

Memorandum

MEETING DATE

MAR 30 2011

AGENDA ITEM

#5

Date: March 23, 2011
To: CCCERA Board of Retirement
From: Cary Hally, Retirement CIO; Chih-chi Chu, Retirement Investment Analyst
Subject: Commitment to Pathway Capital Management

Recommendation

We recommend the Board make a capital commitment of \$40 million to Pathway Private Equity Fund Investors 6 (PPEF 6), subject to successful due diligence and legal review. Pathway has been a successful investment for CCCERA, and it is important to maintain a commitment to Pathway if the Board desires to maintain a diversified private equity program with Pathway.

Overview

Pathway is currently raising capital for Pathway Private Equity Fund Investors 6 (PPEF 6), a multi-investor private equity fund of funds. The target fund size of PPEF 6 is between \$200 and \$300 million, with an expected close at the end of April, 2011. Current commitments to PPEF 6 are approximately \$160 million. This investment vehicle is a follow on investment to Pathway Private Equity Fund 2008 (PPEF 2008), in which CCCERA made a \$30 million commitment.

CCCERA has committed a combined total of \$125 million to Pathway in Pathway Private Equity Fund I (PPEF I), in which CCCERA is the sole limited partner. CCCERA originally committed \$30 million to PPEF I at the end of 1998, and increased the commitment by \$15 million in 2003, \$30 million in 2006, and \$50 million in 2007. In mid-2009, the Board elected to commit \$30 million to PPEF 2008, a \$320.9 million multi-investor fund of funds managed by Pathway. The change with investment vehicles was done primarily to increase diversification and obtain more even vintage year exposure.

In order to maintain consistent vintage year exposure with the combined Pathway portfolio, it is important for CCCERA's to periodically evaluate new commitments to Pathway. This has been the process since Pathway was first hired by CCCERA. New commitments enable Pathway Capital to have the capacity to invest in partnerships of future vintage year, primarily 2012 and beyond.

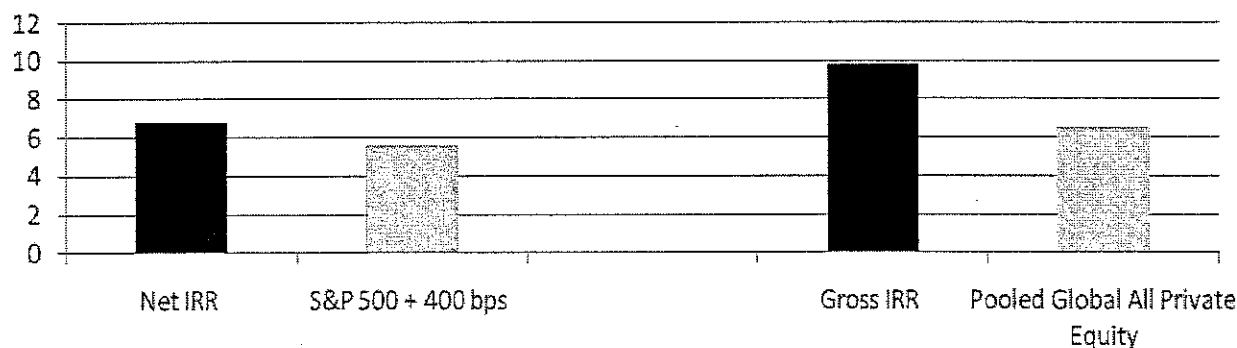
This memo provides a review of CCCERA's investments with Pathway Capital Management, an analysis reviewing the amount of commitments available for CCCERA to make to alternative investments, the possible impacts of making commitments to private equity fund-of-funds on the overall CCCERA alternative investment portfolio, and a summary of the key terms of PPEF 6.

Review of Investment Track Records of Pathway Private Equity Fund I

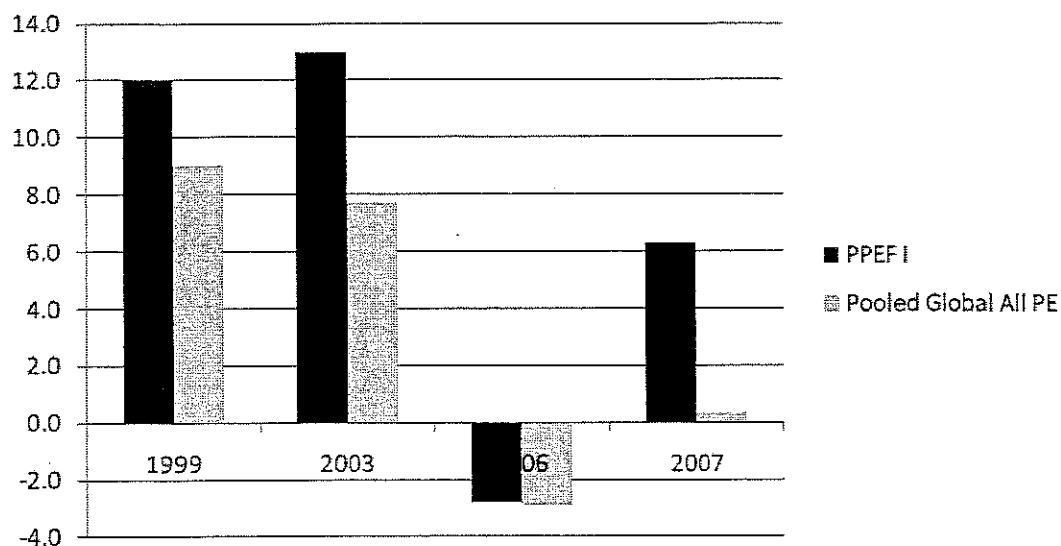
As of September 30, 2010, Pathway had committed all of CCCERA's \$125 million commitment to PPEF I in 42 partnerships. Below highlights information for CCCERA's investment in PPEF I as of September 30, 2010:

- Number of partnership commitments 42 partnerships
- Since Inception Gross IRR as of 09/30/10 9.8%
- Since Inception Net IRR as of 09/30/10 6.8%
- CCCERA Original Commitment \$30 million
- CCCERA Additional Commitments \$95 million
- Total Capital Called \$90 million
- Total Capital Distributions \$45 million
- Market Value as of 09/30/10 \$64 million
- Total Investment Multiple 1.2x
- CCCERA Remaining Commitment \$35 million

The cumulative CCCERA contributions are \$90 million, the cumulative distributions are \$45 million, and the current market value is \$64 million. This results in gain of \$18.8 million and 6.8% net IRR since inception, surpassing S&P 500 + 400 basis points (bps) 5.6% during the same period (dollar-weighted.) CCCERA's benchmark for alternative investments is S&P 500 + 400 bps. The gross IRR since inception of 9.8% exceeds *Thomson Reuters Pooled Global All Private Equity* return during the same period of 6.5% (on a gross basis). Below is the comparison between PPEF I's since-inception returns and relevant benchmarks.



The following chart (compiled with data from Pathway) looks at 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 is slightly different than how we typically look at vintage years, which typically shows comparison of when Pathway makes a commitment to a partnership. 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 by CCCERA. All CCCERA commitment year periods look favorable when compared to the provided benchmark.



In terms of vintage exposure, PPEF I has partnership exposure in every vintage year since 1999 except 2002 and 2010. The following table lists PPEF I's net IRR ranking by vintage year. Vintage year 2011 is too young to be meaningful.

	'99	'00	'01	'03	'04	'05	'06	'07	'08	'09
PPEF I	-2.1%	21.4%	24.5%	26.8%	15.8%	5.3%	-3.8%	3.9%	0.3%	38.7%
Qtrle.	3 rd	1 st	1 st	1 st	1 st	2 nd	3 rd	1 st	2 nd	1 st

Qtrle. – PPEF I's net IRR quartile rank based on *Thomson Reuters* September 30, 2010 *Global All Private Equity* return benchmarks.

Out of the ten vintage years available, PPEF I's performance is ranked in the 1st quartile six times, the 2nd quartile two times and 3rd quartile two times. The sub-par performance in 1999 was due to three venture capital funds with total commitments of \$9 million (out of \$11.6 million contribution to '99 vintage) with an aggregated IRR of -9%. For 2006 vintage, according to Pathway, some very profitable exits are on the horizon which will boost 2006's return and ranking.

Of PPEF I's \$64 million market value, three vintages together accounted for over 50%: \$11.7 million for 2006, \$13.0 million for 2007, and \$11.7 million for 2008, with funding (called) ratio of 85%, 54%, and 42% respectively. The table below details the cash flows for all available vintages.

(\$ in millions, except Total/Paid-In)

Vintage Yr	Commitment	Contribution	Distribution	Mkt Value	Total/Paid-In
1999	\$12.0	\$11.6	\$7.6	\$2.8	0.9x
2000	8.3	8.0	13.8	3.2	2.1x
2001	6.8	6.4	9.8	3.2	2.0x
2003	6.0	6.5	7.2	4.7	1.8x
2004	8.5	8.4	6.6	6.2	1.5x
2005	3.6	3.3	0.7	3.2	1.2x
2006	16.8	14.3	1.4	11.7	0.9x
2007	27.4	14.7	2.6	13.0	1.1x
2008	28.9	12.0	0.3	11.7	1.0x
2009	4.9	3.1	0.0	4.0	1.3x
2011	1.9	0.0	0.0	0.0	Not Meaningful
Total	\$125.1	\$90.0	\$44.8	\$64.0	1.2x

Amounts may not sum due to rounding.

The following table displays the strategy diversification (in market value) of CCCERA's investments in PPEF I:

Mega and Large Buyouts	39%
Medium Buyouts	24%
Small Buyouts	7%
Venture Capital	12%
<u>Distressed/Special Situation</u>	<u>18%</u>
Total	100%

Updates on Pathway Private Equity Fund 2008

In mid-2009, CCCERA committed \$30 million to PPEF 2008, a \$320.9 million multi-investor fund of funds with 12 investors. PPEF 2008 is still in its early investment stage, with 51% of the capital committed to 17 partnerships and only 9% of the total commitment drawn. Nonetheless, four partnerships in the portfolio have already distributed approximately seven hundred thousand dollars back to PPEF 2008. Pathway expects to commit the remaining capital over the next two years. The actual diversification by strategy as in PPEF 2008's committed capital by February 28, 2011 is listed below:

Buyouts	48%
Venture Capital	21%
<u>Distressed/Special Situation</u>	<u>31%</u>
Total	100%

CCCERA Available Commitments to Alternative Investments

Based on the February 28, 2011 plan assets market value of \$5.23 billion, CCCERA has a 7% target allocation of \$368 million to alternative investments.

CCCERA's alternative investments market value as of February 28, 2011 is approximately \$292 million. Outstanding commitments to alternative investments, which have not yet been drawn, total \$239 million. The combination of market values and outstanding commitments is \$531 million. Based on this amount CCCERA is over-committed to its target of \$368 million by approximately \$163 million.

As has been previously discussed with the Board, there is a significant lag period from when a commitment is made until the actual dollars are invested when investing in alternative investments. Most of CCCERA's alternative investments are in private equity fund-of-funds. In this area of alternatives, when 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.

In addition to the lag time involved with investing in alternative investments, consideration must also be given to the change in CCCERA assets value. Over time it is expected for the value to grow. This has historically been one of the reasons to over-commit to close-end alternative investments.

Taking into account changing asset values, lag time and distribution characteristics of investing in private equity, CCCERA still needs to significantly over-commit relative to the desired target of 7% (\$368 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 \$205 million. These figures are detailed in the following table:

	<u>Value (Millions)</u>
CCCERA Total Fund	\$5,254
<i>as of 2/28/2011</i>	
Target Alternatives @ 7%	\$368
Market Value Closed End Investments	
Adams Street Partners	\$79
Adams Street Secondary	11
Pathway	68
Pathway 2008	2
EIF USPF I	7
EIF USPF II	45
EIF USPF III	29
EIF USPF IV	0
Nogales Investment	2
Bay Area Equity Fund	13
Bay Area Equity Fund II	3
Paladin III	11
Carpenter Community BancFund	22
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	\$292

Commitments Not Yet Drawn

Adams Street Partners	\$63
Adams Street Secondary	23
Pathway	35
Pathway 2008	28
EIF USPF III	8
EIF USPF IV	50
Nogales Investment	2
Bay Area Equity Fund II	7
Paladin	12
Carpenter Community BancFund	11
	<hr/>
	\$239

Target to Alternatives	\$368
less Investments	292
less Commitments Not Yet Drawn	239
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Available to Commit	-\$163
<i>plus 100% Over-Commitment</i>	
<i>(reflects funding lag time)</i>	<hr/>
	368

Estimated Available to Commit **\$205**

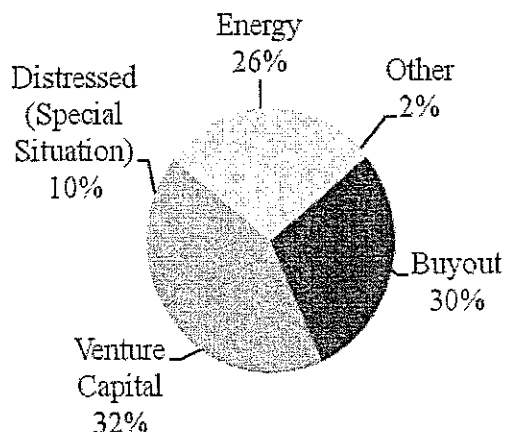
Impact on CCCERA Combined Alternative Investment Portfolio

As discussed in the previous section, the combined CCCERA alternative investment portfolio has \$531 million of invested and committed capital. Currently fund-of-funds account for 58% of the total CCCERA alternative allocation, with 33% in Adams Street and 25% in Pathway. The fund-of funds allocation is broadly diversified in a large number of partnerships and multiple categories of private equity such as various stages of Buyouts, Venture Capital, Special Situation and Distressed. The rest of CCCERA's alternative allocation is direct investing in Venture Capital and Energy partnerships. Altogether, the direct and fund-of funds investments currently have 30% allocation in various stages of Buyouts, 32% in Venture Capital, 26% in Energy, 10% in distressed and Special Situation, and 2% in Other category. This allocation gives CCCERA a balanced alternative portfolio with approximately one-third of the pool in Buyouts, one-third in Venture Capital, and the rest in Energy, Distressed and Special Situation, and Other.

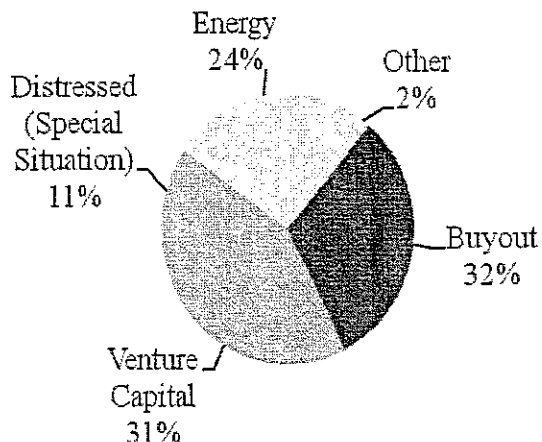
We have evaluated the impact of a \$40 million commitment to Pathway 6, a private equity fund-of-funds. The commitment if approved will increase CCCERA's combined invested and committed allocation from \$531 million to \$571 million. With this additional commitment, the allocation to Buyouts will increase from the current 30% to 32%, the allocation to Venture Capital will decrease 1% to 31%, Energy will decrease from the current 26% to 24%, and the allocation to Distressed and Special Situation will increase 1% to 11%. Overall the allocation to

the fund-of-funds will increase from 58% to 61%. The allocation to Pathway Capital will increase from the current 25% to 30%. The pre- and post-commitment analysis on allocation by strategy is shown in the following two charts.

CCCERA Current Alternative Allocation



**CCCERA Alternative Allocation,
post commitment to \$40M Pathway 6**



As shown, the balance among the various alternative strategies will not be altered significantly with a \$40 million commitment to Pathway 6.

Summary of Key Terms of Pathway 6

The following is a summary of the key terms of Pathway 6 provided by Pathway Capital Management

Investment Adviser:	Pathway Capital Management, LLC
Fund Name:	Pathway Private Equity Fund Investors 6, L.P.
Investment Strategy:	To create a diversified portfolio of private equity funds that pursue a variety of investment strategies, including but not limited to buyouts, venture capital, debt-related, and special situations.
Expected Size:	\$200~\$300 million
GP Commitment:	Up to 1% of Commitments
Commitment Period:	3 years after the commencement date
Term:	Will terminate on the fifteenth anniversary of the commencement date or if later the date on which all the underlying investments have been liquidated and all related obligations satisfied.
Management Fee:	To be kept the same as PPEF I and PPEF 2008, 0.8% (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
Organizational Costs:	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, securities, or other property at such times and in such amounts as it deems appropriate to the Partners, pro rata, based on each Partner's commitment.

CONTRA COSTA COUNTYEMPLOYEES' RETIREMENT ASSOCIATION
DISCLOSURE STATEMENT RE: USE OF PLACEMENT AGENTS

The undersigned is a current or proposed "External Manager" for the Contra Costa County Employees' Retirement Association ("CCCERA"), as defined under CCCERA's Placement Agent Disclosure Policy, adopted on June 9, 2010 ("Policy.") We have received a copy of the Policy from CCCERA. We hereby disclose to CCCERA the following information, which we represent and warrant to be true and correct as of the date hereof:

1. Neither we nor any of our principals, employees, agents or affiliates has compensated or agreed to compensate, directly or indirectly, any person or entity to act as a Placement Agent (as defined in the Policy) in connection with any investment by CCCERA, **except as disclosed on Attachment 1 to this Disclosure Statement.**

[IF THERE IS NOTHING TO DISCLOSE IN ATTACHMENT 1, ITEMS 2-6 ARE INAPPLICABLE.]

2. To the extent of any disclosure set forth on Attachment 1, we attach as Attachment 2 to this Disclosure Statement a resume for each officer, partner or principal of the Placement Agent (and any employee providing similar services) detailing the person's education, professional designations, regulatory licenses and investment and work experience, and whether any such person is a current or former CCCERA Board member, employee or Consultant or a member of the immediate family of any such person.
3. To the extent of any disclosure set forth on Attachment 1, we attach as Attachment 3 to this Disclosure Statement a description of any and all compensation of any kind we have provided or have agreed to provide to a Placement Agent, including the nature, timing and value thereof.
4. To the extent of any disclosure set forth on Attachment 1, we attach as Attachment 4 to this Disclosure Statement a description of the services to be performed by the Placement Agent.
5. To the extent of any disclosure set forth on Attachment 1, we attach as Attachment 5 to this Disclosure Statement a statement whether the Placement Agent or any of its affiliates are registered with the Securities and Exchange Commission or the Financial Industry Regulatory Association or any similar regulatory agent in a country other than the United States and the details of such registration or explanation of why no registration is required.

6. To the extent of any disclosure set forth on Attachment 1, we attached as Attachment 6 to this Disclosure Statement a statement whether the Placement Agent or any of its affiliates are registered as a lobbyist with any state or national government.

We further represent and warrant as follows:

A. We shall provide an update of any changes to any of the information included in this Disclosure Statement within fourteen (14) business days of the occurrence of the change in information.

B. We shall cause our engaged Placement Agent, if any, prior to acting as a Placement Agent with regard to CCCERA, to disclose to CCCERA in writing any campaign contribution, gift (as defined in Government Code section 82028) or other item of value made or given to any member of the CCCERA Board or Staff, or Consultant (as defined in the Policy), during the prior twenty-four month period.

C. We shall cause our engaged Placement Agent, during the time it is receiving compensation in connection with a CCCERA investment, to disclose to CCCERA any campaign contribution, gift or other item of value made or given to any member of the CCCERA Board or Staff, or Consultant, during such period.

Dated: March 21, 2011

EXTERNAL MANAGER

Pathway Capital Management, LLC

Name of Entity

By: 

Authorized Signatory

Print Name Albert M. Clerc

Its Senior Managing Director