

Memorandum

Date: March 6, 2013
To: CCCERA Board of Retirement
From: Timothy Price, Retirement CIO; Chih-chi Chu, Retirement Investment Analyst
Subject: Commitment to Pathway Capital Management



Recommendation

We recommend the Board make a capital commitment of \$70 million to Pathway Private Equity Fund Investors 7 (PPEF 7), subject to successful due diligence and legal review. Pathway has been a successful manager for CCCERA since 1998. With the growth of total fund assets, an increase of our commitment to Pathway will help CCCERA maintain a diversified private equity program at its intended target.

On December 12, 2012 the Board approved a three year investment roadmap to increase CCCERA's alternative investments to the target of 10% of Total Fund assets. The roadmap suggests an allocation of up to \$200 million in 2013. A \$70 million commitment to Pathway 7 would still leave ample room this year for CCCERA to consider follow-on investments in other existing alternative managers and other new opportunities.

Overview

Pathway is currently raising capital for Pathway Private Equity Fund Investors 7, a multi-investor private equity fund of funds. The target size of PPEF 7 is between \$275 and \$325 million, with an expected second close at the end of April, 2013. Current committed capital to PPEF 7 is approximately \$172 million.

In order to maintain consistent vintage year exposure across the Pathway relationship, CCCERA periodically evaluates new commitments to Pathway. This has been the process since Pathway was first hired by CCCERA. From 1998 to 2007, CCCERA committed a total of \$125 million to Pathway Private Equity Fund I (PPEF I) over the course of four tranches, in which CCCERA is the sole limited partner. In 2009, the Board elected to commit \$30 million to PPEF 2008, a \$321 million multi-investors fund of funds. In 2011, CCCERA committed \$40 million to Pathway's last offering, PPEF 6, a \$226 million multi-investors fund of funds closed in a more difficult fund-raising environment.

This memo provides a review of CCCERA's investments with Pathway, an analysis reviewing the available amount for CCCERA to commit to alternative investments, the impacts of making this commitment on the overall CCCERA alternative investment portfolio, and a summary of the key terms of PPEF 7.

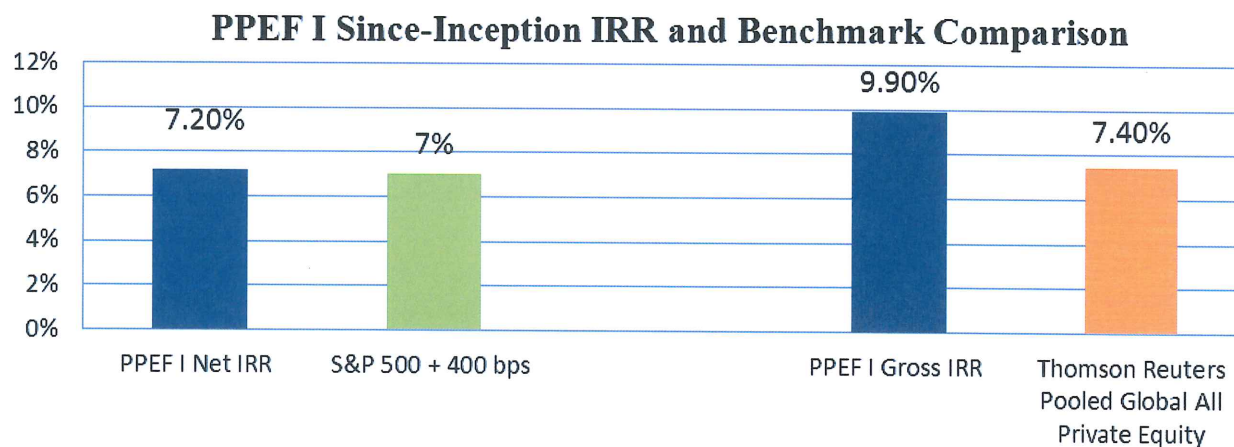
Review of Investment Track Records of Pathway Private Equity Fund I

As of September 30, 2012, Pathway had committed all of CCCERA's \$125 million capital commitments to PPEF I in 42 partnerships. The list below highlights information for CCCERA's investment in PPEF I as of September 30, 2012:

• Number of partnership commitments	42 partnerships
• Since Inception Gross IRR as of 09/30/12	9.9%
• Since Inception Net IRR as of 09/30/12	7.2%
• CCCERA Original Commitment	\$30 million
• CCCERA Additional Commitments	\$95 million
• Total Capital Called	\$110 million
• Total Capital Distributions	\$67 million
• Market Value as of 09/30/12	\$74 million
• Total Investment Multiple	1.3x
• CCCERA Remaining Commitment	\$15 million

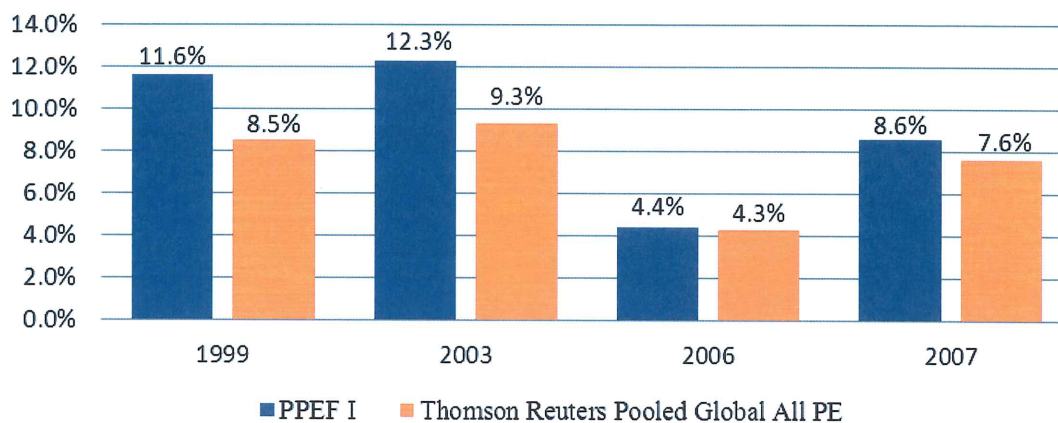
The cumulative CCCERA contributions to PPEF I are \$110 million, the cumulative distributions are \$67 million, and the current market value is \$74 million. PPEF I has delivered \$30 million in gains and a 7.2% net IRR since inception, surpassing CCCERA's alternative investment benchmark (S&P 500 + 400 basis points') of 7% during the same period (time-weighted.) The gross IRR since inception is 9.9%, exceeding *Thomson Reuters Pooled Global All Private Equity* return of 7.4% (on a gross basis) during the same period.

The chart below shows PPEF I's since-inception returns against the relevant benchmarks.



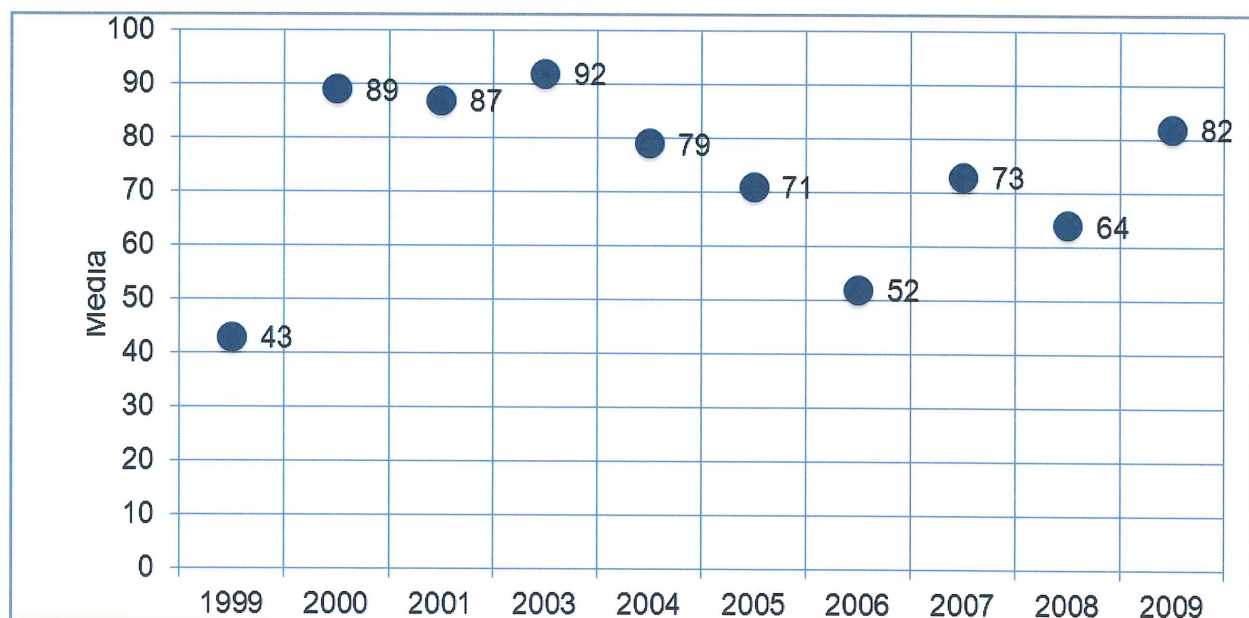
The following chart (compiled with data from Pathway) breaks down the since-inception gross IRR for each commitment CCCERA has made to PPEF I (\$30, \$15, \$30, and \$50 million in 1999, 2003, 2006, and 2007 respectively). This analysis illustrates the results for each commitment CCCERA has made to PPEF I. It shows the level of consistency in how Pathway has managed each commitment for CCCERA. All CCCERA commitments are ahead of the comparable peer benchmarks.

PPEF I Performance comparison by Funding Tranche



PPEF I had partnership exposure in every vintage year since 1999 except 2002 and 2010. The ranking of each vintage year's performance is shown below.

PPEF I Performance Ranking (% above) by Vintage Year



From the comparison above, out of the ten vintage years, PPEF I's performance is ranked in the 1st quartile five times, the 2nd quartile four times and 3rd quartile once, in 1999. The sub-median performance in 1999 was caused by the poor performance of three venture capital funds, which had a total commitment of \$9 million (out of the \$11.6 million contribution to '99 vintage.) These three funds suffered an aggregated IRR of -9%.

Updates on Pathway Private Equity Fund 2008 and PPEF 6

In 2009, CCCERA committed \$30 million to PPEF 2008, a \$320.9 million multi-investor fund of funds with 12 investors. PPEF 2008 has drawn \$9.3 million and committed to 26 partnerships. It has returned \$300,000 to CCCERA. The since inception gross IRR is 8.5% (net is -2.6%).

In 2011, CCCERA committed \$40 million to PPEF 6, a \$226 million multi-investor fund of funds. PPEF 6 has drawn \$2.1 million and committed to 10 partnerships. The IRR calculation is not yet relevant.

Summary of Total Pathway Investments

Overall CCCERA has contributed \$121 million to Pathway funds and received distributions of \$67 million. The combined value of all of CCCERA's Pathway investments is \$83 million. The since inception gross IRR is 9.9%, far exceeding the 7.4% of Thomson Reuters' Pooled Global All Private Equity, a peer group benchmark. The net IRR is 6.9%, slightly below S&P 500+4% return of 7%.

Pathway has constructed a diversified portfolio that includes a broad array of private equity strategies. It is interesting to note that over the past few years the allocation to Distressed/Special Situation has gone up (reducing the allocation to the Buyouts sector), capturing the growing investment opportunities from the Distressed/Special Situation sector in the wake of the global financial crisis.

The table below summarizes the diversification of private equity strategies (by partnership market value plus unfunded commitments) of CCCERA's total Pathway investments.

Buyouts	51%
Venture Capital	18%
<u>Distressed/Special Situation</u>	<u>31%</u>
Total	100%

CCCERA Available Commitments to Alternative Investments

As we have noted in the past, there is a significant lag time in alternative investments between when commitments are made to the Fund of Funds and their underlying funds (and, in turn, the actual company investments). In this area of alternative investments, after a dollar is committed by CCCERA it can take up to six or seven years before the final dollar committed is actually invested. For example, if a commitment is made today with Pathway, it will generally take Pathway three years to commit all of CCCERA's commitment to partnerships, and once Pathway commits to a partnership it can take three years before all the capital is drawn down from a specific partnership. In the meantime, partnership commitments made in the early years may have started to make distributions, which decrease the allocation to alternative investments.

Based on CCCERA's fund value of \$5.85 billion as of January 31, 2013, a 10% target allocation to alternative investments is \$585 million. CCCERA's alternative investments market value as of January 31, 2013 is approximately \$371 million and undrawn commitments are \$233 million, for a combined value of 604 million.

Taking into account the rising asset value, capital deployment lag time and distribution characteristics of investing in private equity, CCCERA needs to significantly over-commit relative to the desired target of 10% (\$585 million) in alternative investments. Using an estimate for over-commitment of 100% in this analysis, the total amount available for CCCERA to commit to alternative investments is \$566 million. These figures are detailed below:

	<u>Value (Millions)</u>
CCCERA Total Fund	\$5,851
<i>as of 1/31/2013</i>	
Target Alternatives @ 10%	\$585
Market Value Closed End Investments	
Adams Street Partners	\$90
Adams Street Secondary	29
Pathway	78
Pathway 2008	11
Pathway 6	3
EIF USPF I	2
EIF USPF II	41
EIF USPF III	47
EIF USPF IV	9
Nogales Investment	3
Bay Area Equity Fund	9
Bay Area Equity Fund II	5
Paladin III	13
Carpenter Community BancFund	31
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	\$371

Commitments Not Yet Drawn

Adams Street Partners	\$46
Adams Street Secondary	53
Pathway	18
Pathway 2008	19
Pathway 6	37
EIF USPF IV	39
Nogales Investment	2
Bay Area Equity Fund II	4
Paladin	8
Carpenter Community BancFund	7
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	\$233

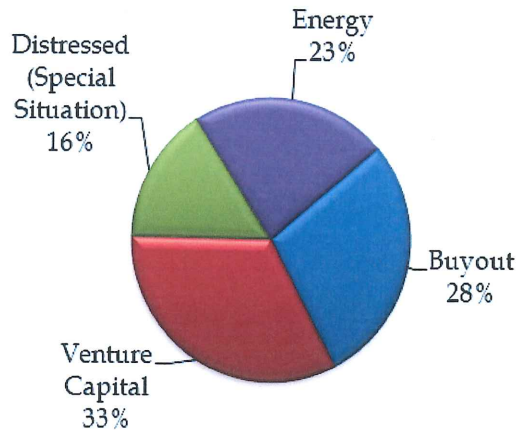
Target to Alternatives	\$585
less Investments	371
less Commitments Not Yet Drawn	233
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Available to Commit	-\$19
<i>plus 100% Over-Commitment</i>	
<i>(reflects funding lag time and asset growth)</i>	
	<hr/>
	585

Estimated Availability to Commit **\$566**

Impact on CCCERA Combined Alternative Investment Portfolio

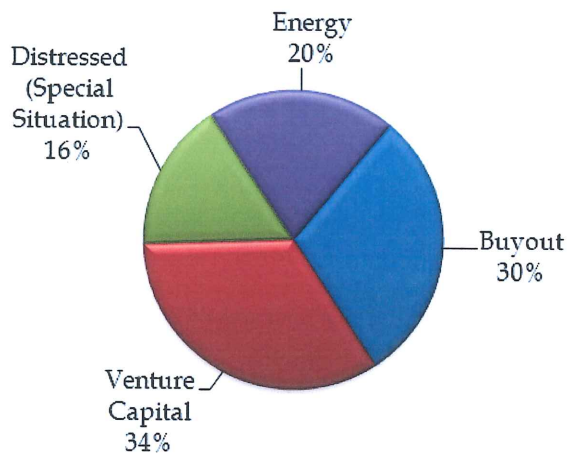
As discussed in the previous section, the combined CCCERA alternative investment portfolio has \$604 million of invested and committed capital. Fund-of-funds account for 57% of the total CCCERA alternative allocation, with 36% in Adams Street and 21% in Pathway. The fund-of-funds allocation is broadly diversified in a large number of partnerships and multiple strategies of private equity such as various stages of Buyouts, Venture Capital, Special Situation and Distressed. The rest of CCCERA's alternative allocation is direct invested in Venture Capital and Energy partnerships. CCCERA's Alternative investments currently have 28% allocation in various stages of Buyouts, 33% in Venture Capital, 23% in Energy, and 16% in distressed and Special Situation. This allocation gives CCCERA a balanced alternative portfolio with less than 30% of the pool in Buyouts, about one-third of the total alternative investments in Venture Capital, and the rest in Energy, Distressed and Special Situation, illustrated in the chart on the following page.

CCCERA Current Alternative Allocation



We have evaluated the impact of a \$70 million commitment to Pathway. The commitment, if approved, will increase CCCERA's combined invested and committed allocation from \$604 million to \$674 million. With this additional commitment, the allocation to Buyouts will increase from the current 28% to 30%, the allocation to Venture Capital will increase 1% to 34%, the allocation to Energy will decrease from the current 23% to 20%, and the allocation to Distressed and Special Situation will stay the same at 16%. Overall the allocation to the fund-of-funds will increase from 57% to 62%. The allocation to Pathway Capital will increase from the current 21% to 30%. The chart below previews CCCERA's Alternative Allocation to different types of strategies with the recommended \$70 million Commitment to Pathway 7.

Projected CCCERA Alternative Allocation



Summary of Key Terms of Pathway 7

The following is a summary of the key terms of Pathway 7 provided by Pathway Capital Management

Investment Adviser:	Pathway Capital Management, LP
Fund Name:	Pathway Private Equity Fund Investors 7, LP
Investment Strategy:	To create a diversified portfolio of interests in buyouts, venture capital, and special situations (including debt-related) investment funds.
Expected Size:	\$275~\$325 million
GP Commitment:	Up to 1% of Commitments
Commitment Period:	3 years after the fund commencement date subject to two 1-year extensions at the discretion of the General Partner
Term:	15 years or, if later, the date on which all the underlying investments have been liquidated and all related obligations satisfied
Management Fee:	<p>To be kept the same as previous funds', at 0.8% of committed capital (standard fee shown on the placement memorandum is 0.9%), reduced after the eighth anniversary of the commencement date according to the schedule but no less than 20% of the Management Fee.</p> <p>There is no carried interest.</p>
Partnership Expenses:	The Partnership will be responsible for organizational expenses and all costs related to its investment activities; all legal, accounting, consulting, and other fees such as costs associated with its financial statements and tax returns; amounts paid or advanced by the Partnership pursuant to its indemnification obligations; premiums for insurance; and the costs of dissolving and winding up the Partnership.
Distributions:	The General Partner may distribute cash proceeds and in-kind securities received from distributions of underlying investment funds, or other income including short term interest income to the Partners ratably in proportion to their respective interests in the assets generating such income.