therefore, be monitored diligently. The Board also believes that performance of the total portfolio, individual asset classes, and investment managers should be monitored and compared to appropriate, predetermined benchmarks.

The Board believes that prudent management of risk is a central element of the investment function and that diversification among asset classes will reduce risk and enhance returns of the overall investment portfolio in the long-term. The Board focuses on a 20-30 year time horizon to manage the investment portfolio. Furthermore, while SDCERS recognizes the importance of the preservation of capital, it also adheres to the principle that varying degrees of investment risk are generally rewarded with compensating returns.

The Board oversees and guides the Fund and its policies subject to the following basic fiduciary principles:

1. To act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and their beneficiaries. The Board's duty to its participants and their beneficiaries shall take precedence over any other duty;
2. To act with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent expert acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character with like aims;
3. To diversify the investments of the Fund so as to achieve a fair risk-adjusted rate of return that will support the long-term soundness of the Fund;
4. To diversify the Fund's investments so as to minimize the risk of loss associated with any single security, asset class, economic sector, and country/region;
5. To minimize the cost of funding benefits for participating employers and the individual participants of SDCERS through prudent investments; and,
6. To incur only reasonable costs of administration.

Further, the Board has assumed the following investment beliefs that provide a foundation for implementation of the strategic investment policy. These investment beliefs are intended to help convey SDCERS' perspective on several foundational investment areas.

- Gain exposure to the broad opportunity set across each asset class
    - Eliminate unintended structural biases
    - Recognize risks associated with structural biases and be comfortable with such risks

- Pay little for beta – use active management for alpha, not diversification
- Eliminate style-box approach to portfolio construction; style boxes are a rigid and artificial construct
- Focus manager selection efforts on skill and not style
    - Hire active managers that can add value regardless of their style and capitalization orientation
    - Allow managers with identifiable skill broad latitude to add value
- Utilize active risk budgeting as a risk control and allocation tool
- Seek to keep fees low – higher fees do not always translate to higher value-added

In order to achieve these goals, SDCERS recognizes the importance of human capital and must invest the necessary resources to build and maintain an appropriate organizational infrastructure.

Furthermore, the Board acknowledges the importance of including Environmental, Social, and Governance (ESG) considerations in the investment process to the extent they serve to mitigate risk or improve investment returns over the long term. As all of SDCERS' investments are externally managed, the Board relies on its investment managers to incorporate ESG considerations into their investment processes to the extent they are material to SDCERS' investment performance. These activities are monitored by SDCERS' investment staff, consultants, and advisors for consistency with the Board's fiduciary duties and reported to the Board each quarter.

Given the dynamic nature of investment markets and risks, evolution of products, institutional investment standards, and risk management practices, the Fund's IPS and associated elements, such as asset allocation, active risk profile, etc. shall be reviewed on a regular basis and updated, as needed, to ensure that the Fund's strategy remains consistent with SDCERS' objectives and circumstances and the overall investment and economic environment.

III. INVESTMENT GOALS

In accordance with SDCERS' Mission Statement, the goal of SDCERS' investment program is to generate adequate long-term returns which, combined with employer and employee contributions, will result in sufficient assets to pay the present and future obligations of SDCERS. The following objectives are intended to assist in achieving this goal:

- Generate returns that support the long-term soundness of the Fund.
- Seek to earn a net-of-fee return in excess of the policy benchmark over the long- term.
- Manage SDCERS' assets on a total return basis, which takes into consideration both investment income and capital appreciation.
- Seek to avoid taking undue risk where there is not a reasonable belief that such risk will be appropriately rewarded.

To achieve these objectives, SDCERS allocates its assets (asset allocation) with a strategic, long- term perspective of the capital markets.

IV. GOVERNANCE

Core Principles

The Board has plenary authority and fiduciary responsibility for investment of monies and administration of SDCERS. The Board will always operate with the highest fiduciary standards with integrity and transparency. Where appropriate, the Board will seek expert advice and may delegate functions to internal sub-committees and Staff, who will serve as fiduciaries to SDCERS.

Delegation

The Board may delegate investment responsibility of Fund assets to multiple investment managers, who shall serve as fiduciaries to SDCERS, subject to these guidelines and the provisions of Article IX, Section 144 of the City of San Diego Charter. The Board may delegate to the Investment Committee responsibility for appointing and supervising investment managers and consultants, including, but not limited to, general investment consultant, real estate consultant, private markets advisors, and/or other asset class consultants or specialists (broadly referred to as Consultant(s) going forward). The Investment Committee is required to report to the Board at least quarterly or as directed. External consultants and advisers retained by the Board to assist with the oversight and management of the investment program shall serve as fiduciaries to SDCERS.

Manager Retention and Termination

The Investment Committee delegates to Staff, with assistance from its Consultant(s), the process of identifying and recommending managers for retention or termination. Staff, working with Consultant(s), will conduct comprehensive due diligence to provide the Investment Committee with necessary and sufficient information in support of recommendations to retain or terminate external investment managers. The specific elements of due diligence will vary based on the asset class and the characteristics of the individual manager(s) and/or strategies under consideration. The due diligence with respect to underlying investment managers shall include, but is not limited to, an assessment of the merits of investment process and philosophy, resources and talent available to the organization, the likelihood that key resources will remain, risk management processes, internal control and compliance processes and procedures, and other organizational considerations.

A recommendation to the Investment Committee to retain a manager shall be supported by evidence of the comprehensive due diligence by Staff and Consultant(s) and a description/analysis of the fit of the manager's strategy/portfolio in the context of the overall portfolio and its objectives.

For private markets investments, SDCERS shall not invest with any direct investment manager or any consultant who has discretion to invest on SDCERS' behalf who elects to waive their fiduciary duty to SDCERS or who has any discretion in calculating their performance fee.

Reasons to terminate a manager may include, but are not limited to: turnover of investment management or other professionals that is likely to have an adverse impact on the performance of the strategy, divergence of strategy from stated objectives, violation of guidelines, legal action or action by any regulatory organization on the investment management firm, a change in the organizational structure that is likely to have an adverse impact on the performance of the strategy, availability of/access to more compelling investment strategies, and poor performance.

The Board and Investment Committee may, at their discretion, delegate authority to Staff to retain investment managers if in their opinion it is prudent to do so. Such retentions shall be presented to and ratified by the Investment Committee at the meeting subsequent to the managers' retention. Any delegation of authority to Staff shall define constraints, such as asset class, size of allocation, etc. within which Staff can retain managers.

Occasionally, it may become necessary to terminate an investment manager and/or limit/freeze an investment manager's trading discretion on an expeditious basis in order to protect the assets of the Fund. In circumstances where it is deemed prudent to terminate an investment manager on an expeditious basis (prior to when such action can be brought forward at an Investment Committee meeting), the Chief Investment Officer (CIO) shall have the discretion, with the approval of the Chief Executive Officer (CEO), to initiate such action as is necessary to protect the interests of SDCERS and its assets. Any action taken in this regard shall be reported to the Investment Committee at its meeting subsequent to when such action is taken, with detailed information on the rationale for termination or limiting/freezing a manager's trading discretion.

Investment Policy Statement Review

This IPS shall be reviewed, at a minimum, every three years or as directed by the Board. Such reviews will focus on the continuing feasibility of achieving the investment objectives and the continued appropriateness of the investment policy relative to SDCERS' circumstances. It is not expected that the investment policy will change frequently; in particular, short-term changes in the financial markets generally should not require an adjustment in the investment policy. However, specific policy issues may be visited whenever the Board deems necessary. Specific occurrences which might suggest to the Board an earlier review include, but are not limited to, a change in the Fund's circumstances and/or a material change in the capital market environment.

V. ASSET ALLOCATION POLICY

The policies of SDCERS' investment program are designed to maximize the probability that the investment goals will be fulfilled. SDCERS recognizes that strategic asset allocation is the dominant determinant of portfolio risk and return. Expected and actual investment returns of the Fund will depend on the asset allocation targets, the mix of investment styles within asset classes, and, to a lesser extent, individual manager performance.

SDCERS adopts and implements an asset allocation policy that is predicated on a number of factors, including:

1. A projection of actuarial assets, liabilities, and benefit payments and the cost of contributions;
2. Historical and expected long-term capital market risk and return behavior;
3. Expected correlations of returns between various asset classes;
4. An assessment of future economic conditions, including inflation and interest rate levels;
5. The current and projected funding status of the Fund;
6. Various risk/return scenarios; and
7. Liquidity requirements.

The Board shall review the overall asset allocation annually to provide a sound fiduciary oversight to the investment process. The implementation of the asset allocation will be conducted annually in the form of a Portfolio Structure Review. Additionally, at least every five years, the Board shall undertake an Asset/Liability study that evaluates the asset allocation policy in the context of projected actuarial liabilities and funding (contribution) practices. This is performed to assess the impact of changes in capital market behavior on the risk and return structure of the asset allocation strategy and the ultimate net cost of funding the benefits owed to participants and retirees.

Permissible Investments

An investment type or strategy may be considered an asset class if the risk, return, and correlation exhibited is sufficiently different from other standard asset categories such as equity, fixed income, real estate, and private markets, which include private equity and infrastructure.

The following asset classes/strategies are appropriate candidates for consideration of inclusion in the portfolio:

- U.S. equity;
- Non-U.S. equity, including emerging markets;
- Global equity, including equities listed above;
- Domestic fixed income, including high yield fixed income, floating rate debt, and preferred stock;
- International fixed income, including high yield and emerging markets;
- Real estate, including private and public real estate;
- Private markets, including private equity and infrastructure;
- Commodities;
- Strategies that utilize public and private market securities typically offered in a hedge fund structure; and
- Other alternative investments (currencies, timber, etc.).

Criteria for Inclusion of Asset Classes

The following criteria will be used in assessing an asset class for inclusion in the Fund:

- Sufficient size and liquidity to permit an investment by the Fund.
- Staff and Consultant expertise to ensure prudent due diligence and a cost-effective implementation.

- The incorporation of the asset class contributes to the return enhancement and/or further diversification of the Fund's assets.
- Ability to measure performance and risk against readily available indices.

Following is SDCERS' target asset allocation, approved by the Board on May 13, 2022.

Asset Class	Benchmark	Target
U.S. Equity	Dow Jones U.S. Total Stock Market Index	19.0
Non-U.S. Equity	MSCI All Country World ex-U.S. Investable Market Index	12.0
Global Equity	MSCI All Country World Index	8.0
Private Equity/Infrastructure*		13.0
Private Equity	Primary: Top 50th Percentile of the Burgiss Database (per SDCERS' Private Markets Program Policies)** Secondary: 67% Dow Jones U.S. Total Stock Market Index/33% MSCI All Country World Index ex-U.S. + 300 bps	*10.0*
Infrastructure	CPI + 500 bps	*3.0*
Return-Seeking Fixed Income	33.3% ICE BofAML US High Yield Master II Constrained Index/ 33.3% S&P/LSTA Leveraged Loan Index/ 33.3% Emerging Market Debt Blend***	5.0
Real Estate	NCREIF Fund Index – Open End Diversified Core Equity Index (NFI-ODCE) + 50 bps	11.0
Opportunity Fund****	78% MSCI All Country World Investable Market Index/ 22% Barclays Intermediate Aggregate Bond Index	10.0
U.S. Fixed Income	Barclays Intermediate Aggregate Bond Index	22.0
Total		**100.0**

*Any uninvested portion of the Private Equity/Infrastructure allocation will be invested in a proportion equal to 78% return-seeking assets and 22% risk-reducing assets.
**Given the need for a time-weighted return, the Burgiss Quarterly Pooled Return (rather than the 50th percentile return) is used to roll up into the Total Fund Policy Benchmark.
***Comprised of 40.0% JPM GBI-EM Global Diversified, 30.0% JPM EMBI Global Diversified, and 30.0% JPM CEMBI Broad Diversified.

****The Opportunity Fund has a maximum allocation of 10%. Any uninvested portion of this allocation is prorated across public equities and U.S. fixed income in SDCERS' 78%/22% ratio of return-seeking (non-Fixed Income) to risk-reducing (Fixed Income) assets.

The Total Fund Benchmark shall represent a weighted average of the individual asset class benchmarks based on strategic target weights to each asset class.

The primary benchmark for private equity is the 50th percentile of the Burgiss Database and is used by SDCERS' Private Markets Advisors to evaluate since inception internal rates of return (IRRs). For purposes of including private equity in Total Fund performance evaluation, a time-weighted return series is needed. The peer-based benchmark of the 50th percentile does not allow for such a calculation, and therefore, the Burgiss Pooled Return series is used as the private equity peer-based benchmark that is rolled into the Total Fund Policy benchmark. Private equity is also evaluated over the long-term against a secondary benchmark of 67% Dow Jones U.S. Total Stock Market Index/33% MSCI All Country World Index ex-U.S. plus a 3% annual premium.

The Benchmarks for each of the asset classes shall be reviewed regularly, but no less frequently than once every three years, to ensure that they remain appropriate. Staff and Consultant(s) shall recommend changes to asset class benchmarks as appropriate. In the event that any of the benchmarks defined above are discontinued or their composition changes, the Investment Committee may in its sole discretion substitute other benchmarks upon the recommendation of the Staff and Consultant(s).

Opportunistic Investments

Opportunistic investments encompass a broad range of alternative strategies that do not fit within traditional asset classes or share characteristics of more than one asset class. Such investments may also be truly opportunistic in the sense that they may be available for investment only during certain market environments. The Board, therefore, adopts a policy allocation of up to 10% of total assets to such investments that have acceptable risk/return characteristics, and which can further the diversification of the investment program. Such investments may include, but are not limited to, bank loan funds, distressed mortgage debt, niche private investments, certain types of hedge funds, and commodities.

Liquidity

SDCERS recognizes that certain investments that entail a greater degree of illiquidity, such as private equity, real estate, and infrastructure, offer the potential for greater return and/or enhanced diversification. As a long-term investor, SDCERS has the ability to bear illiquid investments. In recommending allocations to illiquid asset classes, Staff and the General

Investment Consultant shall consider projections of the net annual cash flows of SDCERS and identify a prudent level of assets that can be committed to such illiquid asset classes. The General Investment Consultant will undertake a liquidity analysis on an annual basis in conjunction with the Asset Allocation Review. Consideration should also be given to the size that such allocations may comprise in times of market stress to ensure that the overall allocation to such categories does not exceed the intent of policy and negatively impact the Fund's ability to meet ongoing cash flow needs.

Leverage

Leverage is a condition where the net potential monetary exposure of an obligation exceeds the value of the underlying assets. Leverage is not permitted at the Total Fund level. Underlying portfolio managers may use leverage so long as it is used in a manner consistent with the discipline for which the Board hired the investment manager and does not introduce material leverage at the Total Fund level. Use of leverage will be controlled by the investment manager's guidelines and will be subject to review by Staff, Consultants, and/or the Investment Committee.

Derivatives

For the purposes of this policy, derivatives include, without limitation: futures contracts; options; options on futures contracts; forward contracts; swap agreements, including swap contracts with embedded options; any instrument or contract intended to manage transaction or currency exchange risk in purchasing, selling, or holding investments; and any other instrument commonly used by institutional investors to manage institutional investment portfolios.

At the Total Fund level, derivatives may be used to maintain the program's strategic asset allocation. External managers retained by the Board may be permitted to utilize derivatives to implement their investment strategies. Each individual manager's guidelines shall specify guidelines regarding derivatives usage. Derivative usage by investment managers should not introduce leverage to the Total Fund.

Under no circumstances may derivatives or leverage be used to circumvent the intent or limits otherwise prescribed by this policy.

VI. REBALANCING POLICY

The purpose of rebalancing is to minimize unintended drift from SDCERS' strategic asset allocation, thus ensuring compliance with policy and reducing portfolio tracking error relative to the policy benchmark. Systematic rebalancing should reduce volatility and increase portfolio returns over the long-term.

SDCERS maintains a defined and disciplined rebalancing process, whereby target allocations to asset classes will not exceed certain rebalancing ranges as outlined in the following chart.

Asset Class	Long Term Target Weight %	Minimum Weight	Maximum Weight
U.S. Equity	19.0	16.0	22.0
Non-U.S. Equity	12.0	9.0	15.0
Global Equity	8.0	5.0	11.0
Private Equity/Infrastructure	13.0	8.0	18.0
Return-Seeking Fixed Income	5.0	2.0	8.0
Real Estate	11.0	6.0	16.0
Opportunity Fund	10.0	0.0	10.0
U.S. Fixed Income	22.0	19.0	25.0
Total	**100.0**		

The adopted rebalancing ranges take into consideration the trade-off between the portfolio tracking error relative to its strategic allocation and the transaction costs of rebalancing. The above ranges were approved by the Board on May 13, 2022.

The Board delegates to Staff the responsibility and authority to:

- Monitor market values against the target allocations.
- Determine whether or not the allocation to any asset class(es) and/or investment vehicle(s) are outside of rebalancing ranges.
- Instruct relevant investment managers to liquidate the appropriate dollar value of securities and reallocate cash in a manner so as to maintain allocations within rebalancing ranges.
- Evaluate and direct portfolio cash flows so as to maintain allocations within rebalancing ranges.
- Utilize low cost passive indices or exchange traded futures contracts, where appropriate, in lieu of existing portfolio managers, to maintain asset/sub-asset class exposure within rebalancing ranges.
- Report to the Board at each Board meeting the status of the Trust Fund asset allocation and any rebalancing activity.

- Evaluate SDCERS' rebalancing process regularly, but no less frequently than every three years, and recommend any changes to the Board, as needed.

When the allocation to an asset/sub-asset class(es) falls outside the range specified in the IPS, a rebalancing transaction shall be initiated to bring the asset class weight within the range, keeping in mind liquidity, costs, and risks. Public market asset classes will generally be rebalanced to the midpoint between target and the edge of the closest rebalancing range in an effort to reduce costs associated with rebalancing all the way back to target. There may be times when this does not hold true and Staff will report a deviation from this guideline to the Board.

Less liquid private assets such as real estate and private equity will not be managed within rebalancing ranges but will instead be managed to target over time through distributions and strategic new investments. Any assets outside of rebalancing ranges will be reported to the Board.

VII. MONITORING AND REPORTING

Purpose

Performance and risk will be monitored to ensure compliance and progress toward stated goals and objectives.

Performance Monitoring

The Fund's performance shall be measured against the actuarial assumed rate of return, inflation, a universe of other public funds, a custom performance benchmark/policy portfolio, or other appropriate measurements.

Investment managers will be measured against stated objectives, an appropriate market index, a broad universe of managed portfolios, and a smaller peer universe of portfolios managed by a similar investment style. Active managers should exceed their respective benchmark net of fees over a three- to five-year period.

Reporting

The Board believes timely reporting and communications concerning the status of investments and their performance is essential. In general, equity and fixed income managers shall provide monthly reports to Staff. Real estate, private equity and infrastructure managers or managers of other non-public market traded investments shall provide reports at least quarterly. These reports are to include:

- Composition of assets,
- Notice of the portfolio's largest industry or sector representations and holdings,
- Portfolio performance compared to the appropriate major index benchmark,
- Such other matters as investment managers feel are necessary.
- Reports from the Consultant(s) shall be provided quarterly to the Investment Committee or the Board. These reports are to include:
    - Performance of the Total Fund and Attribution,
    - Performance of the Individual Managers,
    - Equity Performance,
    - Fixed Income Performance,
    - Real Estate Performance,
    - Private Equity Performance,
    - Infrastructure Performance,
    - Opportunity Fund Performance,
    - Time-weighted Rates of Return and Rankings.

Staff shall report to the Board or the Investment Committee at regular Board meetings regarding the status of investments, including the asset allocation structure of the Fund and a list of managers on the Manager Monitoring Report. Staff shall report on an annual basis the status of securities lending activity and the cash overlay program, and a review of private markets fees and costs pursuant to California Government Code Section 7514.7.

Annual Monitoring of the Asset Allocation

Because the Board reviews and establishes the policy for investments annually in its asset allocation review, the Board shall exercise its fiduciary responsibility to be informed and to exercise oversight as to the general principles established and actions taken by the CEO and CIO in the implementation of the investment policy.

Active Risk Budget

Active Risk, commonly referred to as tracking error, is the risk associated with the differences in returns between the policy benchmark and the actual results of the portfolio. Active risk is only applicable to the publicly traded asset classes and may emanate from two primary sources: (1) differences between the securities held within a particular asset class composite and the asset class composite's benchmark (security selection risk) and (2) the difference between the asset allocation weights of the overall policy and the actual weights across asset classes (asset allocation risk).

Active risk is measured as the standard deviation of the difference between the monthly returns of an active manager's actual portfolio and their respective benchmark(s). The active risk of the Fund will be measured using the most recent five years (60 months). The budgeted amount of active risk will be 1.75% for the aggregated public market asset classes.

Manager Monitoring

Managers will be reviewed on a continuous basis by Staff and the Consultants based on custodial holding reports, quarterly performance reports, manager announcements, monthly performance and compliance reports as required by Staff, and other inputs. These reviews will be summarized in the quarterly report prepared by the Consultant(s) and Staff for Board consideration, who shall report on whether SDCERS' expectations have been met. Managers meeting expectations will be categorized in Good Standing. Managers not meeting SDCERS' expectations will be designated as Under Review. Managers designated as Under Review shall undergo a formal review by Staff and the Consultant(s) and a recommendation for action will be made.

VIII. SHAREHOLDER ACTIVITY

In recognition that proxy voting rights are considered assets of the Fund, the Board acknowledges its fiduciary responsibility to vote proxies in a timely manner and maintain accurate records of all proxy voting activity in compliance with all applicable laws.

To assist the Board in carrying out its fiduciary responsibilities in voting proxies, the Board, at the recommendation of the Investment Committee, has the authority to set proxy voting guidelines to be used in voting proxies on behalf of SDCERS. The Board delegates voting of all proxies to Staff who will then determine, for each applicable investment, whether it is prudent and feasible to delegate the voting to SDCERS' third party Proxy Voting Agent or to direct the investment manager to retain the responsibility to vote proxies on behalf of the Plan. The Proxy Voting Agent will vote all proxies in accordance with SDCERS' Proxy Voting Guidelines. It is expected that the investment manager will vote all proxies in the best interest of the Plan and its beneficiaries. Staff will monitor the voting activities and recordkeeping of the Proxy Voting Agent.

SDCERS' Proxy Voting Guidelines will be evaluated and updated no less than annually.

IX. IDENTIFICATION OF ROLES & RESPONSIBILITIES

Board of Administration

It is the responsibility of the Board to formulate policy, and not the intent of the Board to become involved in either the active implementation of that policy or in the daily operations of SDCERS. It is the duty of the Board to review and monitor the implementation of the policy to assure that investment activities are being performed in a prudent manner consistent with the intent of the Board.

The assets of the Fund are to be managed and invested according to the provisions of the California State Constitution, Article 16, Sections 17(c) and 17(d). These state:

1. The members of the retirement board of a public pension or retirement system shall discharge their duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.
2. The Board shall seek to diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.

Investment Committee

The Investment Committee's responsibilities include, but are not limited to:

- Annually review and recommend the long-term asset allocation strategy and portfolio structure of SDCERS.
- Conduct an Asset/Liability study every three to five years (or more frequently if circumstances warrant) as a basis to establish asset allocation goals and objectives.
- Review, quarterly, the investment performance of SDCERS total fund and underlying portfolios with the assistance of the General Investment Consultant.
- Review, quarterly, real estate performance reports from SDCERS' Real Estate Consultant.
- Review, quarterly, private equity and infrastructure performance reports from

SDCERS' Private Markets Advisors.

- Retain a General Investment Consultant to assist with performance measurement, asset allocation, manager reviews, investment research, manager searches, and other projects as needed.
- Retain a Real Estate Consultant to assist with performance measurement, structure of the program, investment research and recommendations, and development of the strategic policy and annual investment plan.
- Retain a Private Markets Advisor to assist with performance measurement, structure of the program, investment research and recommendations, and development of the strategic policy and annual investment plan.
- Retain a qualified custodian to safeguard SDCERS' assets.
- Monitor SDCERS' investment managers to ensure they adhere to policies set forth in this document and recommend changes to the Board as needed. The Board has the authority to initiate or terminate contractual relationships with SDCERS' investment managers.
- Monitor Staff to ensure the administration of SDCERS' investments in a responsible, cost- effective, risk-minimizing manner.
- Avoid any conflicts of interest.

Investment Staff

The Investment Staff is responsible for the following tasks:

- Maintain the target asset allocations of the Fund in accordance with Board policy. This requires an annual review of the asset allocation policy and an Asset/Liability study to be done every three to five years.
- Rebalance investment portfolios, as necessary, in order to maintain the asset allocation or to make cash available for the payment of benefits or funding of investments.
- Initiate and monitor all wire transfers or movement of monies to or from all investment accounts to external sources.
- Monitor public market, real estate, private equity, and infrastructure managers for adherence to appropriate policies, guidelines, and Investment Management Agreement specifications. Report to the Board any significant violations discovered.

- Maintain relationship with and monitor master custodian to ensure compliance with contract and all commitments.
- Maintain relationships with consultants (general investment, real estate, private markets advisors, and other asset class specialists) in order to obtain necessary assistance with assignments from Staff, the Investment Committee, and the Board in accordance with the contract requirements.
- Conduct manager searches, including the presentation of hiring recommendations, or monitor the General Investment Consultant in investment manager searches as assigned by the Board and Investment Committee.
- Review the public markets Manager Monitoring Report and related private markets monitoring reports for real estate, private equity, and infrastructure; explain any changes; and recommend action to the Investment Committee and Board, if necessary.
- Evaluate any changes in ownership structure of an investment management firm and with the concurrence of the Consultant(s) (general investment, real estate, private markets advisors, and other asset class specialists); authorize the assignment of the firm's Investment Management Agreement with SDCERS to the new ownership entity.
- Manage portfolio restructurings resulting from investment manager terminations with the assistance of consultants, investment and transition managers, and SDCERS' custodian, as needed.
- Conduct special research required to manage the Fund more effectively, as directed by the Investment Committee and Board.
- Assist the Investment Committee in the development, implementation, and revision of the Investment Policy Statement, as approved by the Board.
- Report on investment activity and matters of significance at each Investment Committee and/or Board meeting.
- Monitor the Securities Lending Program in accordance with the Securities Lending Guidelines.
- Conduct research and vote proxies in accordance with SDCERS' Proxy Voting Policy and Guidelines.
- Collect information from SDCERS' investment managers regarding investment decisions made involving Environmental, Social, and Governance (ESG)

considerations that may materially impact the Fund’s long-term investment returns and provide an annual summary of that information to the Board on a fiscal year basis.

- Manage liquidity requirements to meet the Fund’s needs without generating excessive trading costs.
- Avoid any conflicts of interest.

External Investment Consultants

General Investment Consultant

The General Investment Consultant shall be responsible for the following:

- Report to the Investment Committee and Board on the evaluation of the Fund’s performance and compliance as defined in this IPS.
- Assist Staff in making recommendations to the Board regarding: investment policy, strategic asset allocation, asset liability modeling, and asset class and manager structure strategies.
- Prepare a quarterly performance report including attribution of Total Fund, public market asset class and manager performance and one-quarter lagged performance reporting for Real Estate and Private Markets.
- Assist SDCERS in the selection of qualified investment managers, and assist in the oversight of existing managers, including monitoring changes in personnel, ownership, and the investment process.
- Collect information from SDCERS’ public market investment managers regarding investment decisions made involving ESG considerations that may materially impact the Fund’s long-term returns, and provide a summary of that information to the Board on a quarterly basis.
- Assist in the selection of a qualified custodian (including a securities lending agent and/or a cash manager) if necessary.
- Provide topical research and education on investment subjects that are relevant to SDCERS.
- Comply with SDCERS’ Conflict of Interest Policy.

Real Estate Consultant

A detailed set of guidelines and responsibilities are contained in a separate Real Estate Program Policy. Provided below is a list covering the broad responsibilities of the Real Estate Consultant.

- Report directly to the Board, Investment Committee, and Staff on matters of policy.
- Bring any non-conforming items or significant issues to the attention of Staff and/or the Board.
- Monitor the performance of the real estate portfolio and comply with approved policy. Provide information to the General Investment Consultant as requested.
- Prepare the Real Estate Program Policy and Real Estate Investment Plan and, in conjunction with Staff, present the Policy and Plan to the Investment Committee annually for review.
- Prepare a quarterly Performance Measurement Report and present the report to the Investment Committee.
- Collect information from SDCERS' real estate investment managers regarding investment decisions made involving ESG considerations that may materially impact the Fund's long-term returns, and provide a summary of that information to the Board on a quarterly basis.
- Provide Staff and/or the Board with topical research and education on investment subjects that are relevant.
- Comply with SDCERS' Conflict of Interest Policy.
- Monitor all elements of cost of the real estate portfolio and legal structure in order to avoid excess cost.

Private Markets Advisors

A detailed set of guidelines and responsibilities are contained in a separate Private Markets Program Policies. Provided below is a list covering the broad responsibilities of the Private Markets Advisors.

- Report directly to the Board, Investment Committee, and Staff on matters of policy.
- Prepare the Private Markets Program Policies and Investment Plan for Private

Equity and Infrastructure and, in conjunction with Staff, present the Policies and Plans to the Investment Committee annually for review.

- Manage the Private Equity and Infrastructure investment portfolio and legal structure.
- Monitor all elements of cost of the Private Equity and Infrastructure portfolio and legal structure in order to avoid excess cost.
- Identify, perform due diligence, negotiate, execute, and manage commitments and investments through the Private Equity and Infrastructure portfolio.
- Oversee the creation of the appropriate legal documentation for each investment.
- Monitor investments and report quarterly to the Board and Staff on investment performance. Provide information to the General Investment Consultant as requested.
- Manage all aspects of investments made on behalf of SDCERS through their lifecycle, including the disposition of those assets.
- Collect information from SDCERS' private market managers regarding investment decisions made involving ESG considerations that may materially impact the Fund's long-term returns, and provide a summary of that information to the Board on a quarterly basis.
- Review relevant issues in Private Equity and Infrastructure through periodic workshops, discussions, and distribution of research material.
- Comply with SDCERS' Conflict of Interest Policy.

<u>Proxy Voting Agent</u>

The Proxy Voting Agent shall be responsible for the following:

- Vote proxies in a timely manner per SDCERS' Proxy Voting Guidelines or per Staff direction in the case of exceptions to the policy.
- Provide Staff with on-going proxy voting research and analyses consistent with SDCERS' investment goals.
- Provide Staff with company-specific corporate governance profiles, pertinent statistical reporting, and yearly review of the results of corporate annual meetings.

- Comply with SDCERS' Conflict of Interest Policy.

Investment Managers

The investment managers shall have discretion to direct and manage the investment and reinvestment of assets allocated to their accounts in accordance with this document; applicable local, state, and federal statutes and regulations; and the individual specific investment guidelines in their contracts. The Investment Managers shall be responsible for the following:

- Execute a contractual agreement to invest within the guidelines established in the Investment Policy Statement.
- Provide SDCERS with proof of liability and fiduciary insurance coverage as requested.
- Comply with SDCERS' Conflict of Interest Policy.
- Be a SEC-Registered Investment Advisor under the 1940 Act, an insurance company or a bank and be recognized as providing demonstrated expertise over a number of years in the management of institutional, tax-exempt assets within a defined investment specialty.
- Adhere to the investment management style concepts and principles for which they were retained, including, but not limited to, developing portfolio strategy; performing research; developing buy, hold, and sell lists; and purchasing and selling securities.
- Execute all transactions for the benefit of SDCERS with brokers and dealers qualified to execute institutional orders on an ongoing basis at the best net cost to SDCERS and, where appropriate, facilitate the recapture of commissions on behalf of SDCERS.
- Reconcile monthly accounting, transaction, and asset summary data with custodian valuations, and communicate and resolve any significant discrepancies with the custodian (excludes real estate, private equity, and some alternative assets).
- Maintain frequent and open communication with Staff on all significant matters pertaining to the management of SDCERS assets, including, but not limited to, the following:
    - Major changes in the Investment Manager's outlook, investment strategy, and portfolio structure;

- Significant changes in ownership, organizational structure, financial condition, or senior personnel;
  - Any changes in the Portfolio Manager or other key personnel assigned to the SDCERS account;
  - Each significant client which terminates its relationship with the Investment Manager, within 30 days of such termination;
  - All pertinent issues which the Investment Manager deems to be of significant interest or material importance; and
- Meet with the Board or its designee(s) as needed.

Custodian Bank

The Custodian shall be responsible for the following:

- Provide complete global custody and depository services for the designated accounts.
- Manage the cash and enhanced cash funds not invested by managers and ensure that all available cash is invested. If SDCERS elects to manage cash externally full cooperation must be provided to the external manager.
- Provide the General Investment Consultant with portfolio information for performance measurement in a timely manner.
- Provide, in a timely and effective manner, a monthly report of the investment activities implemented by the investment managers.
- Calculate all income and principal realized and properly report the results in periodic statements.
- Provide monthly and fiscal year-end accounting statements for the portfolio, including all transactions; these should be based on accurate security values for both cost and market. These reports should be provided within acceptable time frames.
- Report to SDCERS situations where accurate security pricing, valuation, and accrued income is either not possible or subject to considerable uncertainty.
- Provide assistance to SDCERS to complete such activities as the annual audit, transaction verification, or unique issues as required by the Board.
- Provide appropriate information and assistance to SDCERS in connection with

foreign tax issues, including claims for exemptions and refunds.

- Manage a securities lending program to enhance income if directed by the Board. If the securities lending program is managed externally, full cooperation must be provided.
- Deliver all domestic and international proxy voting materials to SDCERS or its designated proxy voting agent, including meeting notices, voting instruction forms, proxy statements, quarterly and annual shareholder reports, and miscellaneous proxy voting materials.

Securities Lending Agent

SDCERS' policies and guidelines governing securities lending shall be implemented through the Custodian (or third party lending institution other than the custodian or a combination of securities lending providers). The provider will be governed by a separate contract, distinct from a custody relationship, detailing the type of securities lending relationship and program. This is both mandatory and essential in the treatment of securities lending as an investment function with the associated risks and return implications and fiduciary responsibility.

The securities lending agent must exercise investment discretion within the overall objective of: preserving principal, providing a liquidity level consistent with market conditions and the lending and trading activities of the Funds' assets, and maintaining full compliance with stated objectives and statutory provisions. The securities lending provider shall exercise prudence and expertise in managing the cash collateral reinvestment function.

Other External Providers

All other external providers will fulfill their responsibilities in accordance with prevailing contracts and act in the best interest of plan participants.

APPENDIX: Asset Class Descriptions

U.S. Equity – U.S. equity, as measured by the Dow Jones U.S. Total Stock Market Index, provides exposure to all segments of the U.S. equity market, including, but not limited to, growth and value stocks of large-, mid-, and small-capitalization U.S. companies. The Index is the broadest measure of performance of the aggregate domestic stock market.

Non-U.S. Equity – Non-U.S. equity markets encompass those of developed and emerging economies, as measured by the MSCI All Country World (ACW) ex-U.S. Investable Market Index (IMI). The MSCI ACW ex-U.S. IMI covers large-, mid-, and small-capitalization companies across 23 developed (excluding the U.S.) and 21 emerging market countries and covers approximately 99% of the international equity investment opportunity set. Emerging markets are classified as countries in the process of rapid business or social growth.

Emerging Markets Equity – Emerging markets represent countries in the process of rapid economic growth and that are progressing towards becoming advanced, as measured by the MSCI Emerging Markets (EM) Index. The MSCI EM Index captures large and mid-cap companies across 21 Emerging Markets countries and covers approximately 85% of the free float-adjusted market capitalization in each country.

Global Equity – Global equity is classified as U.S., non-U.S. developed, and emerging market securities, as measured by the MSCI All Country World Index. The factors that have made U.S. and non-U.S. equity markets distinct enough to be viewed as separate asset classes have receded in recent years. Increasing similarities among countries and markets suggest that a global approach to investing in the world's equity markets may be optimal.

Domestic Fixed Income – As defined by the Barclays Intermediate Aggregate Bond Index, domestic fixed income consists of investment grade, U.S. dollar-denominated, fixed rate, taxable bonds, including Treasuries, government-related and corporate securities, MBS, ABS, and CMBS. Domestic fixed income may also include high yield securities.

Return-Seeking Fixed Income – Return-seeking fixed income consists of non-core fixed income instruments such as high yield debt, emerging market debt, bank loans or other non-investment grade and investment grade securities. Given the vast array of potential investment strategies, the primary benchmark for this asset class will be an equal weighting of a bank loan market benchmark (S&P/LSTA Leveraged Loan Index or similar benchmark), a high yield market benchmark (ICE BofAML US High Yield Master II Constrained Index or similar benchmark), and an emerging markets blended debt benchmark (40% JPM GBI-EM Global Diversified, 30% JPM EMBI Global Diversified, and 30% JPM CEMBI Broad Diversified or similar benchmark).

Real Estate – Real estate includes investments in real property including office buildings, shopping centers, industrial property, hotels, warehouses, and apartments. Investment vehicles may include direct investments, public real estate investment trusts (REITs), and private partnerships. The real estate performance benchmark is comprised of the NFI-ODCE Index + 50 bps.

Private Equity – Private equity is equity capital that is not quoted on a public exchange. Strategies include leveraged buyouts, venture capital, mezzanine, distressed investments, and special situations. The primary benchmark for private equity is a peer-based benchmark, representing the 50th percentile of the Burgiss Database and is used by SDCERS' Private Markets Advisors when evaluating since inception internal rates of return (IRRs). For purposes of including private equity in Total Fund performance evaluation, a time-weighted return series is needed. The peer-based benchmark of the 50th percentile does not allow for such a calculation and therefore, the Burgiss Pooled Return series is used as the private equity peer-based benchmark that is rolled into the Total Fund benchmark. Private equity is also evaluated over the long-term against a secondary benchmark of 67% Dow Jones U.S. Total Stock Market Index/33% MSCI All Country World Index ex-U.S. plus a 3% annual premium.

Infrastructure - Infrastructure is broadly defined as the essential assets a society requires to facilitate the orderly operation of its economy and can be broken out into three broad categories: transportation, utility, and social. Typically, they are long-lived assets with low growth, similar volatility to real estate, and have an income stream tied to GDP/inflation that is greater than bonds or core real estate. The performance benchmark is the Consumer Price Index (CPI) plus a 5% annual premium.

Opportunity Fund – Opportunity fund investments should generally be truly opportunistic in the sense that they may be available for investment only during certain market environments. The Opportunity Fund can also encompass a broad range of strategies that do not fit into traditional asset classes or share characteristics of more than one asset class. Such investments may include, but are not limited to, bank loan funds, distressed or high yield debt, niche private investments, and certain types of hedge funds. The benchmark for this asset class shall be 78% equities, as measured by the MSCI All-Country World Investable Market Index, and 22% bonds, as measured by the Barclays Intermediate Aggregate Bond Index.

San Diego City Employees'
Retirement System

Real Estate Investment Policy

March 2022

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I. INTRODUCTION

The San Diego City Employees' Retirement System (the "Retirement System" or "SDCERS") has determined that, over the long term, inclusion of real estate investments will enhance the risk/return characteristics of the Retirement System's portfolio investment.

This document establishes the specific objectives, policies and procedures involved in the design, implementation, and oversight of the Retirement System's real estate program. The objectives define the specific risk tolerance and return expectations for the program. The policies provide specifications for acceptable investment structures and management of the various risks associated with the asset class. The procedures provide guidelines for the implementation and oversight of said policies.

II. INVESTMENT OBJECTIVES

A. Asset Allocation

SDCERS has approved a long-term asset allocation target of eleven percent (11%) for investment in real estate and real estate related investments. Given the illiquid and episodic nature of funding private real estate commitments, there will be periods when this long-term target will be approached above or below but not precisely achieved

B. Return Objectives

The Role of Real Estate (Portfolio Objectives)
Real estate is an asset class that institutional investors typically include in their investment asset mix. The Board of San Diego City Employees' Retirement System ("Board") has determined that the objectives of the Retirement System's Real Estate Portfolio are to generate income and provide diversification benefits to the Total Portfolio, while providing competitive returns relative to the benchmark.

Performance Measurement (Long Term Portfolio Benchmarks)
Active management, value creation strategies and the prudent use of third-party debt are approved methods for generating the expected excess return. The following benchmarks have been established for the Real Estate Portfolio:

SDCERS Total Real Estate Portfolio. On a blended basis, the net return for the SDCERS Private Portfolio is expected to meet or exceed the Private Benchmark. The Total Real Estate Portfolio Benchmark over a five-year rolling period is the net NCREIF Fund Index Open-end Diversified Core Equity Index ("NFI-ODCE") + 50 basis points ("bps"). There are no stated return objectives for either the Core or Non-Core Portfolios. The Total Real Estate Portfolio Benchmark includes the use of public real estate securities benchmarks to account for historical positions where SDCERS had significant exposure to publicly traded real estate securities from the first quarter of 1997 through the third quarter of 2016. The respective publicly traded real estate benchmarks are included in the Total Real Estate Portfolio benchmark and detailed below.

<u>Benchmark</u>

SDCERS Total Real Estate Portfolio (Net Total Return)

Q4 2016 – Present:	NFI-ODCE + 50 bps
Q3 2008 – Q3 2016:	NFI-ODCE + 50 bps & EPRA/NAREIT Global Index
Q1 1997 – Q2 2008:	NFI-ODCE + 50 bps & Wilshire REIT

<u>Ancillary Performance Measurement Tools</u>

Though there are no stated return objectives for either the Core or Non-Core Portfolio,, shorter term performance and risk assessment may also be evaluated on a risk adjusted basis using the NCREIF indices in a customized index to reflect the actual composition of the portfolio.

Given the current and anticipated composition of the Real Estate Portfolio, the following methodologies can provide a more detailed and relative measurement of the risk/return profile within segments of the Portfolio. The Core Portfolio will be evaluated compared to the NFI-ODCE. The Non-Core Portfolio will be evaluated using a Private Market Equivalent ("PME") analysis. Due to the Internal Rate of Return ("IRR") nature of real estate performance measurement, especially within the Non-Core segment, a PME analysis examines how the addition of such investments are accretive to the Total Real Estate Portfolio when compared to the NFI-ODCE, a Time Weighted Return ("TWR") Core real estate benchmark. The NFI-ODCE TWR measures are essentially a proxy for IRRs which will then be compared to the Non-Core IRRs which are expected to provide a premium over a long-term horizon given the additional risks undertaken by Non-Core investors compared to Core investors.

III. INVESTMENT POLICIES

A. Portfolio Composition

The Retirement System divides the universe of real estate investments into two primary risk profiles: (1) Core and (2) Non-Core.

Core Characteristics

- Operating and substantially leased properties (75%);
- Modest use of asset level leverage to enhance returns (0% to 50%); on average 20-30% for the overall Core Portfolio;
- Property types include, but are not limited to, office, apartment, retail, industrial, hotel. These asset types comprise the bulk of the assets in the Benchmark;
- Total return is primarily attributable to income (40% to 65%).

The Core Portfolio primarily consists of funds that hold equity investments in real property. The Core Portfolio may also include funds that invest in debt secured by real property.

Non-Core Characteristics

- Non-Core investments include:
  - investment in properties requiring lease-up, rehabilitation, repositioning, expansion or those acquired through forward purchase commitments, and may also include development projects and investments in operating companies with significant underlying or affiliated real estate assets;
- No property types are excluded (may include office, apartment, retail, industrial, hotel or niche property types like student housing, senior housing, or public storage, data centers, life science properties, etc.);
- Total return is attributable to a combination of income and appreciation, often with the expectation that appreciation will comprise more than 50% of the total return.

- Investments may include both equity and debt vehicles.

- Increased levels of leverage are generally used to enhance returns (<75%), which increases the risk profile of this category.

The Retirement System has established the following composition targets for the fully funded Real Estate Portfolio. As noted above, the tactical ranges identified for each risk profile may be out of compliance as the Real Estate Portfolio rebalances or works towards the fully funded target allocations:

	Target Allocation	Tactical Range
SDCERS Real Estate Portfolio		
Core	**70%**	**60% to 80%**
Non-Core	**30%**	**20% to 40%**

B. Risk Management

The primary risks associated with real estate investments are investment manager risk, property market risk, asset and portfolio management risk, leverage, climate and liquidity risks, which could result in the loss of principal.

The Retirement System will mitigate risk in a prudent manner. The following policies have been established to manage the risks involved in investing in real estate.

1. *Defined Roles for Participants*

The real estate program shall be planned, implemented, and monitored through the coordinated efforts of the Board, Investment Committee, Staff, Real Estate Consultant ("Consultant") and Investment Managers ("Manager" or "Managers"). The major responsibilities of each participant are outlined in **Appendix A**.

2. *Permissible Investments*

The Real Estate Portfolio will consist of primarily private investments in instruments that indirectly hold real estate and real estate related assets.

Private Markets. The private markets Real Estate Portfolio should consist of a majority of equity ownership of privately held institutional real estate investments. A portion of the Retirement System's private markets real estate assets may also consist of debt investments (e.g., first mortgages, B ¬note loans, mezzanine financing, preferred equity), not to exceed 30% of the overall real estate portfolio. Compliance with this risk parameter shall be based on a percentage of the private markets Real Estate Portfolio's Net Asset Value at Fair Value as of each quarter end. Real Estate debt investments are to provide additional layers of diversification and offer a level of downside protection.

Public Markets. Public market real estate securities may be considered from time to time for inclusion in the Total Real Estate Portfolio; but in no case to exceed 15% of the total allocation. Inclusion will generally be considered if a significant discrepancy is present between private and public market pricing. It is anticipated that Public market real estate will be used tactically; and not as a long-term structural investment unless T otal Plan liquidity considerations change.

3. *Investment Structures*

The Retirement System recognizes that, regardless of investment structure, real estate is an illiquid asset class. The Retirement System recognizes that Non-Core investments require the assumption of additional risks including diminished investor control and liquidity compared to Core funds and directly held ownership.

The Retirement System may utilize the following investment structures:

a) Individually Managed Accounts ("IMA")

The use of IMA investment structures is not currently permitted, and would require an amendment to this Policy by the Board to be reinstated. The Retirement System is currently in the process of liquidating the existing DWS IMA Portfolio. Details regarding process and duties as the IMA unwinds can be found in Section IV-A: Individually Managed Accounts.

b) Commingled Funds

For the Core component, the Retirement System may consider Open-End Commingled Funds ("OECFs"). OECFs are an infinite life pool of assets, generally organized as trusts, partnerships or private REITs that are generally, but not always, diversified by geography. Individual OECFs may be diversified by property sector or invest in a single property sector.

c) Co-Investments

The Retirement System may consider Co-investments. Co-investments are typically structured as limited partnerships that invest alongside a CF. Co-investments generally have the same limited level of control as CFs, and are typically governed by partnership agreements that are based on the partnership agreement of the related CF.

For the Non-Core components, the Retirement System will generally purchase assets through the ownership of partnership units or shares of Closed-End Commingled Funds. Any legally permissible vehicle will be allowed including, but not limited to, joint ventures, limited partnerships, real estate investment trusts (private), publicly traded real estate securities, and limited liability corporations. OECFs that target Non-Core investments may also be considered.

4. Diversification

The Retirement System will seek to reduce concentration risk by diversifying its Real Estate Portfolio by manager, vintage year, property type, geography and risk profile.

It is expected that at various points in time, the Real Estate Portfolio may be more heavily exposed to a single manager, single property type or location by virtue of opportunities available in the market, which are projected to generate the returns targeted by the Retirement System. Exposure to any single manager, property type (i.e. office, retail, apartment, industrial or other) or geography should be subject to the following guidelines. Exposures outside these guidelines should be brought to the attention, and reviewed by the Investment Committee for exception qualification or risk mitigation. Consultant will provide estimates of when the Retirement System will be in compliance with the below guidelines.

Diversification Guidelines:

Single Manager – The Retirement System should not allocate more than 30% of the Real Estate Portfolio to a single commingled fund manager. Exposure is measured by NAV plus unfunded commitments.

Property Type - The Retirement System seeks to minimize the risk of its Real Estate Portfolio by allocating its assets across the spectrum of property types. The Real Estate Portfolio shall be diversified, with the majority of investments comprised of the four traditional property types: office, industrial, retail, and multifamily (apartment). Allowable property type exposures will be within the range of +/- 15% of the NFI-ODCE weight in each property type. Property types outside of those represented in the NFI-ODCE Index are allowable up to 15% of the total fund exposure.

Geographic - The Retirement System seeks to minimize the risk of its Real Estate Portfolio by allocating its investments across the geographic spectrum.

- Within the United States, allowable geographic exposures will be within the range of +/- 15% of the NFI-ODCE weight in each geographic region.
- The development of overseas markets and investment opportunities provide investors with alternatives to further diversify their programs. However, international investments will be limited to no more than 15% of the total targeted Real Estate Portfolio and may include Core, Value Added and Opportunistic investments. International real estate investments will be held in commingled fund structures with aggregate exposure to multiple property types, regions and operators in order to reduce specific asset risk.

Commingled Funds

Diversification by vintage year, strategy and manager will be used to minimize sponsor, market, or strategy concentration. The Commingled Funds will provide reporting which will allow the Retirement System to monitor its geographic and property type diversification. Any single exposure to an Open-ended core commingled fund should be limited to 30%. The risk associated with reduced investor control and illiquidity in Non-Core strategies will be mitigated by limiting exposure to any single Non-Core manager to 20% and any single Non-Core commingled fund to 10%.

5. *Leverage*

The use of leverage is a prudent tool for enhancing returns and diversifying equity investments, though it does raise the risk profile of investments. As such, the Retirement System has approved leverage targets and limits in order to enhance returns and manage risk levels. The availability and cost of leverage will be factors considered in determining its use. For the Total Real Estate Portfolio, the Retirement System has established a leverage maximum of fifty percent (50%), with a target range of 35-45%. Wherever possible, third party debt should be non-recourse and should not be subject to cross collateralization. At no time shall the origination of new leverage cause the Portfolio to exceed the established limits on a loan-to-value basis. In the event that any leverage constraint is breached due to a contraction in market values, the Staff and Consultant will notify the Board and make a recommendation for action or exception. This also applies to the constraints set forth below.

a) Core
Core assets generally provide an established stream of rental revenue. Because of the predictability of the income stream, third-party debt can be used at relatively low risk to enhance return. For the Core Real Estate Portfolio, target average leverage is 20-30%. The Retirement System has established a forty percent (45%) leverage maximum for the Core Real Estate Portfolio to allow for market dislocation periods.

b) Non-Core
Investments classified as Non-Core generally provide returns with a higher proportion of appreciation, as compared to income, than do Core investments. Such investments will be made through commingled funds and will therefore have specified leverage maximums stated in the offering documents. The offering documents should reflect leverage limitations of no more than 75% upon expiration of the investment period. Exposures outside these limits should be reviewed and approved by the Investment Committee for exception prior to investment.

6. *Valuations*

Investments held in Commingled Funds will generally be marked to market quarterly but in no case valued less than annually, using the valuation methodology approved with the selection of the particular investment.

7. *Monitoring of Investments*

Real estate is an illiquid asset class that requires a long-term investment horizon. The Consultant and Staff recommend that SDCERS monitor each investment relative to a manager's performance, organizational stability, key personnel changes and other firm and fund level issues.

As outlined in Section IV.C., the Consultant prepares a Performance Measurement Report quarterly that provides detailed information concerning performance, diversification, and cash flows.

The Consultant will also provide an annual supplemental report at the end of each calendar year. The report will be a risk-based analysis providing relative and absolute assessments of the aforementioned items (e.g., performance compared to Ancillary Indices, organizational stability, key personnel changes and other firm level issues). The analysis will also review compliance with stated strategy and the impact of current market dynamics. The following categories will be used to classify SDCERS' investments:

<u>Exceptional:</u> These investments are expected to achieve returns that exceed those originally targeted and/or expected from an investment of a similar structure and risk profile

<u>Satisfactory:</u> These investments are expected to achieve returns approximately equal to those originally targeted and/or expected from an investment of a similar structure and risk profile and have similar performance to their peer group

<u>Monitor:</u> These investments may not be expected to achieve their originally targeted returns and may risk the loss of capital. These investments may be expected to underperform their peer group. Additionally, funds may have experienced recent organizational issues

The Consultant and Staff will report to the Investment Committee and Board annually the category ranking for each investment. Investments categorized as "Monitor" will receive additional oversight and evaluation. Commingled funds typically have language allowing for the removal of the General Partner with the approval of a set percentage of Limited Partners. Commingled fund interests may be sold on the secondary market, typically at a discount to current value, which should only be done when proceeds from a sale can be reinvested more effectively, or the outlook for a fund or manager is significantly negative.

C. Discretionary Authority

The Board controls the delegation of discretion. The Policies and Procedures described herein are structured to control investment risk as well as to enhance the Retirement System's ability to execute transactions.

1. Commingled Funds ("CF")

CFs, which includes both open and closed-end vehicles, are structured to give the highest level of discretion to the Manager. The limited investor control of management decisions inherent in CF investments is appropriate given the flexibility required to achieve higher expected returns. Nonetheless, preference will be given to those CF vehicles extending greater investor transparency and control. Investments made in CFs are monitored for compliance with vehicle documents through quarterly performance measurement procedures and through documentation provided with capital calls and income distributions.

2. Co-Investments

Co-investments are typically structured as limited partnerships that invest alongside a CF. Co-investments generally have the same limited level of control as CFs, but offer investors a more favorable fee and carried interest structure than through the main CF. Individual co-investments are monitored in the same manner as CFs, with respect to the Retirement System's Real Estate Portfolio and individual investment guidelines.

IV. INVESTMENT PROCEDURES

The Annual Investment Plan ("AIP") identifies the investment needs of the Portfolio and establishes the parameters for the selection of appropriate investments. The AIP will be presented to the Investment Committee/Board annually for approval. The particular needs for each AIP will be established in light of the structure, objectives and performance of the existing Portfolio as well as current market opportunities. All AIPs will be consistent with the policies detailed in Section III.A-C.

A. Individually Managed Accounts ("IMA")

The existing IMA is in the process of liquidation. The IMA Manager in its role as a fiduciary will continue to retain control over investment sales timelines and recommendations. The IMA Manager will continue to provide the Retirement System with all necessary and required reporting materials and annual asset management plans related to the Retirement System's investments until such time as the account is fully liquidated and closed.

B. Commingled Funds

The following procedures will be utilized in the selection, closing and monitoring of specific Commingled Fund (CF) investments.

1. *CF Selection Process*

   a) The Consultant will maintain an ongoing review of offerings within the institutional marketplace and, based on due diligence findings, refer appropriate CF investments to Staff.

   b) Staff shall review the Consultant recommendations for compliance with agreed upon due diligence procedures for each fund recommendation.

   c) Staff shall verify the compliance of each recommended fund with the approved Real Estate Investment Policy and Annual Investment Plans.

   d) Staff, with Consultant assistance, shall select appropriate CF investments in line with SDCERS Real Estate Investment Policy and Annual Investment Plan for presentation to the Investment Committee/Board.

2. *CF Control and Monitoring*

   CF investments will be monitored quarterly by Staff, with Consultant's assistance, to evaluate investment performance and to ensure compliance with vehicle documents.

C. Co-investments

The following procedures will be utilized in the selection, closing and monitoring of specific co-investments.

3. Co-investment Selection Process

   a) Manager will notify the Consultant and/or Staff of any available co-investment opportunity. Staff and the Consultant will confirm receipt of the notification with one another.

b) Staff shall verify the compliance of the co-investment opportunity with the approved Real Estate Investment Policy and Annual Investment Plans.

c) Staff, with Consultant assistance, shall evaluate the prospective co-investment.

d) Upon a favorable evaluation, Staff, with Consultant assistance, shall present to the Investment Committee/Board or, if the investment meets the criteria set forth below, Staff is granted discretion to proceed with the investment process.

- No more than 2% of the Total Real Estate Portfolio;
- Sponsored by an existing SDCERS real estate fund manager;
- No ground-up development;
- Reasonableness opinion from the Consultant

e) Staff and Consultant will report to the Investment Committee/Board at the next Investment Committee/Board meeting to disclose any co-investment that was made with staff discretion. Staff and Consultant shall report pertinent information regarding the co-investment.

4. Co-investment Control and Monitoring

Co-investments will be monitored quarterly by Staff, with Consultant’s assistance, to evaluate investment performance and to ensure compliance with vehicle documents.

D. Performance Measurement Report

On a quarterly basis, the Consultant will prepare a comprehensive reporting and evaluation system addressing each investment and Manager. The evaluation system shall provide such information as may be required by the Retirement System to understand and administer its investments and Managers.

The content of the report shall include attributes for the investment managers and the Total Portfolio including, but not limited to: income, appreciation, gross and net returns, cash-flow, internal rate of return, diversification, comparisons to relevant industry performance indices and information reporting standards, and Real Estate Investment Policy and Annual Investment Plan compliance. Each investment will be reviewed for significant events and projected performance and an opinion provided with respect to Manager performance. Budget and Management Plan variances, as reported by IMA Managers, will also be provided upon request.

The Consultant shall prepare and forward to the Retirement System a Performance Measurement Report within ninety (90) days following the last day of each quarter, except for year-end reporting which will be prepared and forwarded to the Retirement System within 180 days. The Year-End Report will also include an annual risk-based analysis that will allow the Consultant and Staff to rank investments according to the Consultant's category ranking system (as described above in section B.7).

Exhibit A

Defined Roles for Participants

Duties of the SDCERS Board

- Establishes the role of the real estate investment program in light of the Total Portfolio objectives.
- Approves the allocation to real estate and approves any adjustments to the allocation which may be necessary from time to time.
- Approves the Real Estate Investment Policy and the Annual Investment Plan for the real estate program.
- Controls the delegation of discretion regarding matters of investment selection, manager retention, manager termination, and management of investments.
- Reviews the Real Estate Portfolio on a quarterly basis to evaluate the investment performance and to ensure compliance with policy guidelines and approved Investment Plans.

Duties of the Investment Committee or the Full Board in the absence of an Investment Committee

- Reviews the Real Estate Investment Policy and the Annual Investment Plan for the real estate program. Presents and recommends the Plans to the Board for approval.
- Reviews the Staff's selection of Managers, Investment Partners or Ventures, and Commingled Fund Sponsors and reports selections to the Board.
- Reviews Staff and Consultant recommendations for removal of Managers and make recommendations to the Board.
- Reviews the Real Estate Portfolio on a quarterly basis to evaluate the investment performance and to ensure compliance with policy guidelines and approved Annual Investment Plans, and reports to the Board.

Duties of the SDCERS Staff

- Reports to the Investment Committee and Board on matters of policy.
- Oversees Consultant's preparation /review of the Real Estate Investment Policy and Annual Investment Plan.
- Staff, with Consultant assistance, is responsible for the recommendation for selection, retention, and termination of managers and real estate investments that are in line with the Real Estate Investment Policy, Annual Investment Plan, and/or Board approved tactical plans that may arise from time to time.

- Participates with the Consultant in the Annual Real Estate Portfolio Review, including Budget and Management Plans and Manager Investment Plans. Reports completion to the Investment Committee.
- Brings any non-conforming items or significant issues to the attention of the Investment Committee.
- Documents and monitors funding procedures.
- Completes any other activity as directed by the Committee and/or Board.

SDCERS Staff - Individually Managed Account ("IMA") Duties (For Liquidation of IMA Account):

- Oversees preparation of annual Manager Investment Plans and reports completion to the Investment Committee.
- Reviews the Budget and Management Plans prepared by IMA Managers and reports completion to the Investment Committee.
- Reviews fees for compliance and insures that Incentive Fees are processed appropriately.
- Performs other duties required to execute the IMA Investment Procedures.
- Monitors the closing process, and with legal counsel, reviews and executes any required documentation for re-financings and other capital transactions between IMA Managers and the Retirement System.

SDCERS Staff- Commingled Fund ("CF") Duties

- With the assistance of the Consultant, conducts screening, review, and selection of CF offerings.
- Oversees the commitment process, and with legal counsel, reviews and executes any required documentation.

SDCERS Staff- Co-investment Duties

- With the assistance of the Consultant, conducts screening, review, and selection of Co-investment offerings.
- Oversees the commitment process, and with legal counsel, reviews and executes any required documentation.

<u>Duties of the Consultant</u>

- Reports directly to the Board, Investment Committee and Staff on matters of policy.
- Brings any non-conforming items or significant issues to the attention of the Staff and/or Board.
- Monitors the performance of the Real Estate Portfolio and compliance with approved policy.
- Prepares/Reviews the Real Estate Investment Policy and Annual Investment Plan and, in conjunction with Staff, presents the Plans to the Investment Committee for review.

- Prepares a quarterly Performance Measurement Report (PMR) to evaluate investment performance and to ensure compliance with policy guidelines and approved Investment Plans. Presents Portfolio PMR to the Investment Committee quarterly.
- Assists Staff in the Annual Real Estate Portfolio Review
- Provides Staff and/or Board with topical research and education on investment subjects that are relevant to SDCERS.
- Screen database to identify Manager candidates that exhibit qualities consistent with the qualification criteria and work jointly with Staff to determine portfolio fit.
- Accept and evaluate recommendations made by Staff for portfolio consideration.

Consultant - Individually Managed Account ("IMA") Duties

- Assists Staff in overseeing the liquidation of the existing IMA.
- Oversees Manager preparation of annual Manager Investment Plans and, in conjunction with Staff, and reports completion to the Investment Committee.
- Reviews the Budget and Management Plans prepared by IMA Managers and, in conjunction with Staff, reports completion to the Investment Committee.
- Performs other duties required to execute the liquidation of the IMA.

Consultant - Commingled Fund Duties

- Conducts, or assists Staff in conducting analysis of Commingled Fund offerings in accordance with the Commingled Fund selection process.
- Provides written analysis of Commingled Funds as requested by Staff.

Consultant - Co-Investment Duties

- Conducts, or assists Staff in conducting analysis of Co-investment offerings in accordance with the Co-investment selection process.
- Provides written reasonableness opinion of Co-investment opportunities as requested by Staff.

<u>Duties of the Manager</u>

- Provides performance measurement data in form and substance as requested by the Retirement System.

Individually Managed Account Managers:

- Disposes of assets on behalf of the Retirement System.
- Adheres to the most recent version of the Reporting Standards established jointly by the National Council of Real Estate Investment Fiduciaries ("NCREIF") and the Pension Real Estate Association ("PREA") ("Reporting Standards").

- Prepares Budget and Management Plans to be submitted to the Staff and Consultant.
- Meets with Staff and Consultant for the Annual Real Estate Portfolio Review.
- Provides Consultant, when requested, Annual Review information.
- Assists the Staff in preparing funding or disposition procedures.

Commingled Fund and Co-investment Managers:

- Adheres to reporting standards established by the CFA Institute and ILPA and complies with generally accepted accounting principles ("GAAP").
- Executes and performs its duties under the terms of the investment vehicle documents.
- Provides timely requests for capital contributions.
- Provides quarterly financial statements and annual reports.
- Conducts no less frequently than annually meetings with Staff and Consultant to discuss important developments regarding portfolio, investment and management issues.

Duties of Legal Counsel

- Outside legal counsel, selected by the Retirement System as a representative for the Plan, will review upon request, all real estate related documents and/or provide advice for special investment situations as needed.

Private Markets Program Policy

September 2018

Introduction

The purpose of this Policy Document (the "Policy") for the San Diego City Employees' Retirement System ("SDCERS" or the "System") is to establish the parameters by which the System may invest through its Private Markets Program (the "Program"). This Program consists of allocations to private equity ("PE") and infrastructure. Private Markets ("PM") will refer to the asset classes of PE and infrastructure.

This Policy will ensure that the managers, advisors and other external resources retained by the System adhere to the investment principles and guidelines of the SDCERS Board of Administration (the "Board"), while:

1. Preserving the flexibility necessary to accomplish its objectives;
2. Minimizing risk and correlation to the System's overall portfolio;
3. Optimizing diversification as appropriate; and
4. Maximizing risk-adjusted returns for the Program.

Program Objectives

SDCERS created an allocation for investments in PM in order to:

1. Increase the risk-adjusted returns of the overall portfolio of the System;
2. Increase the diversification of total System assets; and
3. Take advantage of the illiquidity premium of this asset class, given the System's long-term nature of Liabilities.

In order to meet the above Investment Objectives, the Board approved the following targets in Asset Allocation and Return:

Asset Allocation Targets

The allocation targets are: **ten percent (10%)** market value exposure of the System's total portfolio to **private equity**, and **three percent (3%)** to **infrastructure**.

Actual market value exposure will take time to achieve and that can vary significantly. As *commitments* (not market value) to PM partnerships are drawn over time, these commitments must exceed the target market value exposure in a mature portfolio. The proper level of commitments in order to achieve the desired market value exposure shall be reviewed on an annual basis.

Return Targets

New PM programs will experience a *J Curve*: the tendency to deliver negative returns in early years before investment gains are realized in the outlying years. Therefore, SDCERS will focus on the long-term performance of the Program, *net of all fees*.

<u>Private Equity</u>

The role of private equity is to provide higher absolute returns over equities while improving the portfolio's diversification. Given the illiquid and unique characteristics of private equity, there are no perfect or universally accepted benchmarks. However, the two most common ways of benchmarking private equity investment performance are as follows:

- **Peer Benchmark:** Represents performance of actual private equity investments (compiled by a suitable provider of benchmark universe data) with similar style, geography, and vintages and has the potential to better reflect a comparison relative to a similar private equity composite portfolio;
- **Public Market Index plus Premium:** Acts as a long-term, theoretical benchmark as private equity seeks to provide a premium over public market equity over the long term and can provide an estimated measure of the opportunity cost of the decision to invest in private equity.

As such, the Private Equity portion of the portfolio shall be measured against the following two benchmarks:

1. **<u>Policy Benchmark (relative performance / peer benchmark):</u>** To assess the performance of the PE portfolio relative to other PE portfolios, the performance of individual investments made in SDCERS' PE portfolio shall be measured against the **upper half** performance (top 50th percentile) as stated in **Burgiss' Private IQ**[1] database.

2. **<u>Secondary Benchmark (opportunity cost / public market index plus premium):</u>** To assess the performance of the PE portfolio relative to other investments the System might pursue, the long-term performance of investments made in the PE portfolio shall be measured against the **weighted composite performance** of the **Dow Jones U.S. Total Stock Market Index**[2] **(67% weight)** and the **MSCI ACWI ex USA Index (33% weight)**[3] measured **since inception** of the private equity portfolio **plus 300** basis points.

The private equity benchmarks included above reflect revisions to conform to the recommendations included in the Asset Allocation Review and approved by the SDCERS' Board into policy in March 2018.

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[1] Private iQ is database managed by Burgiss, a global provider of investment decision support tools for private capital, that includes the complete transactional history of 8,250 private capital funds representing more than $5.9 trillion in committed capital across the full spectrum of private capital strategies, including private equity, private debt, and real assets.

[2] The Dow Jones U.S. Total Stock Market Index (Ticker: DWCF), a member of the Dow Jones Total Stock Market Indices family, is designed to measure all U.S. equity issues with readily available prices. The index was launched on January 1, 1987 and had 3,766 constituents as of July 31, 2018.

[3] The MSCI ACWI ex USA Index captures large and mid-cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 24 Emerging Markets (EM) countries. With 2,154 constituents as of July 31, 2018, the index covers approximately 85% of the global equity opportunity set outside the US. DM countries include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK. EM countries include: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Russia, Qatar, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates. The index was launched on January 1, 2001.

Infrastructure

The role of infrastructure in the portfolio is to provide SDCERS with exposure to investments with lower volatility returns, recession resilient characteristics, lower correlation with other asset classes, inelasticity of demand, yield generating capabilities, and inflation hedging abilities.

Infrastructure shall be measured against one benchmark:

1. Inflation hedge: To assess the performance of the infrastructure portfolio and its role in the total portfolio as an inflation hedge, the long term performance of investments made in infrastructure shall be measured against the performance of the **Consumer Price Index ("CPI") plus 500** basis points (with CPI defined as Core CPI[4] as published by the Bureau of Labor Statistics) **since inception** of the infrastructure portfolio.

This infrastructure benchmark included above reflects revisions to conform to the recommendation approved by the SDCERS' Board into policy in May 2018.

Program Policies

SDCERS' Private Markets Program has 4 general policies:

1. Private Markets Investments: The Program will invest in PM assets and strategies (i.e. PE and infrastructure) globally, and diversify away from assets and strategies that SDCERS already employs (i.e. not invest in: real estate, general stocks and bonds, etc.).
2. Discretionary Authority: The Program will use discretionary advisors. These are fiduciaries approved by the Board who shall acquire and manage, on a discretionary basis, PM investments on behalf of SDCERS in accordance with Program policies.
3. Risk Minimization: The Program will minimize all risks in a prudent manner. These risks include not only the investment risks of PM, but also risks associated with Program operation.
4. Ethical Standards: The Program will adhere at all times to the highest ethical standards and principles.

Additional details for these policies are:

1. Private Markets Investments (Eligible Investments)

The Program will invest in PM assets and strategies *globally*. PM assets are generally defined as direct investments in projects or companies that are privately negotiated and typically do not trade in a capital market. These investments are usually equity interests that are generally illiquid and therefore long-term in nature. Infrastructure is a subset of private equity, defined as permanent "essential" assets society requires to facilitate the orderly operation of its economy, such as roads, water supply, sewers, power and telecommunications.

[4] The "Consumer Price Index for All Urban Consumers: All Items Less Food & Energy" is an aggregate of prices paid by urban consumers for a typical basket of goods, excluding food and energy. This measurement, known as "Core CPI," is widely used by economists because food and energy have very volatile prices.

PM investments can be made directly or more commonly through investments in limited partnerships and other types of investment vehicles that offer limited liability to investors. While the Program can invest directly, its initial focus will be on these limited partnerships and allow the General Partner to select and manage the direct investments.

Examples of PM strategies are:

- Corporate Finance: Buyouts, Acquisitions, Takeovers, Industry-Focused, Specialized Strategies, Non-controlling Interests, Development Capital, Equity Expansion
- Other Private Investments: Secondary Interests, Venture Leasing, Project Financing, Special Situations, Oil and Gas (Energy) Exploration or Production, Clean Technology, Intellectual Property, Co-Investments, Infrastructure
- Mezzanine Financing: Structured Equity, Subordinated Debt, Captive Mezzanine Funds, Third Party Mezzanine Financing
- Venture Capital: Seed Stage, Early Stage, Middle Stage, Late Stage, Balanced Venture Capital Funds, Growth
- Distressed/Restructuring: Turnaround Situations, Restructurings, Distressed Debt

The Program will avoid assets and strategies that SDCERS already employs (i.e. not invest in: real estate, general stocks and bonds, etc.).

2. Discretionary Authority

The Program will use discretionary advisors (the "Advisors"). These are fiduciaries that shall acquire and manage, on a discretionary basis, PM investments on behalf of SDCERS in accordance with these Policies and fiduciary standards of the "prudent expert" rule.

The Board controls the delegation of discretion. However, using such advisors, who specialize in PM and can perform extensive due diligence / selection, is expected to minimize risk. Staff will evaluate and recommend advisors as appropriate. All engagements of advisors will require the approval of the Board.

With each engagement, Advisors will provide:

A. **Their Investment Plan**: This is a document for Board approval that provides guidance as to the management, operations and investments of the Program. Its components are:
    - Pacing Analysis: This is an identification of an optimal average commitment size as well as a total target commitment level to reach the System's long-term target market value allocation. The Pacing Analysis shall take into account the System's overall allocation to and investments in PM, within each strategy, and across industries and geography. It will endeavor to maintain even vintage year diversification despite short term market fluctuations and the denominator effect.
    - Investment Approach: Advisors shall review and manage investments using a disciplined but opportunistic management strategy. Given the "blind pool" nature of this asset

class, a primary objective will be **access to the best managers**. Advisors shall seek to identify the best managers and opportunities available and highlight this in their Plan.

- Risk Minimization: Advisors will also explain how they intend to minimize the risks associated with this asset class. After manager selection, a secondary goal is to be diversified appropriately across strategies, industries, partnerships and geography.

B. **Annual Review of their Investment Plan**: The Advisors will perform an annual review of their Plan for Board approval. This will consist of a comprehensive analysis of what happened in the past year, and any revisions to the Plan moving forward.

C. **Portfolio Monitoring and Reporting**: The Advisors will provide quarterly monitoring reports and a greater level of detail on the annual reports. There will typically be a one quarter valuation delay. These reports are meant to alert Staff to possible adverse developments as well as provide timely updates on the performance and analysis of investments. The reports shall include, but not be limited to, the following:

- The general investment environment and perceived opportunities coming to the PM
- Allocations made across different industries and subclasses of PE
- An assessment of future outcomes of the investments held
- Summary of investment portfolio performance, along with an update on overall market performance
- New commitments made since the last report
- Summary of draw-downs and distributions

In addition to the above, Advisors will adhere to the following:

a. Valuations: Investments in the Program shall be valued on a quarterly basis according to the standards of the Financial Accounting Standards Board.

b. Audits: The advisors' investment vehicles shall be audited annually by an independent third party.

3. Risk Minimization

The Program will minimize all risks in a prudent manner. There are 2 categories of risk: Asset Class risk and Program risk.

Asset Class Risk

Asset Class risks are the risks associated with PM investments. In general, those risks are:

- Manager risk
- Underlying company risk
- Market risk
- Portfolio management risk
- Liquidity risk

There are several ways to minimize Asset Class Risk, which may include:

- Diversification: The portfolio shall be diversified appropriately across strategies, industries, partnerships and geography as explained above. Diversification reduces the impact of any one investment or style affecting a disproportionate share of the total portfolio.

- Minimum Requirements: Advisors will have a high threshold of minimum requirements to ensure investments are with managers of institutional quality that exhibit a high degree of fiduciary responsibility. Some examples are:

  - Managers must have annual audits by independent third parties
  - The Program will not invest in funds that charge sales / marketing fees
  - All investment structures must provide limited liability to the System

Program Risk

The Program shall be planned, implemented, and monitored through the combined efforts of the Board, Staff and Advisors. To ensure smooth coordination between all parties, it is important to have clearly defined roles for each group.

To minimize Program Risk, the delegation of the major responsibilities of each participant are outlined below:

The **Board's** duties include:

- Approve the retention of external resources such as PM advisors and / or back office, monitoring firms
- Perform annual comprehensive reviews of the Program to ensure compliance with the Policy and the achievement of the Objectives of the Program
- Approve the Advisors' Investment Plans and annual updates to their Plans (as prepared by the Advisors in their Annual Reviews)
- Delegate investment approval authority to the Advisors by entering into an investment vehicle with each Advisor to be managed at the discretion of the Advisors, subject to the parameters and limitations of this Policy

The **Staff's** duties include:

- Recommend changes in the Policy to the Board
- Propose, issue and evaluate responses to RFPs for the selection of advisors and make selection recommendations to the Board
- Manage the System's relationships with advisors and other external resources, to ensure that the System obtains the maximum value from those relationships
- Coordinate the activities of, and communications among, advisors
- Understand the attributes of each recommended investment

- Collaborate with the advisors on the selection of investments for the Program and the monitoring of such investments
- Process capital calls issued by Advisors
- Oversee risk management functions performed by Advisors and through portfolio monitoring
- Analyze the results of portfolio monitoring reports and make recommendations with respect to Investment Plans and Pacing
- Monitor Advisor compliance with terms and conditions of all agreements

The **Advisors'** duties include:

- Develop and implement the strategy for the Program
- Manage the Investment Vehicle, subject to the limitations set forth in such vehicle which should include reference to this Policy
- Monitor all the elements of cost of the Investment Vehicle in order to avoid excess costs at all times
- Identify, due diligence, negotiate, execute, and manage commitments and investments through the Investment Vehicle, subject to Policy and Plan
- Oversee the creation of appropriate legal documentation for each commitment
- Monitor investments in the Investment Vehicle and report quarterly to the Board and the Staff on investment performance
- Manage all aspects of investments made by the Investment Vehicle through their lifecycle, including the disposition of those investments
- Review relevant issues in PM through periodic workshops, discussions and distribution of research materials

4. Ethical Standards

The Board, Staff, Advisors and all other participants in the Program will adhere at all times to the highest ethical standards and principles. Items of note are:

- Disclosure: The Board, Staff, Advisors and all other participants in the Program shall strive for transparency on all activities while preserving the confidentiality of trade secrets pursuant to California law. Disclosure of any payments made by an investment manager or advisor to obtain a commitment from SDCERS shall be disclosed to SDCERS prior to an investment.
- Conflicts of Interest: The Board, Staff, Advisors and all other participants in the Program shall avoid all conflicts of interest that may arise. In the event that conflicts of interest are identified, the identifying party shall disclose such conflicts to the Chief Compliance Officer of SDCERS.