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Host: Ted Eliopoulos
Guests: Dan Millman, John Lee, Jim Hurley, Bobby Turner

Video Transcript

Ted Eliopoulos:
Good morning everybody. Wonderful job you did this morning on the panel. Wonderful to see you again Ginger. Well, I'm Ted Eliopoulos. And first I thank you all for coming to the real estate breakout session. We're really happy to see some real estate practitioners at the conference today. We actually knew in seeing the participation list coming in that it was a small and strong group of real estate professionals here and the overwhelming majority were here for the other asset classes. But we thought it very much important to include real estate in the discussion today so we thank you all for coming and joining us. I'm Ted Eliopoulos and I'm a senior investment officer for real assets, which includes the great majority of asset classes, real estate, which we're going to be here talking about. It also includes as Joe alluded to earlier, infrastructure and timberland. But today's focus is on real estate. I'm joined in our panel here today by Jim Hurley who is right next to me as our senior portfolio manager, who's in charge of the group within real estate that we call our new investment group. He's the head our acquisitions group so he heads the group that's responsible for our real estate strategy and executing the strategy by searching for, finding and closing partnerships for new partners and partnership strategies. And fortunate to be joined by Dan Millman and John Lee from Canyon Capital who are again you heard from Joe a little bit earlier today, and we'll set the context today in my presentation and our panel's presentation today, to talk about the CalPERS real estate emerging manager program mandate that Canyon has been selected for and now named the Canyon Catalyst Fund. In the audience is the founder and principle of Canyon Capital, Bobby Turner is here today. And glad that you're here joining us and will be here to help participate in the discussion today and afterwards…

Bobby Turner:
(indiscernible) told me to come.

Ted Eliopoulos:
Yeah. And I think that will suffice for introductions. Hopefully you can hear us well. Given the intimate sort of setting here, we're certainly open to really interactive sessions, questions any one has, there's no real formality tour presentation. If we could have constructed a, you know, a circular room maybe it might've made it a little bit earlier, but don't let any of the formalities of the room keep you from asking any, any and all questions. Welcome. Glad to have you all. So with no further adieu, why don't I, we have some, I'd say 10-15 slides to go through to try to give some perspective and context for the real estate

program as a whole, and the emerging manager program for CalPERS in particular, and then drill down on some of the very specifics of the Canyon Catalyst Fund as well. Its objectives and purpose. So with that, let me start off with an initial slide on the CalPERS real estate program. In 2011, two really major initiatives for CalPERS real estate really culminated in 2011, with our staff and our board. One was to revisit what the role of real estate is meant to be within the overall portfolio. And while that can seem rather dry and basic, in this case, Joe lead a very intensive effort in asset allocation process to look at the roles of each asset class within CalPERS. And there was no more dramatic a change in the definition and the purpose and the role for an asset class than there was for real estate within the overall portfolio. And you can see the main definitions for the role of real estate for, that was adopted, really providing the diversification to public equities for the overall fund. And providing stable income and cash yields to the fund is what was decided. What was so dramatic in shifting in this asset allocation process for the role of real estate, was in equal measure for the past decade for CalPERS real estate with these diversification goals was an equal measure on providing nominal returns and enhanced returns for the fund from the real estate group and that, that role was dropped off of the role for real estate and really focusing on the traditional role of real estate in a US pension fund to provide that diversification. The job that the real estate group, I and Jim in large measure in taking that role is to construct a portfolio construction that would meet that role for the pension fund going forward. And as a result, really focused on quite a change to the construction of our portfolio going forward as well, that you can see here. One, a 100 percent of our focus is on private real estate so we had a fairly substantial public securities, public (indiscernible) portfolio as part of our construction in the past. That exposure is now entirely gained through our public equity portfolio. We had had several programs targeting debt, mainly private debt in commercial real estate. Those programs are being transitioned out of the portfolio and future allocations again looking exclusively at private US real estate. The other byproducts of the role of real estate, this one can seem a bit counterintuitive, but the focus on the United States, given our role to have a low correlation to overall global equity market, we really put a focus on the portion of the portfolio that focuses on real estate is US Centric. So 80 to 90 percent of the real estate portfolio is focused on the United States. Again, a big change from the portfolio construction in the past which had a much more significant footprint targeted outside of the United States. Lastly, in looking at the structure and history and lessons learned of the CalPERS real estate portfolio, very much a focus and structuring our business model going forward with separate accounts. We found looking at our history of our portfolio that the best success we had in the program was through our separate account structure. So that is not 100 percent of our focus but is our preferred vehicle for accessing opportunities.

The pie chart on the side just Joe covered it. The target for real estate is 10 percent. We're at 9 percent today. And I think with the changes to the portfolio construction, what we'll see over this next five to seven year period is a fairly significant selling off of our portfolio that doesn't meet the new definition, the new role of real estate over the next five to seven years. And therefore, we will be a very large investor in the United States and particularly in core commercial real estate in the United States for the next, for the next decade.

I did, it might seem a little boring to start off, or a little basic, but this is really I can't emphasize enough how, what a dramatic shift this is for CalPERS real estate, our portfolio construction, why we're doing things and how we're looking at building out our portfolio over time.

Male Audience Member:
Excuse me. On your returns, that 7 percent. Is that nominal or real?

Ted Eliopoulos:
That's nominal. It's nominal after fee. And that return profile and standard deviation profile again we're, the target's put into our asset allocating study as well. So it's a 10 year look. So the next, the next slide shows the basics of the structure of the going forward portfolio, CalPERS real estate portfolio. And at the foundation, we call our base portfolio, there we are targeting 75 percent of our portfolio and on the next page we'll talk a little bit more about each of these. But by far, the largest portion of our portfolio going forward is in what we are calling our base portfolio which targets US core commercial property and the four property types, and the next slide'll go into that in a little bit more detail. But this naturally follows from the role of real estate and the desire to build a stable income cash yield and portfolio going forward. In addition to this base portfolio, we have a target of 15 percent for domestic tactical, so those are for tactical strategies in the United States. It can range anywhere from zero to 30 percent of the new portfolio going forward. A large piece of that strategy we talk about core's historic role, it'll be quite a bit of core commercial real estate, but more timing based. So the ability to move in and out of core property markets in the US. Importantly, as we will see on the next slide, domestic tactical is the home for the CalPERS emerging manager program. Lastly, a 10 percent target to international tactical. We've targeted 10 percent of the fund to look at, or to invest in the emerging markets, principally the brick countries outside of the US, the growth engines of the world markets.

The next page as promised is a little bit more detail on the structure of each of the, of each of the programs and the base portfolio. You can see the focus on high quality assets and high quality locations, held for very long terms. Our hold periods are meant to be 10 to 20 years in this portfolio. Base is meant to deliver and be accountable for delivering actual cash yield to the fund, to CalPERS. Here we expect, you know, a very large relationships, we hope to get some cost efficiencies with those relationships. And the geography is in the US and not only in core commercial real estate, but just the four basic four property types. So apartment, industrial, retail and office. Here you can see for each of these programs, we highlight that another principle goal of the real estate program going forward is to have much, many fewer partners than we have in the past. So the goal for the base portfolio is to have five to 10 partners. That will be the same for each of the three buckets that we cover, so for the entire portfolio construction we anticipate having 20 to 30 partners. That contrasts with the 90 partners in the real estate program at its height and we currently have a little over 60 real estate managers in the program. So that again you can see some of the comments that Joe was making. It's a much different environment in context for CalPERS in general. But CalPERS real estate in particular than let's say in 2004-2005, when the program was really ramping up with very, broad ranging investment goals at that time. We're in a different context, a different environment, different role of the portfolio going forward.

For domestic tactical, you can see the tactical strategies allow for repositioning strategies. Looking for distressed opportunities, either distress in a capital stack or structuring, or otherwise. But also allows for development as well. All kinds of range of core value added and opportunistic strategies in the United States. It again targets five to 10 partners and importantly, includes and specified in our overall strategy that one of the to-do items when this overall real estate strategy was developed, was to bring to the board an emerging manager program that would fit in the domestic tactical bucket and we'll move to that. And then lastly, the international tactical has a very, you know, a very similar theme. The one piece of note is in the international tactical similar to the rest of the portfolio, again very much focused on building and then owning in these foreign emerging markets, cash yielding, core-like, income producing properties. Again, because of the role of the real estate within the overall program. So that in three pages is the summary of real estate strategy that we presented to the Board in early 2011. And I'm gonna transfer now to the emerging manager program that after the real estate strategy role, the strategy was adopted by the Board, the to-do item was to come to the Board and propose an emerging manager strategy within our domestic tactical program that would fit with the new role of real estate and would fit with the new strategy adopted by the Board. And would look at and take advantage of the long history that real estate had in investing in different structures, different vehicles, a wide array of managers that could be defined under any of the definitions that we looked at earlier today as emerging managers. And use that experience and lessons learned to bring forward a program to the Board. Which we did at the August 15, 2011 Board meeting. And that's worth saying that one of the great things about CalPERS is we're a public agency so our CalPERS real estate strategy that I tried to summarize in three pages is on our website. So there's a 40 page version on our website. Same with the emerging manager program. It was a program that was proposed and adopted in open session and that's on our website as well, so there's a 10 or 15 page version of the emerging manager program as well. And I can't emphasize enough how important it is to take advantage of the public nature of CalPERS and access those information. I know Bobby, Bobby knows. I, every one of our current managers, or any manager that comes to propose a strategy for us to consider, the first thing I do is quiz them on our strategic plan. If they haven't read our strategic plan, then I'm not all that interested in really meeting with them. Our time is important, we've done our homework, we've placed all of our information out in the public realm. It's incumbent on managers to understand that, you know, take use of it and come prepared to engage in their discussions and meetings with us. The broad objectives of the emerging manager program are listed here. We will see, you'll see those objectives run through our presentation here today. So, what are the basics of the formal emerging manager program that we adopted and we use those words formal and program intentionally because the experience for at least CalPERS real estate in this space over the previous 10-15 years period, was much more informal. There was, and there was no program. So, one of the lessons learned and one of our objectives in presenting a program to the Board was to formalize the effort more and to form a program that would have structure and could be measured, understood and succeed over time. So you know, the presentation is in, it was in quite a bit of detail to the Board, I'm looking at Mr. Jelinsic who's a, on our Board and sat through those hearings. But it was a very formal process. A lot of effort went into it. And tried to select, you know, the basic pieces of it on this slide. It's a formal part of our domestic tactical portfolio going forward. We allocated, proposed to the Board and the Board approved up to $200 million of equity capital to be devoted to the program, at its beginning. We decided on a California focus. In fact, it's the, the entire focus of the plan is focused on California, so our emerging manager program is focused entirely on emerging managers and underlying assets that will be located in California. Part of, you know, our lessons learned, was to really start with a well constructed, well defined program and succeed with it. And over time, look at growing the program and looking, look at issues of expanding it beyond our current boundaries. But very important to us at the beginning to size it, and I think we called it our walk before run strategy. We really wanted to size it in a way that we can handle it, we can manage it, we can monitor it, and we can succeed with it. The other key part of the program is that we, you know, had a business model choice to make. We could either, you know, manage it, manage the program internally and have staff source and select emerging managers directly. We could invest with fund-to-funds which we had some experience in. And what we decided to do was look and we had over 90 managers and look at the managers and from, from that group, look and find and select an existing CalPERS real estate investment manager who had a proven track record with us, and who had what we thought the skill set to select, monitor and very importantly mentor emerging managers in this space. Part of what I think we saw in our experience, that is particularly with real estate staff where those responsible for directly overseeing these, these strategies is the mentorship piece of it was lost. There's a lot, and I'm sure Canyon will be able to talk a little bit, there's a lot to being a general partner for CalPERS. We've got a lot of requirements and we can really, really inundate managers with our requirements. And we, I know Jim could attest to it as well from a staff perspective, we're spread very thin. So for us it was very key in structuring a separate account with a proven manager that their competency set, but also their charge, is to really mentor and allow these emerging manager relationships to flourish. The last piece, Lori covered, we did a fairly intensive survey in the country of all the different emerging manager definitions. We looked at them. We settled for real estate on, on this definition of investment managers with less than a billion dollars of AUM and limited to the first, second or third fund, or separate account that they've raised. That was the program that we proposed to the Board, it approved it in August. Subsequent to that, we looked at quite intensively our manager set. We interviewed a number of our managers, went through a very, very quick and easy, no very very scrutinized process of evaluating the capabilities and capacities of a number of our managers. And for variety of reasons, we were very glad and very happy and very, very proud to select Canyon Capital to serve as the mentoring manager. That's the next page. And they've been given the responsibility to begin and fill out the emerging manager program for CalPERS. We've asked them to perform these key responsibilities. And it's a very much a hands-on and intensive process, not only to source and select talented firms to invest in, but also to mentor the emerging managers, not only in the investment management business but the institutional investment management business to get them to succeed. Much of that includes providing not only back office and technical support, but really mentoring them how to succeed, not just in their business but in their business with growing a relationship with CalPERS over time. The program calls for an annual update and you know, a formal assessment of the program after two years with the Board. And again, those will be conducted in public and open session as well.

So that's, that's the jist of the CalPERS piece of it. So what we thought we'd do with this panel now is I turn it over to Canyon to talk about the Canyon Catalyst Fund. So, I think, it's pretty, just one button. That'll get you going.

Dan Millman:
Well forgive me, we're going to cover a little bit of a familiar ground but then of course there's plenty of time for questions and follow up. So, as Ted mentioned the Canyon Catalyst Fund is a $200 million joint venture between Canyon Capital Realty Advisors and CalPERS. We will be investing through programmatic joint ventures with California based companies, focused on California urban real estate. The objectives of the fund are very straightforward. Risk adjusted returns. Number one priority for the fund and frankly for all CalPERS investment managers is to generate positive financial returns. Access opportunities that might not otherwise be available. So it's our belief that emerging managers have access to overlooked and unique deal flow and that this provides an opportunity to generate returns. And this deal flow's gonna come form the detailed knowledge that emerging managers possess and the deep relationships that many possess within their areas of focus. Increased diversity among the manager pool. We believe that, as CalPERS does, that newer and smaller firms will provide a broader pool of diverse managers. And then finally to develop a scalable program. Our success will be judged not just on financial returns but our ability to evolve emerging managers into managers that have a direct relationship

with CalPERS. Qualifications. Operator develop with less than a billion dollars in assets under management. On their first, second or third comingled fund or separate account vehicle. Headquartered in California. Focused on California urban markets. Urban markets to us in California mean San Diego, greater Los Angeles, Orange County, San Francisco Bay Area, East Bay, Sacramento. We're certainly open to being persuaded about the urban character of, of other markets but that's how we think about those. Demonstrated track record of the key individuals. Now to us, focusing on emerging managers that means the track record of the firm, but beyond that it means the track record of the individuals involved in the firm. There was talk earlier this morning about members of larger firms that spin out and form their own. And that's something that we will be keenly focused on as well. The ability to invest meaningful capital. So to us that means meaningful as a percent of the principle's net worth. So not necessarily you know, we're not looking for in all cases an 80/20, 85/15 partnership. But something where the principles have a material amount of their capital at risk alongside of the venture. And then d) property type experience and geography where they're focused.

In terms of the structure we mentioned it's gonna be programmatic joint ventures. We will allocate between 25 and 50 million to each emerging manager partner. That can be levered to 50 to 100 million dollars worth of capital to invest. We'll seek between four and six managers. We will allocate to differentiate between product type and geography so that we don't have managers out competing with each other in the market place. We mentioned a co-invest amount. That's meaningful to the principles. We're starting with something like 955 but again we're open to look at that on a case by case basis. There'd be a market based promote over a preferred return. All the deals within the fund will be cross-collateralized, that is the cash in-cash out will be mixed between the individual deals. We're looking for the return on that programmatic joint venture overall. And then we will not be investing in comingled funds. So this will be direct allocations to owner-operators to make direct investment in real estate vehicles. With that, let me turn it over to John. John is, has been leading our efforts at this point in terms of sourcing the market for managers.

John Lee:
So, thank you Dan. Given the programmatic joint venture structure of the program, I'm sure you are all interested in terms of what are the specific deal types that we're gonna be focused on. We're gonna be looking at value add and opportunistic strategies. And what does that mean. It can be a range of lease up plays, property redevelopment strategies, and select ground up development. Really focused on value add opportunities and strategies that span kind of a three to four year life of an investment. We're looking across all of the major property types, so office, retail, industrial, multi-family, mixed use. A couple of exclusions here are hospitality and land use entitlement plays. So those are two areas where we will not be making investments in this particular fund. Once again, California urban locations as Dan noted. And we're gonna be looking at

deal sizes, ranging from five million to 30 million dollars, total capitalization. And that is obviously a range where institutions right now are not as active so we believe there's a market opportunity there, but really I think the intent of the allocation of capital from our standpoint is that we are able to have each manager create a pool of assets that effectively works like a fund. So if there's a $50 million equity allocation that's levered to $100 million, given these deal sizes, each manager could have four assets or more within their particular pool. And that gives us an opportunity to help mentor and advise them as to how to manage that pool in an institutional format. Once again, 50 percent leverage across the portfolio. Individual assets could be levered up to 65 percent. For selection criteria of the emerging managers, we're gonna look at several different criteria. Some of these have been mentioned before. In no particular order, but certainly starting with fund strategy, we want to understand what do the managers view as the investable opportunity in the market place. How does that overlap with their expertise and we would like to understand that from a property type perspective, from a geographic perspective, obviously understanding that this fund is particularly focused on California, size of deal, as well as risk profile of their strategy. Management team. This is a critical component as well. Obviously we want to understand who the key principles and senior investment professionals are that comprise the firm. How long they've been together as a team, whether in the current firm format or have worked together in the past. And that leads into track record. The track record of those individuals both as a team, as well as in previous formations or as the individuals themselves, their professional background and track record with doing deals in the market place. Pipeline, obviously this is an important piece because we want to understand not just the strategy but how that is illuminated by the deal that they're able to bring to the table, or the deals that they see as potential opportunities in the market place. Ownership structure. This ties in somewhat to management team. We obviously want to understand who the owners of the firm are. In some cases, ownership of the firm ties directly to the principles who are transacting the business but that is not always the case. There can be silent partners, there could be corporate entities or even private equity firms that are owners and we just like to get a better understanding of that. And then also infrastructure and back office. As I think you know, Ted has noted and Dan has talked about as well, the institutional investment management business can be very time intensive and people intensive business. We just like to understand the current state of the firm's infrastructure and back office to support those efforts.

So what is our selection process. We as of September 1st, have really been in market sharing the details of this program. And as we noted, we're looking to select between four and six emerging managers. But obviously before we get to the point of selection, we obviously want to understand what the universe looks like, and given that we're focused on groups that are directly operating the real estate, and with the criteria of a billion dollars or less assets under management, first, second or third time fund, it could be a fairly broad universe. And we want to be in the market place, understanding what this universe looks like, the various strategies that these managers are looking to implement. So, we are in the market now. This is an important forum for us to understand and meet new managers that perhaps we haven't interfaced with. And even though we've really been in the market only since September 1st, we have made a significant amount of progress. So I would certainly want to share that if anybody is interested in interfacing with us directly here, in regards to the specifics of the program, or registering interest, now is a timely point in which to do so.

Bobby Turner:
John, why don't you ask people to raise their hands so you get a sense of the audience (indiscernible) today.

John Lee:
Sure, that's a good point. So for those of you who are in the audience who are interested form a manager perspective in participating in the program, if you could just raise your hands. Great. Okay, that's fantastic. One thing I'd like to share in regards to the process. We are making our way through it, we will look to begin making our selections in early 2013, so obviously we're winding up the year now, but I would say that first quarter of 2012 will be the point at which we start making selections. And that will run through certainly the middle of the year, maybe into the third quarter. So. I certainly encourage all of you, those who are interested, to be in touch with us. We'll have our contact information up here. But given that there's no one to my left, I think we're probably turning to Q and A now.

Bobby Turner:
Do you mind if I say a few things?

John Lee:
That'd be great.

Bobby Turner:
I think so far it's been a very (indiscernible). Where we've got CalPERS, we've got Canyon. (with microphone) I think one thing that should be stressed is why we at Canyon wanted this assignment. Because we look at, we sort of look at this and people can be sympathetic and people can be empathetic in life, and it's hard when you sit up there on this podium to sense, get a sense of empathy. There's a lot of sympathy possibly for emerging managers but having started Canyon 30 years ago, I can empathize. Because I remember back 30 years ago I was an emerging manager, yes, white, balding and Jewish was emerging at that point in time. And I remember sitting with my partners saying we have a great track record of investing in real estate, we're smart guys and we had a great compelling opportunity to invest in the urban markets. And I remember saying to my partner, it should take us six months to raise the fund. And he sort of looked at me and said why would you think it would only take six months to raise a fund. To which I responded, well we're smart, we're young, we're hungry,

we've got great political relationships, our track record's great, it should take us six months. To which they looked at me with a little it more sagely advise and said it's gonna take us two years to raise the fund. I said bullshit, why would it take two years, that's ridiculous, the opportunity'll be gone. So I bet them six months, they bet me two years. And if you bet on both of us you'd been right because it took us two years and six months to raise the first fund. It's funny but it's not funny. It's a pain in the ass being an emerging manager. Notwithstanding, be careful what you wish for. Because becoming emerged is not necessarily the golden goose either. As much as we love Jim and we love Ted, it can be a pain in the ass to work with a major institutional investor. The compliance, the reporting, the oversight, can be daunting. I had, I started off with a full head of hair before I started investing CalPERS money. It's tough.

Ted Eliopoulos:
And I didn't have any gray hair.

Bobby Turner:
But it is tough, and we sort of look at it and our whole vantage point to want this assignment was from the fundamental belief that we believe that this is not a political asset class. That this is a smart asset class. We believe that investing in diversity and making money are not mutually exclusive. In fact, we believe that investing in diversity and emerging managers generates better risk adjusted returns than not. And the reason being is simple. You know, what are we all paid to do. Invest money. Who's here to want to invest money? Everybody you want to invest money? Okay, that's really easy to do, right. You hit send on a wire instruction and the money goes out the door. But how are you held accountable? You gotta get the money back. That's how you're held accountable. That's how you get more money from Jim and from Ted. And the reality is there's four ways to create wealth in life. Number one is you can inherit it. I failed. Number two, you can marry it. I failed miserably. Greatest deficit spender you'll ever meet. Number three, you can speculate, which we're not very good at. Number four, you can be value investors. And value investors requires one to scour the marketplace looking for opportunities that are overlooked, misperceived, difficult to underwrite, and then do three things really well. Identify, quantify and mitigate risks. Well the reality is that most emerged managers are missing the biggest risk of opportunities today and that's the changing demographic, DNA of this country. And unless you have ethnic diversity within these organizations that can identify, quantify and mitigate the risks, you are going to lose money. And that's why we're so passionate about the emerging managers platform. Because we believe that by paying it forward, someone took a risk on us years ago. Notwithstanding, the job that CalPERS has is to do what? Make money for its pensioners. So it's not just because you're diverse, or you're emerging, you get money. You gotta be diverse, emerging and you gotta have the infrastructure, the capacity and the DNA to want to make sure that you recognize that as much fun as it is owning your own business, guess what, you don't work for yourself. You work for these guys, and you work for every pensioner that comes every day

and works their butt off for 20-30 years for California Employees Pension Fund and it's our job first and foremost to never lose them money. So it's a huge responsibility, but once you get it, nothing can be better than being emerged other than in a down market. But, that is basically the overview of why we wanted this assignment.

Ted Eliopoulos:
Thanks Bobby. I think that's a good transition point. If now's a good time for any questions, dialogue. We'll try and provide some answers. And then I think that there will be, when we're formally concluded here, opportunities to talk to all of us and any of us for some time after this session.

Male Audience Member:
Thank you for the presentation. It was very helpful. Ted you mentioned something earlier that I'm struggling with. Did you say that you have 60 managers today and you're trying to get to 15 managers? Isn't it inconsistent then to talk to other people in this room about becoming a manager. I gotta believe you have at least 15 good ones out of the 60. How does this work?

Ted Eliopoulos:
Yeah. It's 20 to 30 managers is the target going forward. Many of the existing managers we have now are in strategies that are not part of the strategic plan going forward. So it's not that they're good or bad or indifferent, it's just that it's not a fit for us going forward. So our job is to construct a portfolio that fits the strategy that we have laid out. So in that respect, particularly with the emerging manager program, it's starting denovo. So we have a new allocation, new program, growth of new manager in that program. So it's a dynamic. We're losing many. Many, many more managers than we're gaining but we're still gaining a few in those strategic areas that we're looking for new managers.

Bobby Turner:
Can I make a comment. It's discouraging when you sit here and realize that gee, 10 percent or 15 percent of the portfolio is going to be in domestic tactical. But let's also understand the scale of CalPERS. That 10 percent of the overall portfolio will be in real estate. So that's $20 billion. Then you've got 15 percent which will be domestic tactical, which is $3 billion, of which a meaningful portion will go into emerging managers. Emerging managers can not think that this is a one day ballgame. This is, it's a builded business, it takes years, it takes patience, it takes commitment. What this platform will do is empower emerging managers to get the Good Housekeeping Seal of Approval from CalPERS. So five years from now, 10 years from now, you go out and you raise your own funds. You don't have to go to CalPERS to get a fund. You can say you graduated University of CalPERS Emerging Managers Program. And the fact is maybe they're not hiring new additional managers, but you go down to some other big pension fund. So this is an opportunity to create credibility and have that Good Housekeeping Seal of Approval from CalPERS.

Male Audience Member:
Hi. I figured I'd stand up. Darrel Carter. I was once an emerging manager and then I guess I merged and then I got submerged. And I guess I'm emerging again. One comment first, I want to say that it's a compliment to good choice on Canyon and Bobby. Bobby's been a long term friend. It was always, I've always admired your diversity within your company. I think you've done a great job and fantastic company. Now, on with the realities of what you're proposing. Having once been a partner of CalPERS and knowing the, the mechanics of reporting and things like that, I just want to go through a few numbers for an instance. And one of the challenges in this program. Okay, for managers 40 to 50 million dollars each, per manager, you won't invest in funds so let's say optimistically for the $50 million that manager gets 200 basis points of asset management fees. That's a million dollars a year if my math is still working. It costs to do business with you about $100,000-125,000 to a million two to a million and a half to build a company that can do all the reporting, asset management, the investment, the talent, etc. Okay. So, by virtue, why do companies succeed? Because they have very innovative niche strategies. Okay. I can't develop a business that does exactly what Black Rock does and expect me to compete with them, so I've got to find niche areas where I can be the category killer in that niche. So, separate account, I don't make enough money to stay in business. If I'm in the fund business, and I already have capital then what I'm doing is creating the second product. Why, because my fund investors are not gonna want either you invest in my current fund which helps me, or I've got to create a separate product which then creates a whole other level of overhead. Okay. That's the reality of why this is challenging. Because the worse thing in the world is to give someone just enough money for them to go out of business.

Jim Hurley:
Thank you for those comments. I, just to give you a little background on my experience. I spent about eight years with a very large investment advisor. Spent several years with another large pension fund. Then spent a short time with an emerging manager and then came to CalPERS. So, I do empathize as Bobby was talking about with some of your problems, especially…

Darrell Carter:
With all due respect, I mean those are actual metrics of what happened. I mean it's not, you know, I'm not sure, anyway I'm sorry.

Jim Hurley:
No, but so with respect to profitability, it's a real, I understand the challenge, especially during that two year period when you're calling people, trying to raise money. It's very hard to meet payroll as an emerging manager and I think having been in this business for 20 years, a lot of pension funds staff what they do is they tend to oversimplify and they tend to think that all the managers are extremely profitable. But there are two dramatically different sets of managers as

far as the ones that make money. Black Rock, Black Stone make a fortune. Smaller firms don't. And it's very hard I tried to do it for a short period of time, to meet payroll and you're on a different time scale than the pension funds. We think in terms of years, a lot of you folks are thinking in terms of your next payroll. But to, so how do you make money on $50 million commitment when your fees are a million dollars. I think …

Darrell Carter:
(indiscernible)

Jim Hurley:
As far as, okay. That was part of our thought process in putting together this mentoring program. So we have somebody here with a team who's been through that himself. And I hope on the things he's telling you is be real careful about your expenses. You have to do two things. You have to demonstrate you can get it done as far as al the institutional requirements. But you have to be really careful about your expenses. I don't know, would you agree with….

Bobby Turner:
Yeah. I think he said one of the most dangerous things is to allow, one of the most dangerous things is to allow an emerging manager to fail, right?

Darrell Carter:
But you're giving them enough capital where they cannot sustain themselves in that separate account business…

Bobby Turner:
Yeah, I…

Darrell Carter:
…and you're allocating 100 million dollars, probably somebody can stay in business or at least be able to get off the ground before, and you know, sustain themselves before they raise additional money. But otherwise you're really just putting them in a box where it's just going to be tough and not scalable. And hey guys, I've done it twice. I'm doing it a second time. I can tell you everything it costs to build it, you know, (indiscernible) and I started Free Capital exactly 20 years ago with a $100,000 and believe me it was struggling and it was tough. And you know, doing it again three years later is not any better. And having gone through it I know every bit of costs. You know, we've been partners with CalPERS, we know what it costs, and you know, increasingly the requirements for accounting and asset management are a lot higher. Bobby, you and I know…

Bobby Turner:
Listen. Been there, done it, appreciate it. We're sensitive to it. The worst thing we can do is give the 16 year old boy the keys to the car with a six pack. Okay. So one of the things we're not gonna do is make the mistakes historically that

emerging manager programs have done and that is a very hands-off fund-to-fund program where you're giving absolutely discretion to someone who is not emerged yet. So part of the separate account structure was is we believe that it takes the nurturing, it takes the oversight, it takes the guidance. Not the smothering as dear friend of ours would say. But the oversight to help these firms become emerged. And we are there to help, you know, expedite that process. There are other, the reality is we want to provide positive leverage. A million dollars on 50 million is, you're right, there's not gonna be a 200 basis point fee. It'd be something less. Notwithstanding, we built a $20 billion organization out of nothing over 20 years and when we first started, we didn't have a million dollars in fees coming in. We were emerging managers. And I think there tends to be a sense of entitlement in the industry. There seems a sense of hubris and expectations of what the big pension should and would pay. You know, there is that demonization going on in investment advisors. There's the one percent and there's the 99 percent. Well I try to tell people we put at least 1-1/2 percent so I call myself the 1-1/2 percent of a 2 percent co-investment. But the reality is is these guys here, every day are fighting the battle of the perception that investment advisors make too much money. Because there's not an alignment of interest. So we've got to balance the two. What is fair compensation. This is not a venture capital fund. As Joe mentioned today, it's to the opportunity, it's not the responsibility here to bet and gamble on emerging managers. It's to support. And it's to mentor and it's to encourage growth as they become emerged, and there's a fine line between the two. You know, this is an experiment. It's a new model for CalPERS. It's something that we wanted to do, but we're open to suggestions. We don't, you know, again we don't assume we know all the answers. We're gonna play it by ear as we go along. But we do know certain things that we won't do. We won't invest in funds because again we're not going to delegate authority to an emerging manager. You're a hybrid as you said, you emerged, submerged, now you're emerging again so we are going to take each individual opportunity on its face. And there are obviously abilities for us be flexible.

John Lee:
You know, one other thing worth noting, if you look at the universe of people who fit the general qualifications, you really have a number of different business strategies and implementations, on the ground in terms of the way their firms are set up. So in some cases, they're saying okay we're going to spin out and we're gonna go specifically raise a pool of capital and basically have no revenue stream. But on the other end, you have people who have consulting businesses, or they have existing assets in a portfolio that may be generating, you know, a variety of different fees, or coming from another perspective. And it's just a very wide variety of firm situations. So I think to Bobby's point, we look on each case on a case-by-case basis to really determine what the situation on the ground is for that manager.

Male Audience Member:

I was going to ask a question but you may have answered it. Whether to not this, whether or not this seems to preclude a startup, a true startup when this rolls out. It doesn't have assets currently under management or what have you. (indiscernible)

John Lee;
Well certainly we're talking to managers really across the entire spectrum from an experience and robustness of firm standpoint. So, clearly if a group is a spin off so to speak or has a senior principle or individual who is forming their own firm, they often can look back on their own prior experience and say this is the foundation for what our business plan is gonna be and have no assets. But obviously, you know, there are firms that have been in existence as a firm with the same set of key principles for, you know, a longer period of time. We really want to at a minimum understand that entire universe. We haven't made any determinations from a selection standpoint, but obviously looking at that entire universe helps inform our decision making.

Male Audience Member:
(indiscernible) isn't currently owning and operating for the sake of having that experience in the past and planning to do that going forward.

John Lee:
Yeah, and the differentiation is owner operator developer as opposed to fund, fund manager.

Bobby Turner:
I hope that everyone appreciates the following. We're all in this because we're passionate about providing opportunities for diversity in emerging managers. The biggest mistake we can do is to lose money. If this catalyst fund loses money, game over. How is Ted, how is Jim going to go back to the Board, and say gee we want more money, because there's the political side of this. We cannot afford to lose money. So therefore, we've got to make it fairly disciplined in our approach. If we start making exceptions, if we start wavering form the discipline, if we lose money, there won't be more emerging manager workshops, because the naysayers will win the day. And that's the same thing that happened 20 years ago when we went into the urban markets. If we lost money investing in markets of diversity, you never would've raised another fund. So we're very, very cognizant of the fact that if we fail, it's gonna set back this initiative for another decade. And we can't afford to fail.

Male Audience Member:
Have you decided whether the fees will stay on commitment or on (indiscernible)…

Bobby Turner:

Case-by-case. We've got great flexibility. The wonderful things about Ted and Jim is they've given us great flexibility. They've given us great lateral movement to do what we feel is best because again, we can truly empathizes. There maybe a case where somebody really needs a great fee. And there, it's a fantastic team, and in some instances they won't need a larger fee. Just depends on the group.

Female Audience Member:
Can you address the kind of return expectations you will have with the 50 percent leverage?

John Lee:
Sure. So once again, the part of the risk spectrum we're looking at is that value add to opportunistic range. At the 50 percent leverage, that obviously is going to reduce the maximum amount of levered IR you could receive. But just as a general guideline, we'd be looking at a mid teens levered return to the equity. So call it, you know, 15 percent plus. And given the, whatever the specific strategy is, you know, we could then say well that should be higher given the risk profile. You know, but I would say 15 percent plus is going to be the target.

Female Audience Member:
Gross?

John Lee:
Gross level.

Male Audience Member:
Another question. I understand CalSTRS might have a similar program at some point. Would there be any co-investing with this fund or in isolation?

Bobby Turner:
You're looking at the wrong person here. We work for those folks here. (indiscernible) This is CalPERS money and we're doing what's best for CalPERS with this allocation.

Jim Hurley:
Yeah, you know, we have a very close working relationship and close really personal relationship with our friends over at CalSTRS and particularly in their real estate program. So we have and always will collaborate and share ideas with them. And we'd be open to doing that for sure. What we found in the past is we're probably better collaborating and working and sharing ideas, and it just adds to the complexity to try and get both pension funds with different roles, structures and portfolios to actually structure a program like this. But it's a great idea and when we talk with our friends at CalSTRS all the time about it. In theory it makes so much sense, you know, to be able to do that because you can

amplify the amount of capital pretty quickly. And then it makes a lot of sense in that regard. It does add some complexity to an already complex area.

Male Audience Member:
Assuming that, say four to five emerging managers are selected and I think talking about the cost of operation. Would those four to five working with Canyon avail themselves of Canyon's back office or would PERS be looking for each EM to you know, be redundant, set up their own back office, or you know, third party. Because what I'm hearing is that if there are some, since this is sort of a start up program, if there are some efficiencies gained, you know, by say you know working with, you know, with Canyon, they know what the requirements are for PERS and even talking about other ways to drive down cost of operation, talking about the debt side. I don't know if there's an assumption that all four to five are gonna seek out their own debt sources or, you know, are there some, you know, are there some benefits working through Canyon and working through PERS to drive down those costs?

Ted Eliopoulos:
You might talk a little bit about maybe emerged process too to try and you know, talk about the startup at the beginning but we also have some, some hopes for how this program might develop over time, and the capabilities and the capacities and the back office that will get built up over the course of the program.

Dan Millman:
So let me start with the back office. It'd be our, we don't anticipate doing anything for the manager except providing advice, guidance, and sharing experience. So we would hope to address the efficiency question and we'll get to the efficiency on the financing and structuring side in a minute. But we would, we would share our experience, look at this time of the year you need x, y, z, or you need this sort of accounting structure, this sort of auditing. These are the CalPERS requirements as it relates to procurement of insurance, requirements for pre-approval of legal counsel and on and on and on. So hopefully we get to an efficiency point. But we would be looking for the emerging manager to handle accounting, reporting functions, again with our assistance in terms of the most efficient way to structure those and deliver those. In terms of debt, legal resources, procuring experts, third parties, absolutely, that's something we expect to spend a lot of time on. So, for us, as we can see sort of the mentorship phase of this within our organization, we see it really in two parts. That is, market and product type expertise, we've got representation in the geographic areas and we've got experts across product type. But then also corporate expertise whether that's through our general, internal general counsel's office, insurance experts, our financing expertise, banking relationships, legal relationships, tenant relationships, whether it's commercial or retail. Those kinds of things. Absolutely we'll be open.

Bobby Turner:
I think the idea was to provide leverage when and where we can. Our universe of relationships will become our emerging managers' universe of relationships. Access to the very best in class, providers of all sorts of services. We also expect our services to buy into this program, recognizing that our emerging managers can't afford to pay $800 an hour for legal. Notwithstanding we would expect some of our major law firms to give dramatically reduced pricing for our emerging managers in the pursuit that eventually as these managers become merged, they will become great clients going forward for our service providers as well. So that's a real advantage to our emerging managers to leverage off of our stable of advisors.

Dan Millman:
Also going to efficiency, so we've done loan agreement, we've borrowed from all the major institutions and many national institutions, regional institutions. No reason to start over in terms of drafting a loan agreement. Lease agreements, partnerships, all those acquisition type things, we've got them, no reason to start over.

Bobby Turner:
Pricing, recognizing if a product or a development falls into a community redevelopment area. Making sure to put them in touch with the right banker rather than going to B of A general banking, go to the B of A community development corporation. And you'll save 200 basis points in your loan. Things like that.

John Lee:
For the service providers, it's a big benefit for them because they have the opportunity to really get in on the ground floor, become trusted advisors of the next Canyon. So, you know, hopefully develop relationships for firms that are growing you know, over the next five, 10, 20 years.

Dan Millman:
And to Bobby's point too, I mean the people that we work with subscribe to the same philosophy of pay it forward.

Female Audience Member:
(indiscernible)

Male Audience Member:
Good afternoon. In terms, in terms of the, once the selection process occurs beginning next year, how, what's the expectation of actually deploying the capital in the first year? Talk about that process. What's your expectation in terms of moving that money?

John Lee:

So Marcello, I think what we'd be looking at is an investment period for each of the managers, depending on the size of allocation, between 18 and 24 months to deploy. So that's all once again going to be taken on a case-by-case basis. Four to six managers over the $200 million, the allocations will range once again between $25 and 50 million. Depending on their pipelines coming in, depending on the, you know, how robust the opportunity set is. That 18 to 24 month period will likely be sufficient to get the capital out. but you know, to the extent that it's not, that'll be something obviously we will be engaging very active discussions with our managers on an ongoing basis. So we'll have a great understanding of that.

Bobby Turner:
Yeah, but let's not kid ourselves. We're in the business of investing money. You've got two emerging managers come to our doorstep, one has no idea where the deal flow is coming form, the other emerging has ten deals that they've been looking at for the last number of years. I think we're gonna go with the guy that's got ten deals. I think that's the business we're in. We're, our job is the deploy the capital intelligently, it's not to sit on it ands hope you find deals going forward. Part of the definition of an emerging manager, or a good emerging manager for us, is someone who has got a discreet and proprietary flow of deals. That will definitely differentiate an emerging manager vis-à-vis the rest of the, those participants.

Male Audience Member:
John, this one's for you. I'm still interested why equity, say exclusion of debt given what's going on out there (indiscernible).

John Lee:
That comes back to the role of real estate. So, we are, we are defined in terms of equity real estate. All debt strategies are fixed income group.

Male Audience Member:
(indiscernible)

John Lee:
Yes. But that said, we were able to persuade CalPERS that there is a compelling opportunity in the distressed debt environment at this point and so to the extent, it's the acquisition of debt with the purpose of getting to the real estate that's permitted under the program. So very narrow definition on the debt side, but we will not be originating debt or buying debt at a discount to hold to maturity.

Male Audience Member:
On the same vein, there doesn't seem to be a place for infrastructure or the real assets in the real estate emerging manager program that you describe. CalPERS has a view or strategy for including other real assets in the emerging manager program?

Ted Eliopoulos:
Yeah, for infrastructure, it's such a new program for CalPERS. It's a, it's an emerging manager program by definition for CalPERS. It's a new staff, new program, there, the infrastructure business model is to look for and access direct infrastructure opportunities. So their, their business model is different. I think as infrastructure matures over time, there might be a place for it but in the meantime, just bring proposals, bring ideas to our infrastructure group. They are, they are mining through all of them so it's too early to structure a formal program there.

Male Audience Member:
(indiscernible)

Ted Eliopoulos:
Just the size, yeah, in terms of the opportunities in infrastructure looks for, their sweet spot is they've defined it as 100 million to 250 million dollar direct opportunities.

John Lee:
And Ted, for people with interest in infrastructure, they should submit through the internet portal. Through IPTS.

Male Audience Member:
I have a question. At some point will the emerging manager program extend beyond California?

Ted Eliopoulos:
Don't know. Don't know. I think what, this is the first, the first step. We wanted to start close to home and really prove out the case for the program and its success before we looked at expanding in terms of geography or size. So it's an open question. But I would not expect it in the next two years, just to give you a sense. All right. I think we're right at 1:00, so seeing no other questions, there we go…

Male Audience Member:
That 15 percent number, that was the five year?

John Lee:
15 percent IR? That would be an IR target over the, yeah, over the life of the investment.

Ted Eliopoulos:
Thank you everyone. Thank you for coming. We really appreciate it.