

**ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM
BOARD OF RETIREMENT
2223 E. WELLINGTON AVENUE, SUITE 100
SANTA ANA, CALIFORNIA**

**INVESTMENT MANAGER MONITORING
SUBCOMMITTEE MEETING**

**August 3, 2017
9:00 A.M.**

MINUTES

The Chair called the meeting to order at 9:01 a.m. and read the opening statement into the record. Attendance was as follows:

Present: Frank Eley, Chair; Charles Packard, Vice Chair; Russell Baldwin; and Shawn Dewane

Also present: Suzanne Jenike, Assistant Chief Executive Officer; Molly Murphy, CFA, Chief Investment Officer; Shanta Chary, Director of Investment Operations; David Beeson, Investment Officer; Anthony Beltran, Visual Technician; and Julius Cuaresma, Recording Secretary

A. INDIVIDUAL MANAGER PRESENTATIONS

Mr. Beeson introduced the presenting managers, Hayfin and Park Square Capital, two of OCERS' non-U.S. direct lending strategies within the credit asset class. He noted that both strategies look to capitalize on the European direct lending supply-demand imbalance that arose from the 2008 Global Financial Crisis: facing increased regulatory restrictions, European banks materially reduced their balance sheets by exiting the middle market direct lending space.

Mr. Beeson stated that OCERS committed \$50 million to Hayfin's Direct Lending Fund (DLF) in December 2013. Mr. Beeson reported that OCERS' net asset value was \$34.1 million as of March 31, 2017.

Mr. Baldwin and Mr. Beeson discussed the European middle market direct lending space.

Mr. Beeson also described that Hayfin and Park Square Capital are relatively similar to private equity funds, but with shorter fund terms, approximately 5-7 years.

Mr. Baldwin and Ms. Murphy discussed possible political risks associated with these funds.

Ms. Murphy observed the risks of the current credit environment, noting the abundance of covenant light (cov-lite) deals.

Ms. Chary and Ms. Murphy observed that Hayfin and Park Square tend to focus and operate in developed European countries, where bankruptcy laws are strongly enforced, rather than in the periphery, where there tends to be lax regulatory enforcement.

Ms. Chary observed that, due to OCERS' significant direct lending exposure, OCERS is increasingly weighing direct lending's upside opportunity relative to the downside risks as the credit cycle matures into its late stages.

Ms. Sarika Jain, member of the public, addressed the Committee about Hayfin's leverage.

Mr. Dewane and Mr. Beeson discussed Hayfin's distributions and Hayfin's ability to recycle capital.

Mr. Dewane and Ms. Murphy discussed Hayfin's rate exposure and the capital structure of Hayfin's investments.

HAYFIN

Presentation by Tim Flynn

The key highlights of the presentation were:

Firm update: As of March 31, 2017, Hayfin managed approximately €9 billion in assets across three strategies: Liquid Credit, Direct Lending, and Special Opportunities.

Market Overview/Outlook for 2017-2018: The manager observed that Hayfin's appetite to take regulatory risk has been diminished in the current environment given new political regimes.

Portfolio Strategy: Hayfin's Direct Lending Fund (DLF I) invests primarily in senior debt (typically secured by first ranking liens on all of the company's assets) of middle market European companies. Hayfin's investment team includes a number of lawyers who have extensive bankruptcy workout experience. The fund is unlevered at the portfolio level and is diversified by the number of investments, geography, and industry. The manager intentionally avoids rate risk, and so their deals are entirely floating rate.

Performance: As of June 30, 2017, DLF I has returned approximately 6.4% net IRR. The manager noted that the investment period has ended and has started to return capital to LPs.

Mr. Beeson, Mr. Baldwin, Mr. Eley, and Mr. Flynn discussed Hayfin's ownership structure.

Mr. Flynn reported that since the firm's 2009 launch, Haymarket Financial (the holding company), was 58% owned by a majority of institutional investors, with 42% owned by Hayfin (subsidiary of Haymarket). In January 2017, British Columbia Investment Management Corporation (bcIMC) announced their purchase of that 58% - the transaction closed in June 2017. He reported that more recently, Hayfin is approximately 45% owned by the employees, with the balance owned by bcIMC. He explained that bcIMC, as a strategic, long-term investor, is a silent partner of Hayfin.

Mr. Packard and Mr. Baldwin asked about Hayfin's investments that are more troublesome.

Mr. Flynn responded that DLF I has made 90 loans, with three defaults. He stated that Hayfin does not expect to lose their principal from those defaults.

Mr. Baldwin, Mr. Eley, and Mr. Flynn compared the manager's perspective on their current opportunity set, relative to their opportunity set three years ago.

Mr. Flynn remarked that increased supply relative to demand has muted their targeted risk-reward levels. He explained this cautious outlook is less of a macro call, and more of a micro perspective, rooted from the ground up, company by company.

Ms. Murphy and Mr. Flynn discussed the cov-lite credit environment.

Mr. Flynn noted that Hayfin avoids deals without covenants. In each deal analyzed, Hayfin collectively measures the entire investment package of the company (e.g., cashflow, deal terms, maturity, covenants, loan-to-value).

Mr. Eley asked about possible scenarios where the manager's investments fall below their risk-return targets.

Mr. Flynn responded that, even in down markets: since they have the senior most obligations in cap structure, their loans tend to avoid impairments. He explained that Hayfin's ultimate risk is liquidity risk, i.e., OCERS needed T+1 cash, and the associated opportunity cost of that liquidity risk.

Ms. Sarika Jain, member of the public, addressed the Committee about the manager's portfolio, including sourcing/origination (primary versus secondary), leverage, and geography.

Mr. Stephen Weintroski, member of the public, addressed the Committee about the European high yield junk bond market.

The Committee recessed at 9:53 a.m.

The Committee reconvened at 10:07 a.m.

PARK SQUARE CAPITAL

Presentation by Osvaldo Pereira & Roger Kempink

Mr. Beeson introduced Park Square Capital, where OCERS is committed to two strategies, Credit Opportunities II and Credit Opportunities III.

He stated that OCERS initially committed \$100 million to Credit Opportunities II (\$50 million in November 2013 and an additional \$50 million in May 2015). He also noted that, as of March 31, 2017, the net asset value was \$88.7 million, with approximately 87% drawn down. OCERS has also received approximately \$8 million in callable distributions.

Mr. Beeson reported that OCERS committed \$50 million to Credit Opportunities III in December 2016. He also reported that, as of June 30, 2017, this strategy has invested approximately 20% through their credit facility.

Mr. Beeson also described the fund's allowed use of leverage, specifically a 1:1 ratio only on senior secured assets.

Mr. Beeson also reported that the manager has one investment on its internal watch list.

The key highlights of the presentation were:

Firm update: Park Square, a European credit focused firm (specifically on the junior debt and large-size senior debt space), manages approximately €7 billion.

Market Overview/Outlook for 2017-2018: Regulatory agencies continue to force European banks to shrink their balance sheets, leaving Park Square with a continued ample opportunity set. In an environment where market participants are mispricing risk, the manager understands that there are two ways for Park Square to make money: invest in high quality businesses on low leverage, or conversely invest in riskier businesses on an unlevered basis. Park Square's goal is to achieve high quality repeatable returns, so they invest in the former manner, rather than the latter.

Portfolio Strategy: As credit investors, Park Square appreciates that they do not participate in the upside, so the main focus is on preserving capital while conservatively seeking 2 – 2.5x their investment. They seek to get involved early in deals that have conservative structures and tight loan documentation. Park Square has no investments in the European periphery, e.g., Spain and Italy.

Performance: Credit Opportunities II has generated an 8.0% net IRR since inception. Credit Opportunities III is early in the investment period and performance data is not yet meaningful.

Mr. Pereira described that Credit Opportunities II is 90% invested, which is essentially completely invested – they intentionally have dry powder to opportunistically add to current and/or initiate new investments, while also maintaining the ability to manage FX risk.

Mr. Pereira observed that Credit Opportunities III has experienced a healthy re-up rate, with slightly over €1 billion in capital (equity commitments and debt).

Mr. Beeson asked about Park Square's subscription credit facility.

Mr. Pereira responded that the facility does the following: 1. Works as a capital line in managing capital calls; 2. Functions as a bridge until the end of their fundraising; 3. Alleviates J-curve issues for LPs.

Mr. Packard, Mr. Eley, Ms. Murphy, and Mr. Beeson compared and contrasted the return objectives of Park Square Capital and Hayfin, particularly each manager's respective investment period and use of leverage.

Mr. Baldwin, Mr. Packard, and Mr. Pereira discussed the differing lending opportunity set and regulatory environment in Europe relative to the U.S, and how European and U.S. banks are uniquely tackling regulatory changes.

Mr. Eley and Mr. Periera discussed global central bank policy and intervention, including the initial rationale behind quantitative easing and the intended and unintended consequences of quantitative easing.

Mr. Eley and Mr. Pereira discussed how Park Square marks and values their portfolio, particularly during more volatile market periods.

Mr. Pereira specified that Park Square uses U.S. GAAP accounting and mark-to-market valuations, rather than valuing at hold-to-maturity or at hold-at-cost.
Mr. Packard and Mr. Pereira discussed Park Square's portfolio characteristics by country.

Mr. Pereira described examples where Park Square has U.S.-based investments due to the underlying companies' majority of revenues derived from Europe.

Mr. Beeson and Mr. Pereira discussed Park Square's sole investment presently on their internal watch list.

Mr. Baldwin, Mr. Packard, and Mr. Pereira discussed Park Square's energy exposure, the disruption renewables have caused on traditional energy businesses, and the potential impact upon Park Square's portfolio.

Mr. Eley asked if there are other positions that are of some concern.

Mr. Pereira responded that the portfolio does and will continue to have some investments trading below par.

Mr. Stephen Weintrobki, member of the public, addressed the Committee about the manager's overall presentation, as well as the manager's view of money velocity and of the triple-B market.

Ms. Sarika Jain, member of the public, addressed the Committee about the manager's targeted opportunity set, specifically where their loans are in the capital structure, as well as the manager's investment team (structure, equity ownership, and position responsibility).

A **motion** was made by Mr. Packard and **seconded** by Mr. Baldwin to receive and file the manager presentations. The **motion carried unanimously.**

PUBLIC COMMENTS:

None

COMMITTEE MEMBER COMMENTS:

None

STAFF COMMENTS:

None

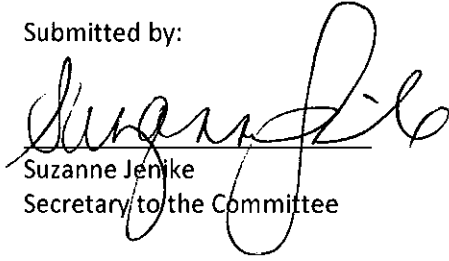
COUNSEL COMMENTS:

None

ADJOURNMENT:

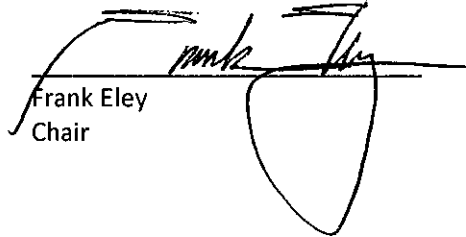
The Chair adjourned the meeting at 11:30 a.m.

Submitted by:



Suzanne Jenjke
Secretary to the Committee

Approved by:



Frank Eley
Chair