November 18, 2024

Board of Retirement
Ventura County Employees' Retirement Association
1190 South Victoria Avenue, Suite 200
Ventura, CA 93003

SUBJECT: Co-Investments Program Recommendation

Dear Board Members,

This proposal outlines the potential benefits, risks, and program structure for establishing in-house a limited partner (LP) co-investment program and includes a recommendation for investment of up to $20 million for 2025 and adding an investment officer experienced in evaluating and executing co-investments.

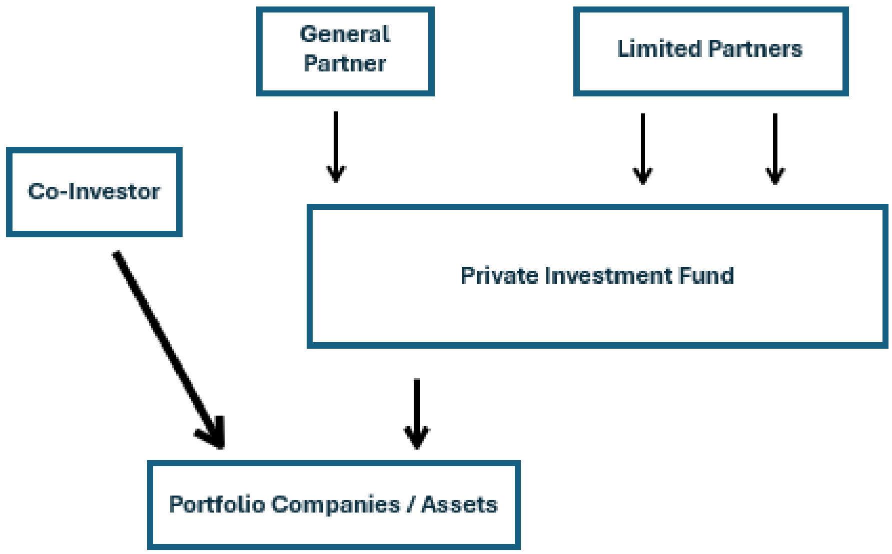
Background

Since 2010, VCERA has committed a total of $173.5 million to co-investment funds, representing 2.1% of VCERA's total portfolio as of June 30, 2024. Currently, all co-investments are made through private equity co-investment funds, which offer reduced management fees and carried interest compared to primary private equity funds. However, there is an opportunity for VCERA to increase exposure to high-quality investments with the potential for greater cost savings by directly co-investing with top quality managers alongside investments they are also making in funds VCERA is invested in.

What are Co-Investments?

A direct **co-investment** involves investing directly into a portfolio company or asset alongside a general partner (GP) in private equity, credit, infrastructure, or real estate investments. These investments are typically offered on a **zero or reduced fee basis**, making them an attractive option for institutional investors seeking to increase their exposure to specific assets while minimizing costs.

- **Offered by General Partners (GPs)**: LP co-investments are usually extended to limited partners (LPs) who are already invested in a GP's fund or have strategic relationships with the GP.
- **Co-investment Deals**: These investments typically do not carry the management fees or carried interest associated with a fund investment, allowing LPs to avoid additional costs and enhance their return on investment.



Benefits of Co-Investments

Co-investments offer several advantages that can help VCERA improve its portfolio's performance and align more closely with its investment objectives:

1. **Zero or Reduced Fees**: Co-investments are generally offered on a zero fee and zero carried interest basis, leading to substantial fee savings.

2. **Increased Exposure to High-Conviction Deals**: Co-investments allow VCERA to increase its allocation to select, high-conviction deals, supporting a more targeted investment strategy.

3. **Faster Capital Deployment**: Co-investments enable the deployment of capital more quickly, improving liquidity and helping mitigate the *J-Curve* effect (the period during which a private fund investment typically generates negative returns).

4. **Improved GP Relationships**: Successfully executing co-investments strengthens relationships with General Partners, which can lead to future benefits such as additional *fee breaks* and *more co-investments opportunities* deal flow.

5. **Estimated Fee Savings**: $20 million co-investment program will yield an estimated fee savings of up to $4.5 million over the life of the program, depending on the performance of the underlying assets. :
    1. HarbourVest's projected 2x multiple: Estimated savings of $3.9 million.
    2. Adams Street's projected 2.25x multiple: Estimated savings of $4.5 million.

These savings would directly enhance VCERA's return on investment by avoiding fees and carried interest typically associated with traditional co-investment funds. See and carry savings, over a 10 year life, using the more conservative example above of HarbourVest with 2x multiple:

Assumptions		
Committed	$	20,000,000
Gross Multiple		2
Management Fee		0.80%
Carry		12.5%
Fund Life		10 years
Co-Investment Savings vs. Fund Investment		
Management Fee	$	1,600,000
Carry	$	2,300,000
Total savings from co-investment	$	3,900,000

Common Misconceptions About Co-Investments

Despite the clear benefits, there are several misconceptions about co-investments that can hinder their adoption:

1. **Co-investments are only offered for bad deals**: Co-investments are an important portfolio management tool for GPs. They offer an opportunity to co-invest in high-quality deals, not "bad" ones. It's unimaginable that a GP would explicitly select investments that would perform poorly, particularly because the GP is also investing in these deals on behalf of their fund, so even have their own personal money at stake. Additionally, GPs often use co-investments to strengthen relationships with LPs, which can directly impact the success of the GP's next fundraising effort.

2. **LPs must always approve co-investments**: LPs are not obligated to participate in any co-investment. Open communication and respect for GPs' time ensure continued access to future opportunities.

3. **Co-investment opportunities are not transparent**: General Partners typically welcome due diligence for co-investment opportunities and will normally share all their underwriting and investment memos, especially when LPs are proactive and communicative.

4. **Skilled GPs don't offer co-investments**: In fact, skilled GPs frequently use co-investments to manage portfolios and offer them to trusted LPs who can execute swiftly and effectively.

Risks and Mitigation Strategies

While co-investments offer significant advantages, they do come with certain risks that need to be carefully managed:

1. **Concentration Risk**: Co-investments expose VCERA to more concentrated positions in a portfolio company or asset. However, by aligning investments with VCERA's overall portfolio objectives and maintaining a diversified approach across asset classes (Private Equity, Credit, Infrastructure, and Real Estate), concentration risk can be mitigated.

2. **Headline Risk**: With increased concentration in a portfolio company or asset, there is a potential for greater headline risk. However, co-investors have more visibility into the operations and direction of the company, enabling them to manage risk more effectively.

3. **Speed of Execution**: Co-investment opportunities require a decision including legal work usually within 3-6 weeks, which can be challenging. To mitigate this, staff recommends **delegating decision-making authority for co-investments to staff** within a defined framework, rather than requiring Board approval for each opportunity. This will allow VCERA to act more quickly and capture opportunities when they arise.

Building a Successful Co-Investment Program

To implement a successful direct co-investment program, the following components are critical:

1. **Internal Investment Expertise**: Ensure VCERA has strong due diligence processes in place and skilled professionals capable of evaluating co-investment opportunities effectively.

2. **Alignment of Interests with GPs**: Ensure that the interests of VCERA and the General Partners are aligned through well-structured co-investment deals.

3. **Leverage Existing Relationships**: Build on strategic partnerships with established managers who have a proven track record of success.

4. **Legal and Operational Expertise**: Secure legal resources to review co-investment agreements and ensure that terms align with VCERA's interests. Operational resources should be in place to handle monitoring and oversight of co-investments.

Other California Funds with Co-Investment Programs

Several other California pension funds have co-investment programs, which can provide useful guidance for VCERA:

- **LACERS**: Up to 25% of both Private Equity and Private Credit portfolios may consist of co-investments (AUM: $23.1B)

- **LACERA**: Up to 30% of their annual private equity budget may be allocated to co-investments (AUM: $78.9B)

- **OCERS**: Up to 10% of private equity and private real assets commitments can be allocated to co-investments (AUM: $23.6B)
- **SCERS**: Allocated up to $100 million over 4 years for buyouts and other co-investments (AUM: $13.3B)

Summary
By establishing an LP co-investment program, VCERA could improve portfolio returns by avoiding unnecessary fees, accessing high-quality investment opportunities, and building stronger relationships with GPs. The proposed $20 million program is a low-risk, high-reward initiative that can be expanded in the future, depending on the results. Staff recommends moving forward with this strategy to enhance VCERA's private asset allocations and improve long-term performance.

THEREFORE IT IS RECOMMENDED THAT THE BOARD APPROVE:

1. Establishment of an in-house co-investment program with a $20 million allocation for calendar year 2025 for limited partner (LP) co-investments across Private Equity, Credit, Infrastructure, and Private Real Estate asset classes, alongside funds in which VCERA is invested in.

2. Approve and direct staff to take the necessary steps to hire an Investment Officer with private markets co-investments experience to help build VCERA's LP co-investment program, ensuring that proper due diligence, monitoring, and execution are carried out.

3. Delegate to the CIO the discretion to approve individual co-investment opportunities within established guidelines which enable sufficient time for prudent decision-making.

Sincerely,

Daniel P. Gallagher

Dan Gallagher
Chief Investment Officer

APPENDIX

Projected Annual Fee and Carry Savings for VCERA for a $20 million co-investment *per year* for 10 years using conservative assumptions.

CHART 1

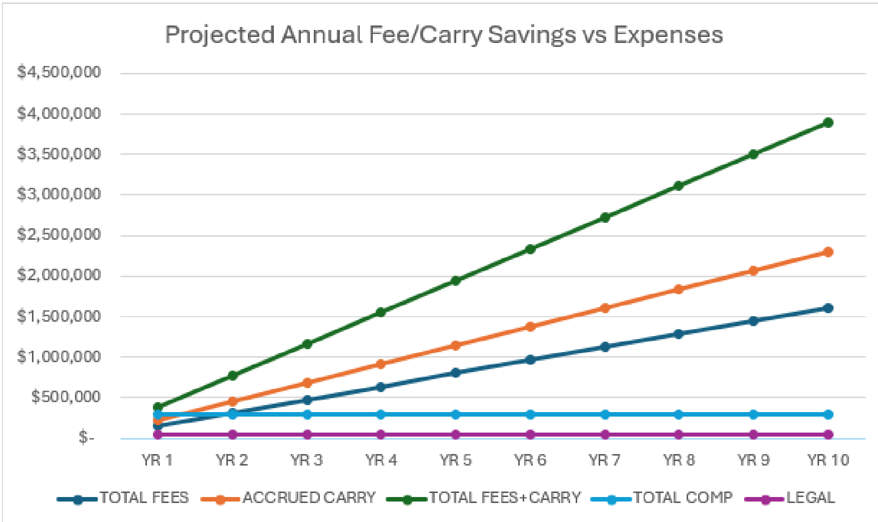
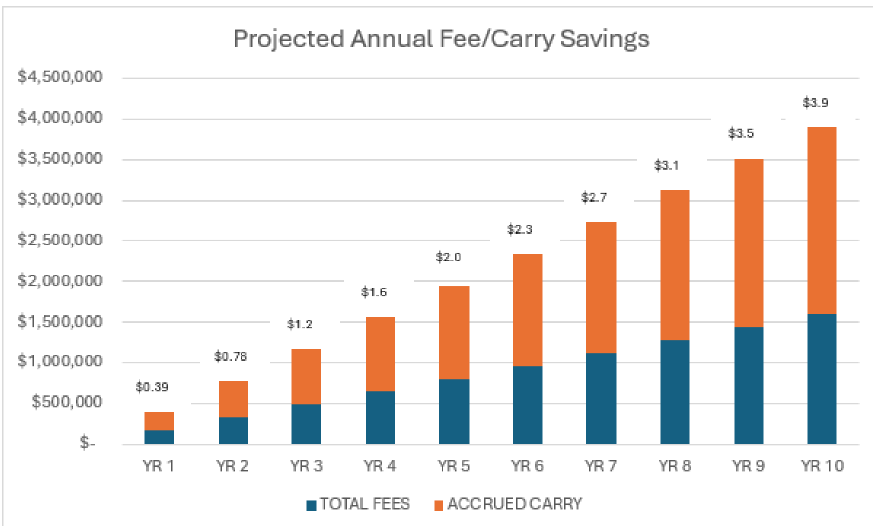


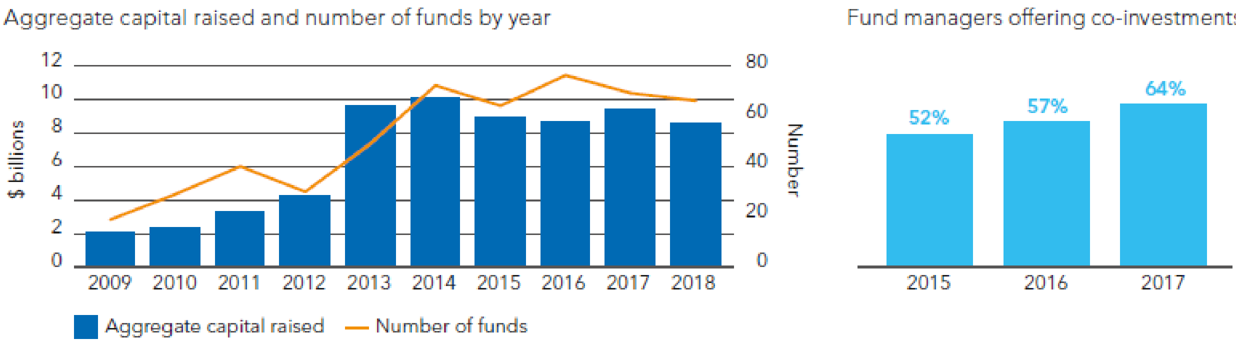
CHART 2



Assumptions:

- Management fee: 80bps
- Multiple: 2x multiple
- Carry: 12.5%
- Life: 10 years
- Legal Expenses: $40,000 per year
- Total Comp Expenses: $300,000 per year
- $20 million co-investments each year for 10 years

Figure 1: The development of the co-investment market:



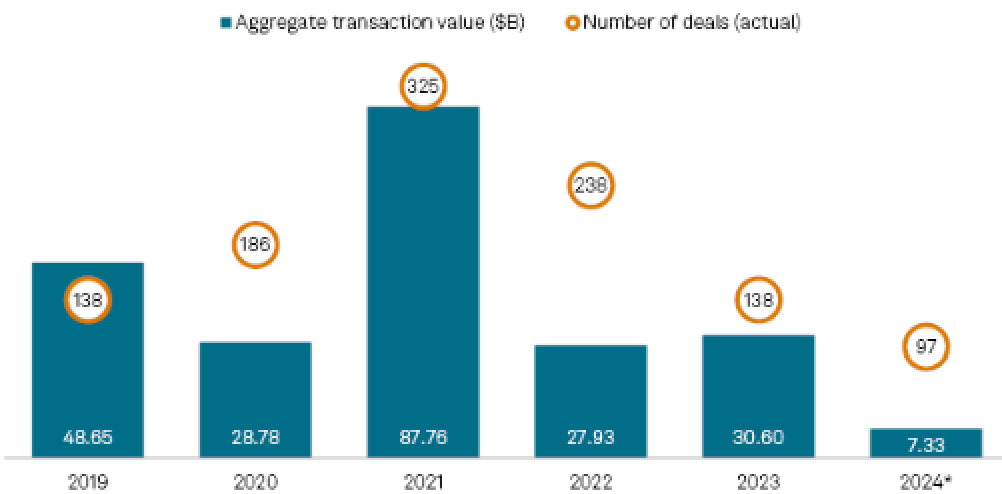
Source: Preqin – Historical Private Equity Fundraising Statistics (co-investment and co-investment multi-manager) derived on 29 January 2019.

Source: Preqin – 2018 Global Private Equity & Venture Capital Report, derived on 29 January 2019.

1 As of 30 June 2018.

2 Preqin – 2018 Global Private Equity & Venture Capital Report derived on 29 January 2019.

Limited partner coinvestments with PE/VC, 2019–2024 ($B)



Data compiled July 25, 2024.

PE/VC = private equity or venture capital.

* Year to date through July 24, 2024.

Analysis includes global whole-company acquisitions, minority stake acquisitions, asset acquisitions, and rounds of funding announced between Jan. 1, 2019, and July 24, 2024, where the buyer/investor in the deal is or includes private equity or venture capital, and is co-investing with corporate, union, and government pension plan sponsors, family offices or family trust, or endownment fund sponsors.

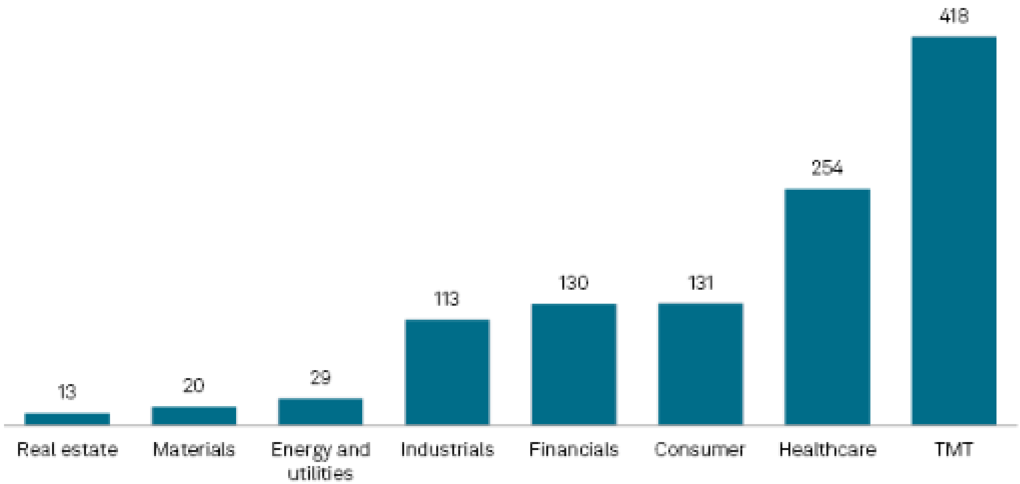
Coinvestments include deals or funding rounds where the limited partner invested alongside a PE/VC firm.

Excludes terminated deals and add-on acquistions.

Source: S&P Global Market Intelligence.

Number of limited partner coinvestments with PE/VC, 2019–2024*

Sector breakdown



Data compiled July 25, 2024.

PE/VC = private equity or venture capital; TMT = technology, media & telecommunications.

* Year to date through July 24, 2024.

Analysis includes global whole-company acquisitions, minority stake acquisitions, asset acquisitions, and rounds of funding announced between Jan. 1, 2019, and July 24, 2024, where the buyer/investor in the deal is or includes private equity or venture capital, and is co-investing with corporate, union, and government pension plan sponsors, family offices or family trust, or endowment fund sponsors.

Coinvestments include deals or funding rounds where the limited partner invested alongside a PE/VC firm.

Excludes terminated deals, deals with unclassified sectors, and add-on acquistions.

Source: S&P Global Market Intelligence.

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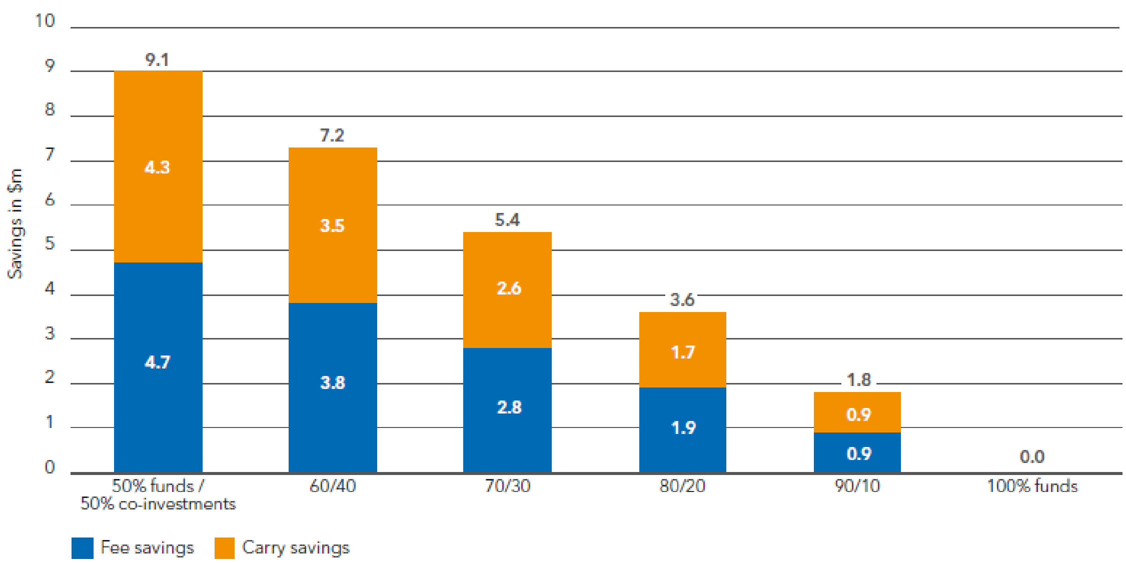
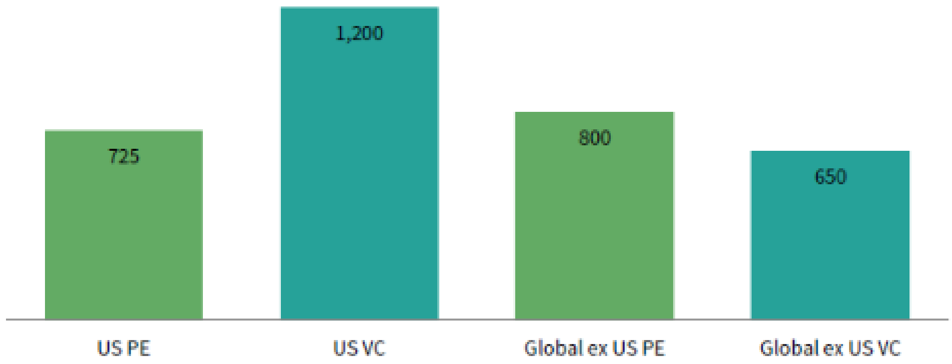
Figure 5: Simulating cost savings ranging from 100% funds to a balanced program ($100m commitment)



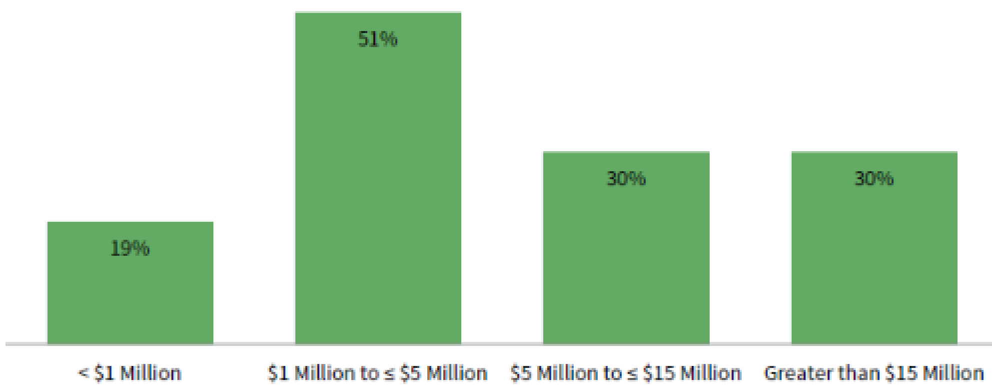
Source: BlackRock Private Equity Partners. Gross deal level returns = 2.0x. Fund terms: 2% fee, 20% carry deal-by-deal, 8% hurdle. Co-Investments terms: 0.75% fee, 10% carry European, 8% hurdle. Calculations based on $100m program and represent life-time estimates. Does not represent an actual product. It cannot be guaranteed that similar savings will be achieved in the future.

FIGURE 2 AVERAGE GROSS TO NET SPREAD
Basis Points (bps)



Source: Cambridge Associates LLC Private Investments Database.
Notes: Calculated as the spread between gross company-level returns and net fund-level returns using 622 US private equity
funds, 1,043 US venture capital funds, 443 global ex US private equity funds, and 146 global ex US venture capital funds. The
sample excludes funds that do not provide company-level data.

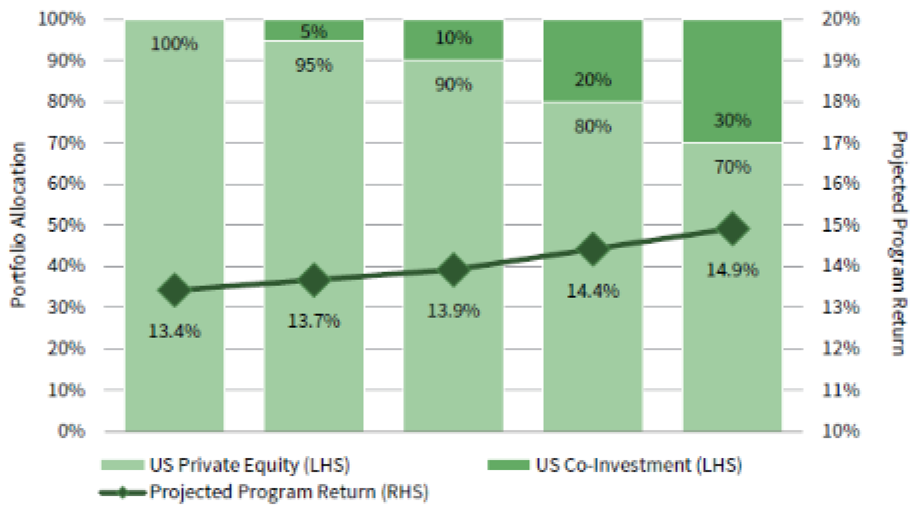
FIGURE 3 PERCENTAGE OF CA COMPLETED CO-INVESTMENTS BY INVESTOR AMOUNTS
As of December 31, 2018 • Percentage (%)



Source: Cambridge Associates LLC Private Investments Database.
Notes: Represents percentage of completed co-investments that included an individual client investment within the given size ranges.

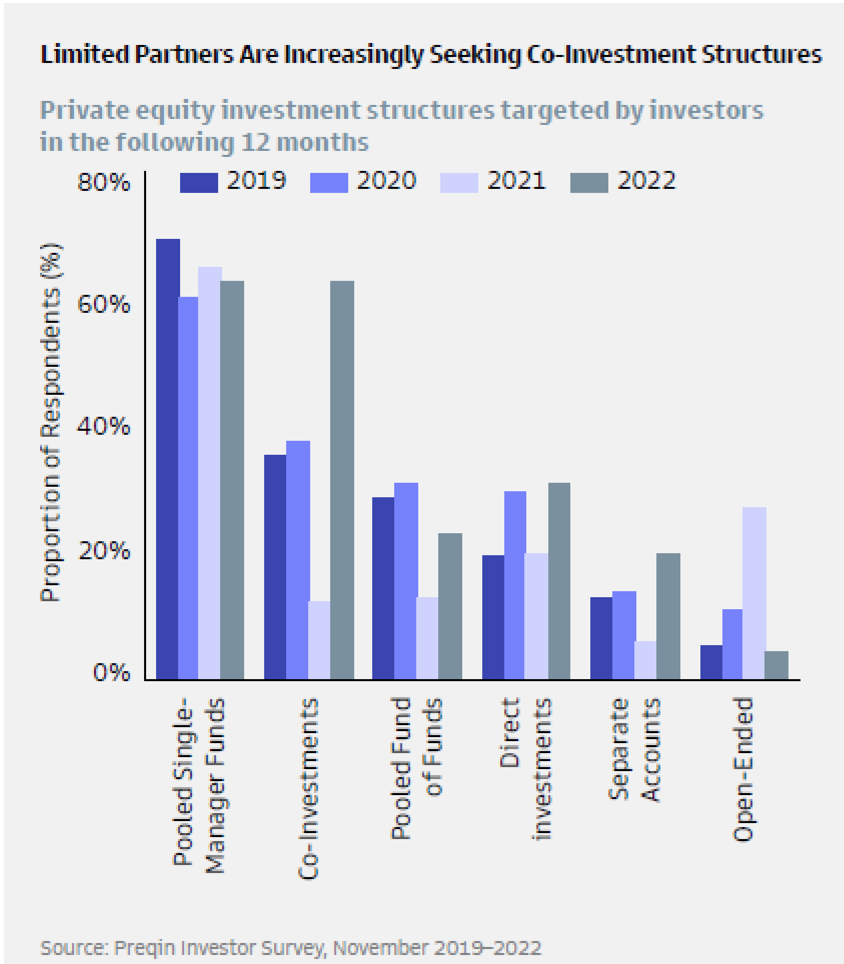
FIGURE 5 PRIVATE EQUITY PORTFOLIO RETURNS WITH CO-INVESTMENT ALLOCATION

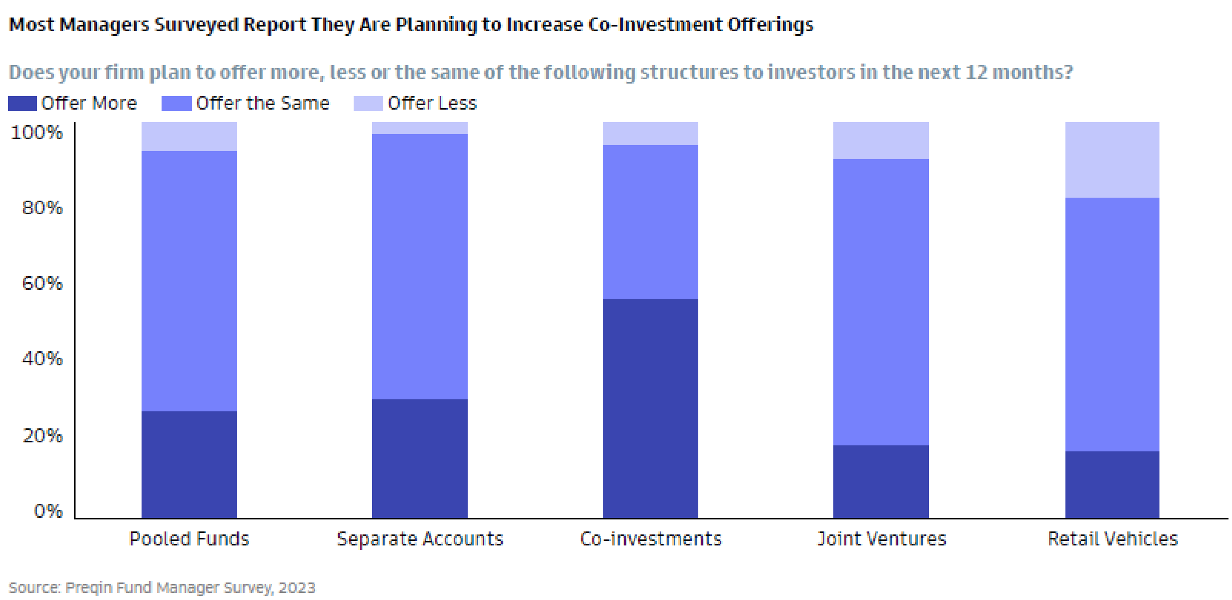
As of September 30, 2018 • For Illustrative Purposes Only



Source: Cambridge Associates LLC Private Investments Benchmark Index.

Notes: To calculate the weighted projected program return, the 25-year periodic return for US private equity through third quarter 2018
was used, equal to a 13.4% net IRR, and co-investment returns were projected to be 500 bps higher. Weighted portfolio returns are
calculated by applying the strategy weights to long-term returns.


Limited Partners Are Increasingly Seeking Co-Investment Structures
Private equity investment structures targeted by investors in the following 12 months
2019
2020
2021
2022
80%
60%
40%
20%
0%
Proportion of Respondents (%)
Pooled Single-Manager Funds
Co-Investments
Pooled Fund of Funds
Direct investments
Separate Accounts
Open-Ended
Source: Preqin Investor Survey, November 2019–2022


Most Managers Surveyed Report They Are Planning to Increase Co-Investment Offerings
Does your firm plan to offer more, less or the same of the following structures to investors in the next 12 months?
Offer More
Offer the Same
Offer Less
100%
80%
60%
40%
20%
0%
Pooled Funds
Separate Accounts
Co-investments
Joint Ventures
Retail Vehicles
Source: Preqin Fund Manager Survey, 2023