

September 18, 2017

Item Name: Changes to Infrastructure Board Investment Consultant**Program:** Investment Office**Item Type:** Action**Executive Summary**

The primary purpose of this agenda item is to address the resignation of StepStone as the Infrastructure Consultant and obtain the approval of the Investment Committee (Committee) to engage another firm to act as Infrastructure Consultant effective October 1, 2017. In addition, staff recommends taking this opportunity to reduce the level of complexity and expense associated with the management of the Board's investment consultants by aligning the contract terms for the Infrastructure Consultant and the Real Estate Consultant. In approving this agenda item, the Committee is authorizing staff to take the steps necessary to expeditiously contract with the firm selected by the Committee and, should the Board so choose, to align the contract terms for the infrastructure and real estate consulting functions.

Recommendation

Staff recommends that the Committee:

- 1) Accept the resignation of StepStone Group LP (StepStone) as the Infrastructure Board Investment Consultant (the "Infrastructure Consultant") effective end of day September 30, 2017, and select **either** suboption (a), (b), or (c) below;
 - (a) Authorize staff to (i) issue a Request for Proposal (an "RFP") to contract with a firm to assume the responsibilities of the Infrastructure Consultant and (ii) engage a Spring-Fed Pool consultant as selected by the Committee to serve as the interim Infrastructure Consultant until such time as the Committee awards a new Infrastructure Consultant contract;
 - (b) Authorize staff to engage and contract with Meketa Investment Group (Meketa), the second highest scorer during the last Infrastructure Board Investment Consultant RFP (No. 2013-7086) to assume the responsibilities of the Infrastructure Consultant effective October 1, 2017; **or**
 - (c) Authorize staff to engage and contract with Pension Consulting Alliance, LLC (PCA), to assume the responsibilities of the Infrastructure Consultant effective October 1, 2017;and,
- 2) Authorize staff, during the contracting process for the Infrastructure Consultant selected by the Committee to extend the term of the current service period for the Infrastructure Consultant (currently expiring February 29, 2020) to align with the expiration of the contract term of the existing Real Estate Board Investment Consultant (the "Real Estate Consultant") Contract (No. 2016-8262), which expires on March 31, 2022.

Of the suboptions identified above, staff recommends, for reasons of continuity and efficiency and to minimize disruption to the investment process for this important asset class, that the Committee avail itself of the applicable exemption from the RFP process and select 1(b) or 1(c), and take this opportunity concurrently to align the contract term of the current Infrastructure Consultant with that of the current Real Estate Consultant.

Strategic Plan

This agenda item supports Strategic Plan Goal A - Improve long-term pension and health benefit sustainability. The firm acting as the Infrastructure Consultant will provide the Committee with advice and recommendations on the Real Assets Program, which plays an integral role in the success and sustainability of the Total Fund.

Investment Beliefs

This item supports CalPERS' Investment Belief 10, that strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives.

Background

The role of the Infrastructure Consultant is to act as an independent fiduciary advisor to the Committee and provide opinions on matters relevant to the prudent and optimal management of the Infrastructure program. Additionally, the Infrastructure Consultant is to align the execution of contracted services with CalPERS' Investment Beliefs, which (1) are a guide for making decisions, (2) provide context for CalPERS' actions, and (3) reflect CalPERS' values.

CalPERS and StepStone are parties to Agreement No. 2014-7393 for the providing of infrastructure consulting services to the Committee (the "Current Infrastructure Consulting Contract") for a term commencing on March 1, 2015 and, absent earlier termination, expiring on February 29, 2020. StepStone has tendered its resignation as Infrastructure Consultant effective September 30, 2017 (*Attachment 1*). The current Infrastructure Consulting Contract was awarded to StepStone at the conclusion of the Infrastructure Investment Board Consultant RFP No. 2013-7086 released on April 25, 2014.

Meketa placed second during the previous Infrastructure RFP to StepStone and previously served the Committee from 2010 to 2014 as the Infrastructure Consultant. Meketa is also serving the Committee as the Private Equity Board Investment Consultant as of March 16th, 2017.

PCA was awarded the Real Estate Consultant contract at the conclusion of RFP No. 2015-8014 released October 8, 2015. PCA will continue to act as the Real Estate Consultant, the secondary general pension consultant, and the primary adviser for matters relating to the Responsible Contractor Policy. PCA's proposed team has experience in both Real Estate and Infrastructure.

Analysis

Staff's recommendation is based primarily on the following:

Recommendation 1(b) or 1(c)

- Board Consultant RFPs require significant expenditure of resources and time for the committee members chosen to participate in the process, committee meeting scheduling, and INVO and OSSD staff to develop, administer, and manage;

- Two firms, Meketa and PCA, are consultants known to the Committee and have the industry and professional experience to fulfill the duties of the Infrastructure Consultant.
- Meketa participated in and ranked second in the last Infrastructure Consultant RFP;
- PCA is the Board's current Real Estate Consultant;
- Many consulting firms with expertise in Infrastructure are also in the asset management business and may be or may become conflicted; and
- The majority of consultants available in the pool do not have infrastructure expertise.

Recommendation 2

- Aligning the contract term of the new Infrastructure Consultant with the existing Real Estate Consultant provides the Committee and staff an opportunity to:
 1. Strategically manage board consultant contracts
 2. Reduce the complexity of the ongoing management of Board consultants
 3. More efficiently manage the board consultant contract process, and reduce the expenditure of resources required to contract with the consultants
- The Committee may want to consider consolidating board consulting work, in alignment with the recent consolidation of the Real Estate and Infrastructure investment teams and policies.

Effect of StepStone Resignation

StepStone's resignation as the Infrastructure Consultant will, upon acceptance by the Committee, create the immediate need for the Committee to select and engage a qualified firm to assume the duties of the Infrastructure Consultant. The program procedures for Real Assets include a requirement for a Private Asset Class Board Investment Consultant to, among other things, provide an opinion on infrastructure investment transactions before the transaction may be closed. As a result, if the role of the Infrastructure Consultant were to remain vacant for any period of time, there could be a significant negative impact on the infrastructure investment process.

Upon approval of the agenda item, StepStone's resignation will be effective end of day September 30, 2017, and the successor firm as selected by the Committee shall assume the duties of the Infrastructure Consultant effective beginning of day October 1, 2017.

Potential Replacements

Both Meketa and PCA are established firms with the experienced staff and resources to effectively assume the role of Infrastructure Consultant. Each firm's proposed key persons for the Infrastructure Consultant are in their respective "Proposed Key Persons" submissions (*Attachments 2 and 3* respectively). Meketa previously served as the Committee's Infrastructure Consultant from 2010 to 2014 and PCA has been serving the Committee as the Real Estate Consultant for approximately seven years. Engaging Meketa or PCA through a new contract and/or letter of engagement or using the existing Real Estate Consultant contract with PCA would allow staff to expeditiously engage either vendor, avoid a lapse in services to the Committee, and provide continuity of services to the Committee from a known contractor.

The Investment Office (INVO) maintains pools of investment consultants, including consultants to act in the capacity of a Board Investment Consultant, should the need for such consultant arise. A list of such consultants is in section I of the Board Investment Consultant Background Information (*Attachment 4*). The pool of consultants is not specific to Infrastructure and of the firms in the current pool, only Meketa and PCA have the resources, experience, and infrastructure expertise to assume the responsibilities without a disruption of services to the Committee.

Alignment of Contract Terms

Staff recommends the Committee also authorize staff to align the Infrastructure Consultant contract term with the expiration of the Real Estate Consultant, which terminates on March 31, 2022. Aligning the terms of the Infrastructure and Real Estate Consultant contracts allows staff and the Committee to more efficiently manage Board Investment Consultant RFPs and potentially issue a consolidated Real Assets RFP in 2022 (covering Real Estate, Infrastructure, and Forestland) allowing the Committee the option of awarding the contract to one, two, or three firms. A consolidated Real Assets RFP would reduce complexity in the management of the Board Consultants and potentially the cost of the services.

Such alignment will result in a reduction of staff and Committee hours dedicated to the RFP, reduce the number of agenda items brought before the Committee relating to these RFPs, and potentially reduce amount of staff time devoted to ongoing contract management surrounding these types of Board Consultants. While reducing the staff resources dedicated to RFPs, the Committee would retain the option of awarding contracts to individual firms for each real asset class, to a single firm for the entire Real Assets program, or a combination thereof. The list of current Board Consultant contracts and background information on the prior Board Consultant RFPs are detailed in *Attachment 4*.

Budget and Fiscal Impacts

Meketa and PCA have proposed fees of \$121,000 per year, equivalent to the annual fees in the current StepStone contract. Should the Committee authorize staff to issue a new RFP, the cost of the Infrastructure Consultant services will likely increase because (1) the current annual rate of \$121,000 is based on a RFP from 2014, and (2) since both Meketa and PCA are currently providing services for the Committee in other capacities, both firms are regularly travelling to CalPERS, whereas a new firm would likely have to incorporate onboarding services and travel expenses into their fees.

Benefits and Risks

The services of the Infrastructure Consultant support the Committee in meeting its obligations to manage the System prudently and provide members and beneficiaries with benefits, as required by law. It is imperative to have a firm in place acting as the Infrastructure Consultant, to ensure continuity in the management of the Real Assets Program and minimize any interruptions in the provision of critical services to support the Committee and staff in fulfilling their fiduciary duties. A vacancy in the role of the Infrastructure Consultant may cause significant delays in the consummation and execution of investment transactions currently underway, which may hinder staff's ability to meet the return objectives of the portfolio.

Attachments

- Attachment 1 – StepStone Group LP – Letter of Resignation
- Attachment 2 – Meketa Proposed Key Persons
- Attachment 3 – PCA Proposed Key Persons
- Attachment 4 – Board Investment Consultant Background Information

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