

# 2023 Private Credit Portfolio Strategic Plan

Santa Barbara County Employees' Retirement System

April 26, 2023



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# SBCERS Private Credit Portfolio Review



# SBCERS Private Credit Portfolio Highlights

## SBCERS is in the 6<sup>th</sup> year of building the Private Credit Portfolio

### Performance

- The SBCERS Private Credit Portfolio generated **\$25 million** in value since it was launched in 2018.
- The Portfolio's since inception net IRR of **9.2%** outperformed the Credit Suisse Leveraged Loan Index by 6%.
- The Portfolio's since inception net multiple of **1.16x** was within our expectations.

### Strategic Objectives

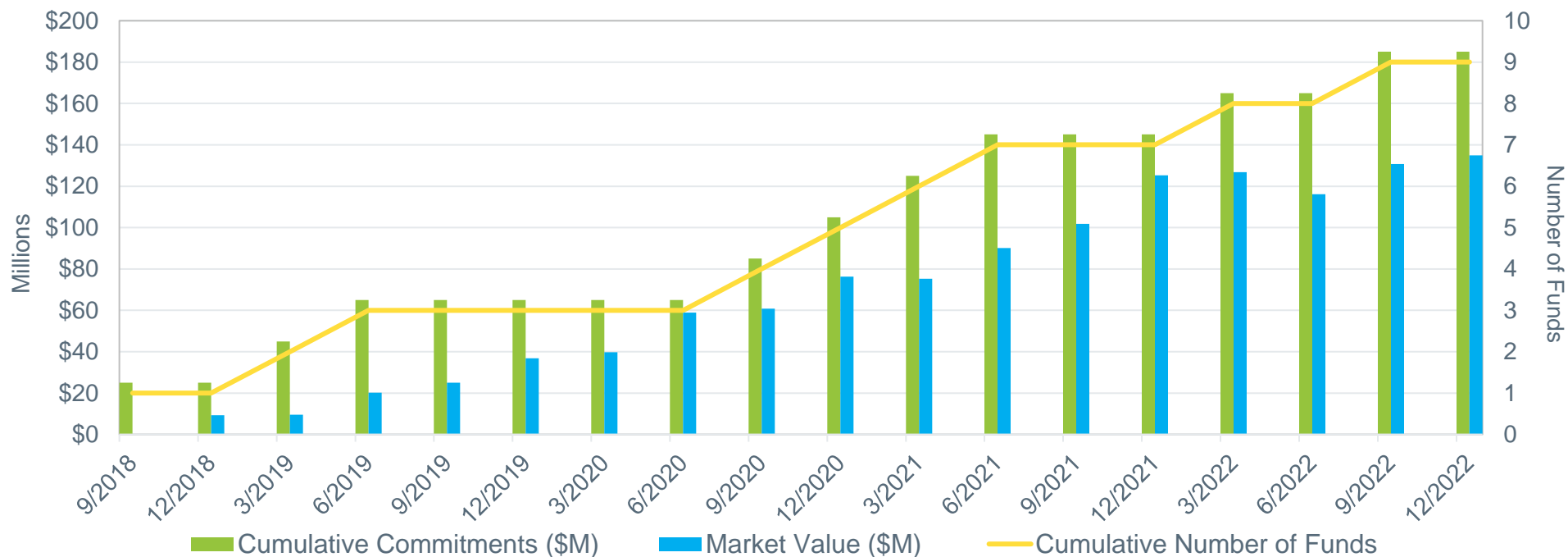
- RVK aims to assist SBCERS in establishing a diversified and conservative Private Credit Portfolio.
- The Portfolio has a strong foundation of several high-quality managers.
- The Private Credit Portfolio allocation was 3.48% as of December 31, 2022 and is on pace to achieve the 4.95% target allocation by approximately 2026.

# SBCERS Private Credit Portfolio Timeline of Events

Date	SBCERS Private Credit Portfolio Event
September 2016	The current asset allocation is initially approved, including an 11% allocation to Non-Core Fixed Income
February 2017	RVK reviews a structure analysis, comparing potential sub-asset class structures within Non-Core Fixed Income
March 2018	The Board approved a Non-Core Fixed Income structure of 33% EMD, 33% Bank Loans, 33% Private Credit
July 2018	\$25 million commitment to <b>AG Direct Lending Fund III</b> (first private credit investment)
February 2019	\$20 million commitment to <b>First Eagle Direct Lending Fund IV</b> (previously called THL Credit Direct Lending)
April 2019	\$20 million commitment to <b>PIMCO Private Income Fund</b> (first evergreen fund)
October 2019	The current asset allocation is reconfirmed (initially approved in September 2016)
July 2020	\$20 million commitment to <b>Deerpath Capital V</b>
December 2020	\$20 million re-up commitment to <b>AG Direct Lending Fund IV</b> (first private credit re-up)
February 2021	\$20 million re-up commitment to <b>First Eagle Direct Lending Fund V</b>
June 2021	\$20 million re-up commitment to <b>Deerpath Capital VI</b>
September 2021	Private Credit Portfolio Investment Guidelines added to the SBCERS Investment Policy Statement
June 2022	\$20 million commitment to <b>AG Direct Lending Evergreen Fund</b>
August 2022	The Board approved a Non-Core Fixed Income structure of 25% EMD, 30% Bank Loans, 45% Private Credit
September 2022	\$20 million commitment to <b>Ares Pathfinder Core Fund</b>

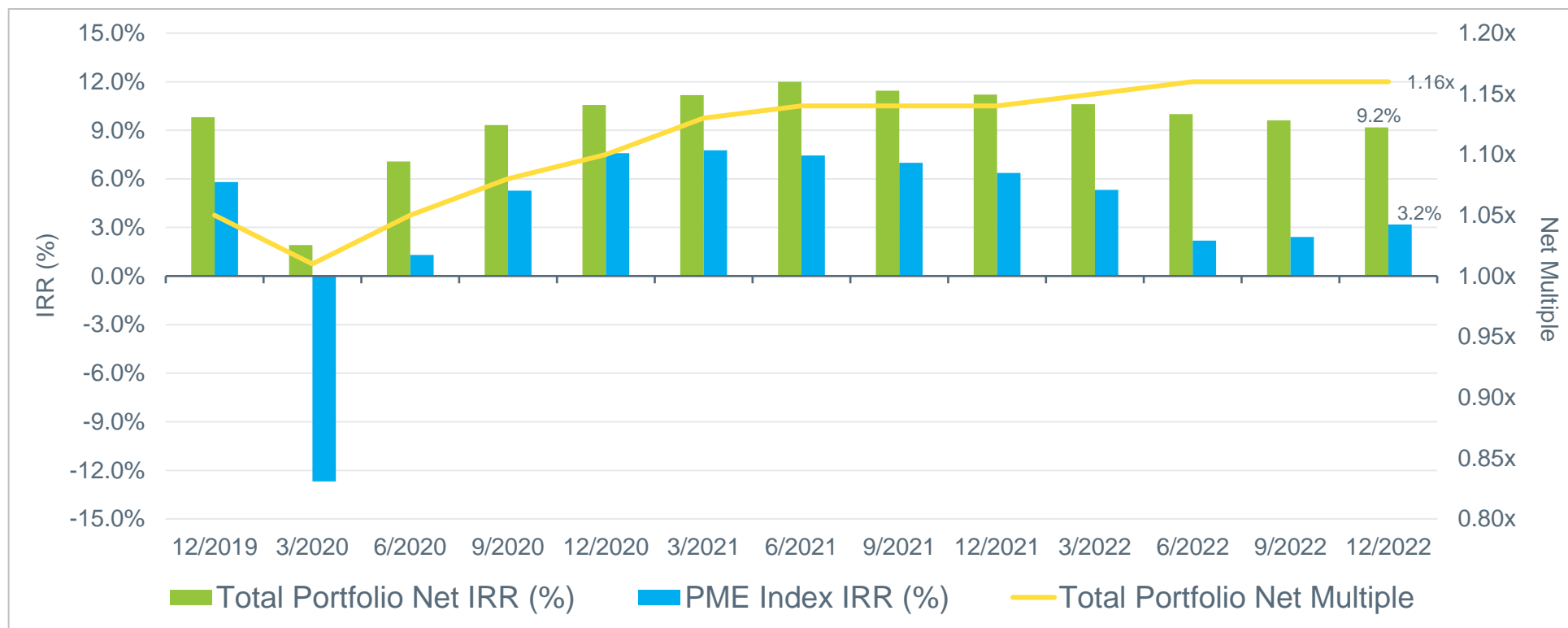
# SBCERS Private Credit Activity

## SBCERS Private Credit Portfolio Growth



- SBCERS has committed \$185 million to nine funds across five managers since the Private Credit Portfolio was launched in 2018.
- Individual vintage year commitments have been approximately \$40 million, in line with the initially recommended annual pacing as the Private Credit Portfolio ramps to the target allocation.

# Private Credit Portfolio Performance (As of 12/31/2022)

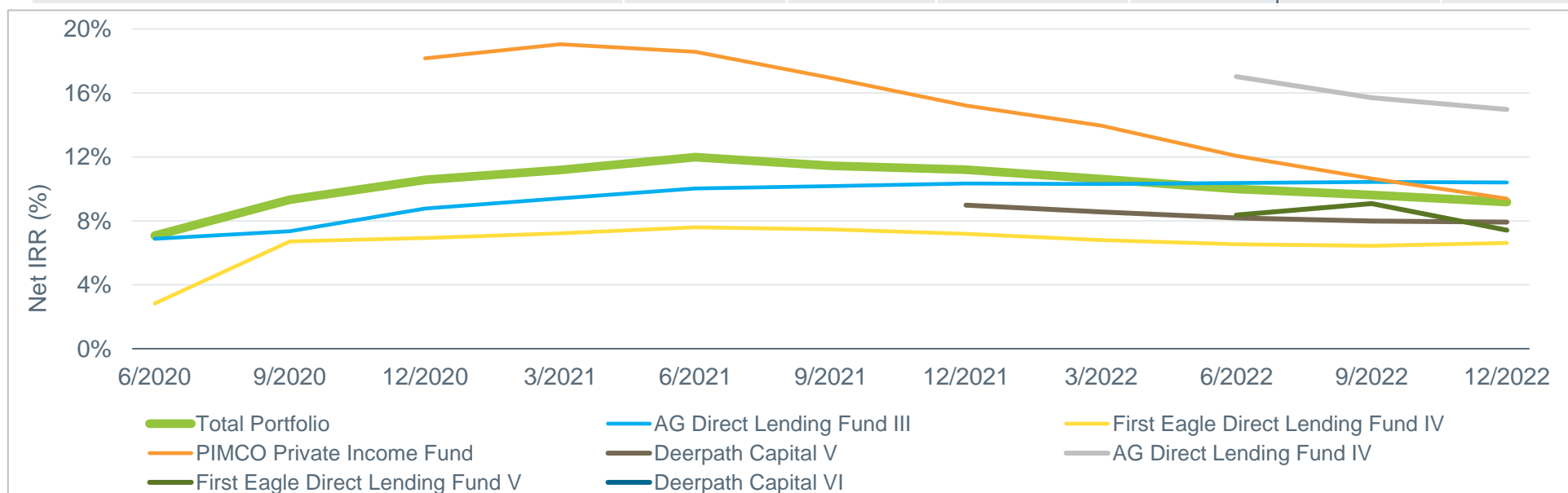


- The Portfolio's since inception net IRR of 9.2% outperformed the Credit Suisse Leveraged Loan Index (PME Index) by **6.0%**.
- The Portfolio's since inception net IRR of 9.2% outperformed the Secured Overnight Financing Rate (SOFR) + 4% by **4.0%**.
  - SOFR + 4% is the Portfolio's official long-term performance objective as outlined in the IPS.
- The Portfolio's since inception net multiple of 1.16x is within our expectations.

Performance is as of 12/31/2022 and has been calculated by RVK. PME Index IRR represents the IRR calculated using the Credit Suisse Leveraged Loan Index, assuming an index investment with the same cash flow timing.

# Private Credit Manager Performance (As of 12/31/2022)

Fund	Vintage	Net IRR	PME Index IRR	IRR Quartile	Net Multiple	Multiple Quartile
AG Direct Lending Fund III	2018	10.4%	3.9%	2 <sup>nd</sup>	1.36x	1 <sup>st</sup>
First Eagle Direct Lending Fund IV	2019	6.6%	3.7%	3 <sup>rd</sup>	1.08x	4 <sup>th</sup>
PIMCO Private Income Fund	2019	9.4%	5.0%	2 <sup>nd</sup>	1.28x	1 <sup>st</sup>
Deerpath Capital V	2020	7.9%	2.6%	3 <sup>rd</sup>	1.15x	1 <sup>st</sup>
AG Direct Lending Fund IV	2020	15.0%	0.2%	1 <sup>st</sup>	1.18x	1 <sup>st</sup>
First Eagle Direct Lending Fund V	2021	7.4%	-1.08%	3 <sup>rd</sup>	1.07x	2 <sup>nd</sup>
Deerpath Capital VI	2021	8.2%	-0.61%	2 <sup>nd</sup>	1.08x	2 <sup>nd</sup>
AG Direct Lending Evergreen Fund	2022	N/M	N/M	N/M	N/M	N/M
Ares Pathfinder Core Fund	2022	N/M	N/M	N/M	N/M	N/M
<b>Total Portfolio</b>		9.2%	3.2%		1.16x	



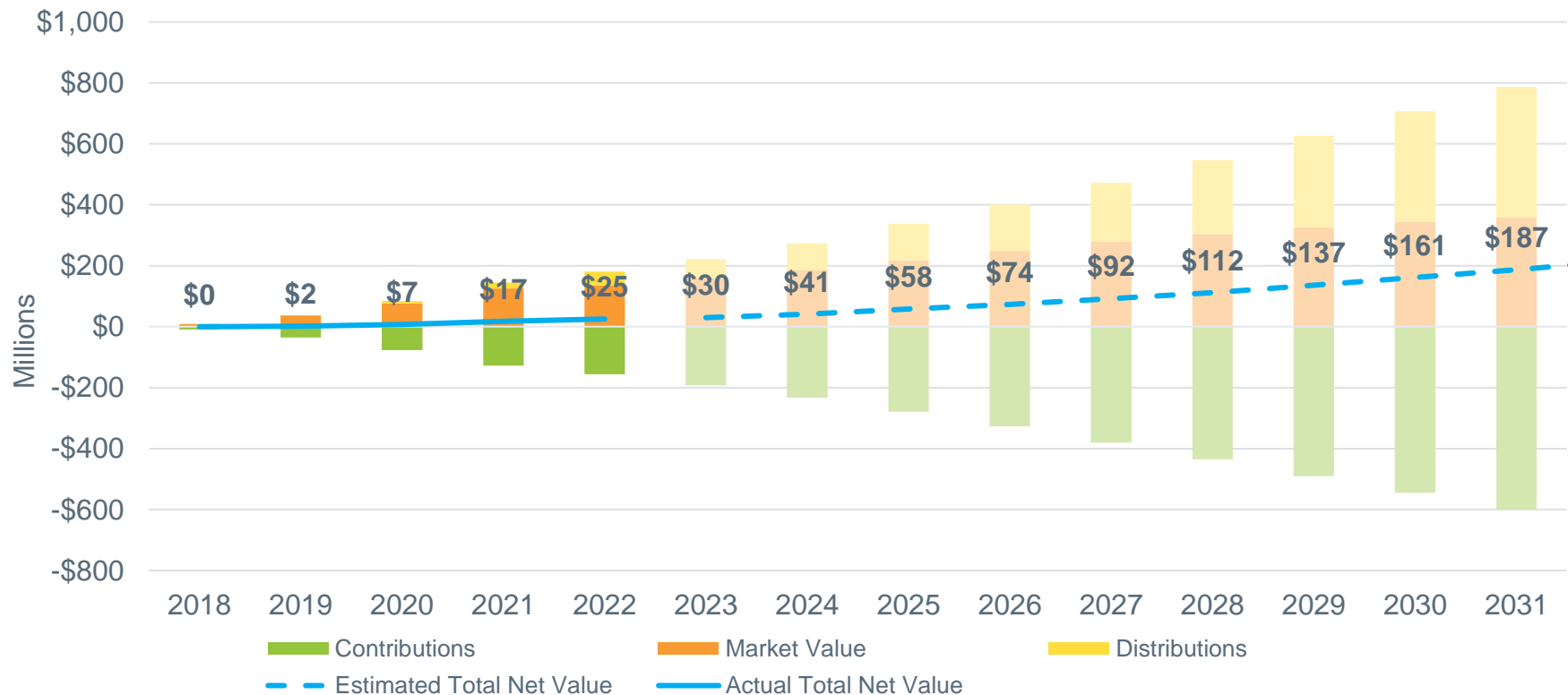
Performance is as of 12/31/2022 and has been calculated by RVK. Net IRRs are shown only if an accurate IRR could be calculated with one year or more of cash flows. Applicable IRRs are marked with "N/M" for not material. Fund vintage shown represents the year of board approval. Each fund has been compared against the Private Credit - Direct Lending peer group provided by Preqin and uses the most up-to-date data as of 03/2023. The peer group contains both levered and unlevered strategies. PME Index IRR represents the IRR calculated using the Credit Suisse Leveraged Loan Index, assuming an index investment with the same cash flow timing.



# Private Credit Portfolio Value Creation Analysis

- The Private Credit Portfolio generated \$25 million in value since it was launched in 2018.
- Including new commitments, the value of the Private Credit Portfolio is expected to increase over time as existing investments mature and additional capital is contributed to the Portfolio.
- RVK estimates the Private Credit Portfolio will have created approximately \$187 million in total net value by 2031.

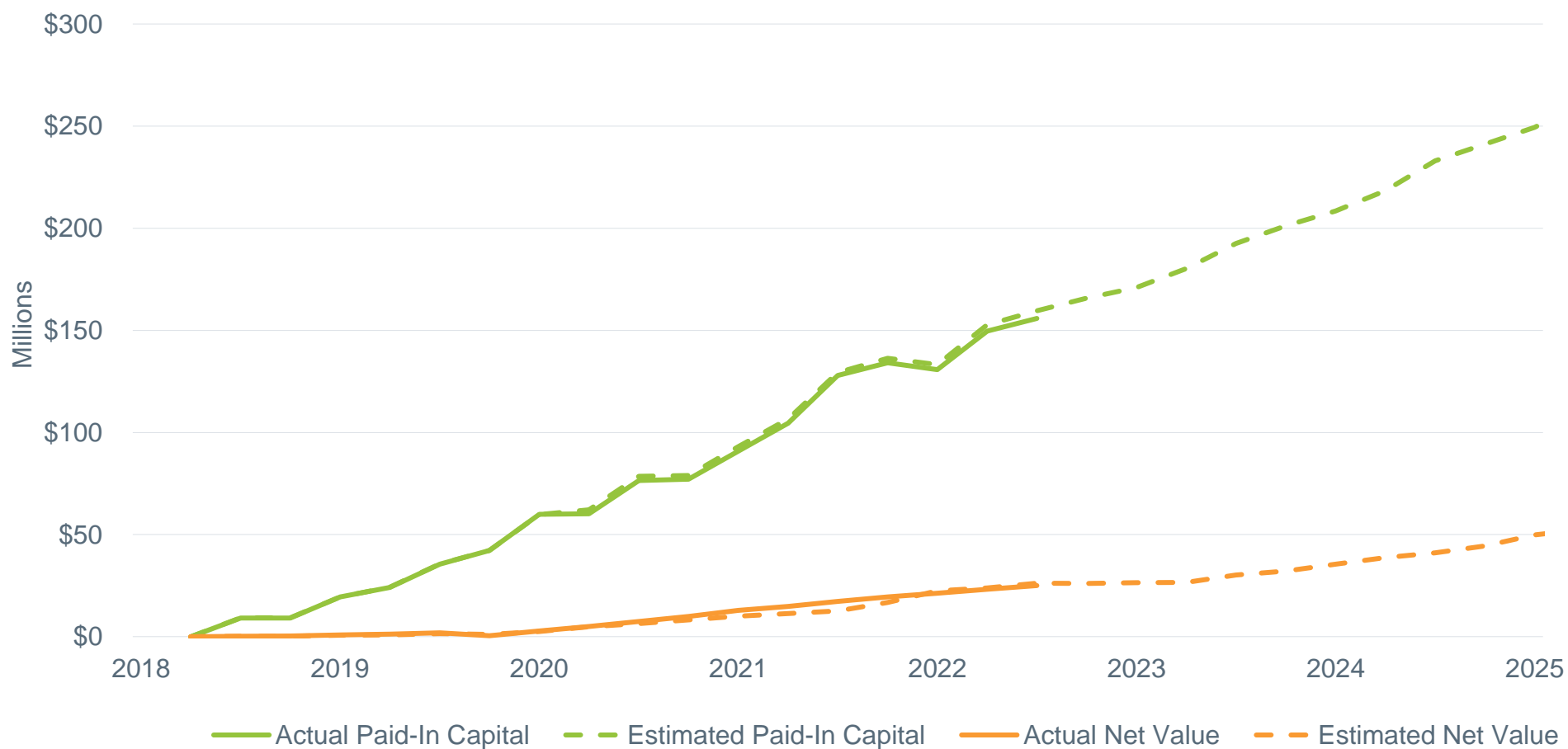
## SBCERS Value Creation



# Paid-in-Capital vs Value Creation

- The Private Credit Portfolio has generated \$25 million in value with \$156 million in paid-in capital since the portfolio's inception in 2018.

## SBCERS Value Creation



# SBCERS Private Credit Strategic Plan



# Strategic Plan Summary

- The **Strategic Plan** is a near-term investment strategy designed to achieve the long-term investment objectives of the SBCERS Private Credit Portfolio.
- RVK is working with the SBCERS staff to maintain the annual Strategic Plan. SBCERS' preferences around Portfolio administration, diversification, and views on different market segments have been implemented accordingly.
- SBCERS Private Credit Portfolio long-term objectives:
  1. Augment the long-term risk-adjusted returns of SBCERS' Non-Core Fixed Income.
  2. Deliver a robust and consistent level of return, primarily from the income generated by its underlying investments.
  3. Provide diversification to SBCERS' overall investment program.

# 2022 Strategic Plan Update

## Review of themes and objectives identified for 2022

### Manager Relationships

- Build a new relationship with at least one additional private credit investment manager to maintain manager diversification.

### Pacing Plan

- Commit \$40 million between two private credit funds in order to reach the target allocation by approximately 2024.

### Strategic Exposure

- Consider commitments to new sub-strategies such as specialty finance or asset-backed debt to achieve sub-strategy diversification.

### Status

- ✓
- Committed to Ares Pathfinder Core Fund

- ✓
- Consistently committed to two funds annually since the Portfolio's inception

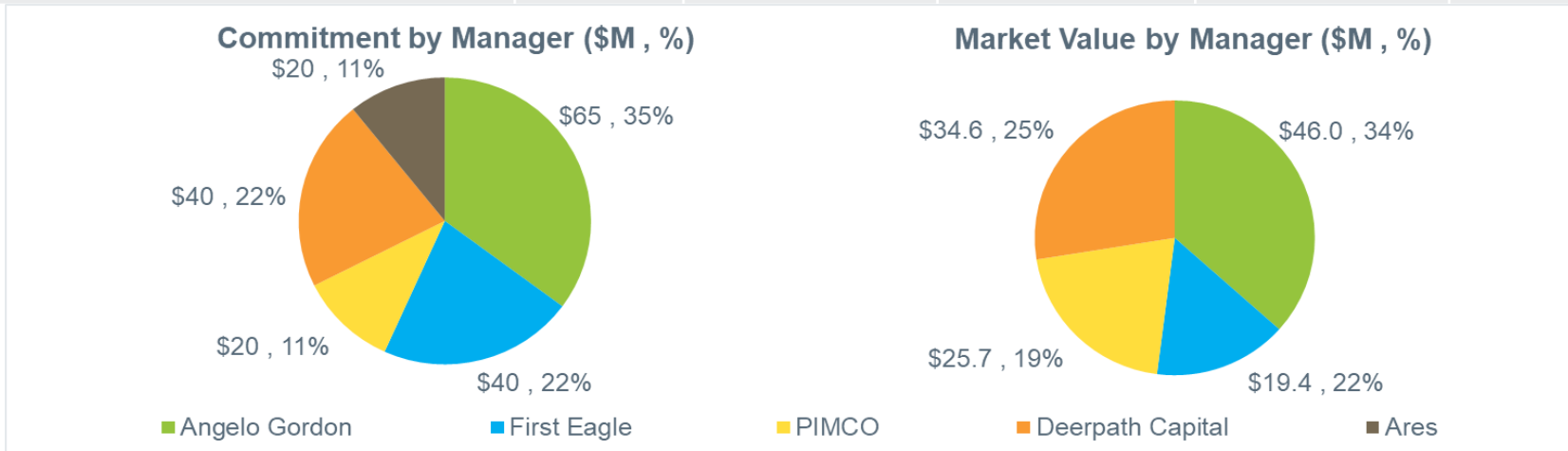
- ✓
- Committed to an asset-backed specialty finance fund in Ares Pathfinder Core Fund

# Private Credit Portfolio Summary

Strategic Plan:  
Manager Relationships

- SBCERS has established relationships with five top-tier private credit managers.
- The Private Credit Portfolio will remain diverse across several managers, as no more than 35% of commitments may be allocated to a single investment manager, as outlined in the IPS.

Fund	Vintage	Commitment (\$M)	Commitment Funded (\$M)	Market Value (\$M)	Market Value Allocation (%)
AG Direct Lending Fund III	2018	\$25	\$23.0	\$17.8	13.1%
First Eagle Direct Lending Fund IV	2019	\$20	\$17.1	\$16.6	12.2%
PIMCO Private Income Fund	2019	\$20	\$20.0	\$25.7	18.9%
Deerpath Capital V	2020	\$20	\$18.3	\$18.8	13.8%
AG Direct Lending Fund IV	2020	\$20	\$17.1	\$18.8	13.8%
First Eagle Direct Lending Fund V	2021	\$20	\$12.9	\$12.8	9.4%
Deerpath Capital VI	2021	\$20	\$15.5	\$15.8	11.6%
AG Direct Lending Evergreen Fund	2022	\$20	\$9.5	\$9.5	7.0%
Ares Pathfinder Core	2022	\$20	\$0.0	\$0.0	0.0%
<b>Total Portfolio</b>		<b>\$185</b>	<b>\$133.4</b>	<b>\$135.8</b>	<b>100.0%</b>



# Pacing Recommendation

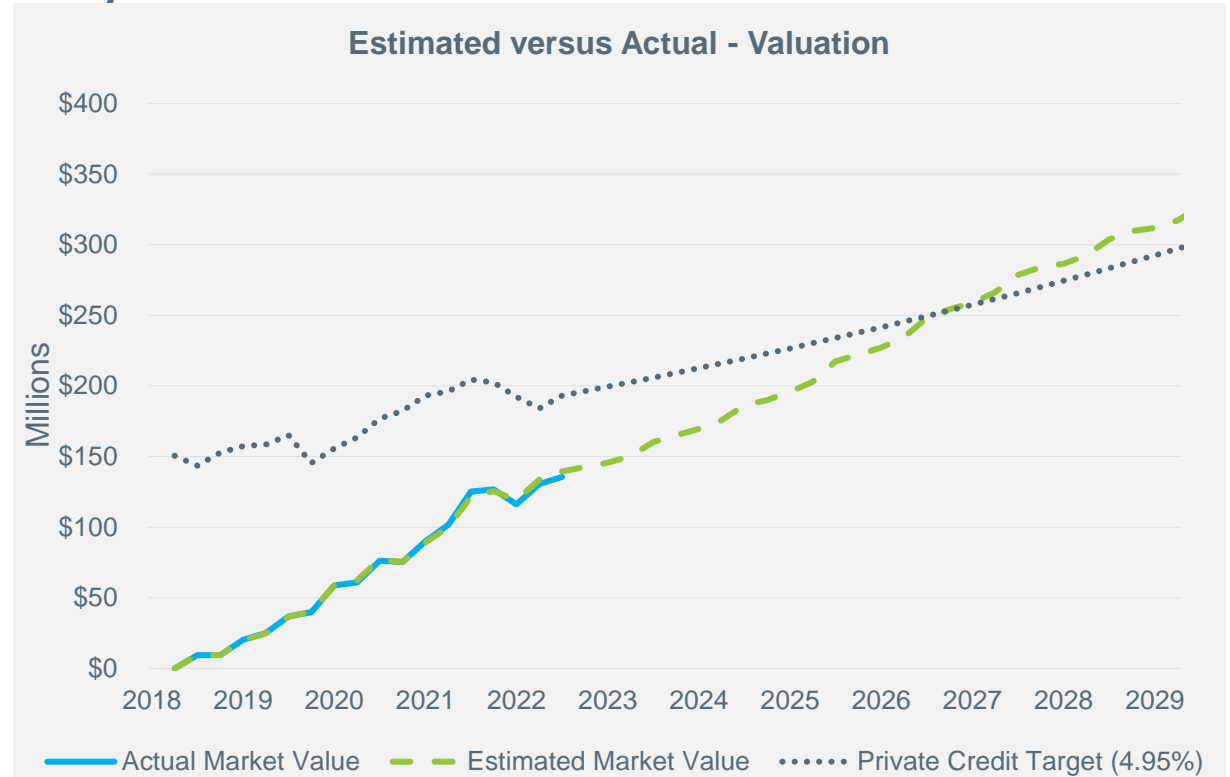
- In 2022, RVK recommended annual commitments of \$40 million to reach the target allocation.
- After updating our pacing analysis in 2023, RVK recommends increasing the annual commitment schedule to \$55 million.
- The SBCERS' allocation to private credit is expected to reach the target allocation of 4.95% by approximately 2027.

## Recommendation

Year	Commitments
2023	\$55 million
2024	\$55 million
2025	\$55 million
2026	\$55 million
2027	\$55 million

**RVK recommends annual commitments of \$55 million to achieve the target allocation by approximately 2027.**

## Expected Results



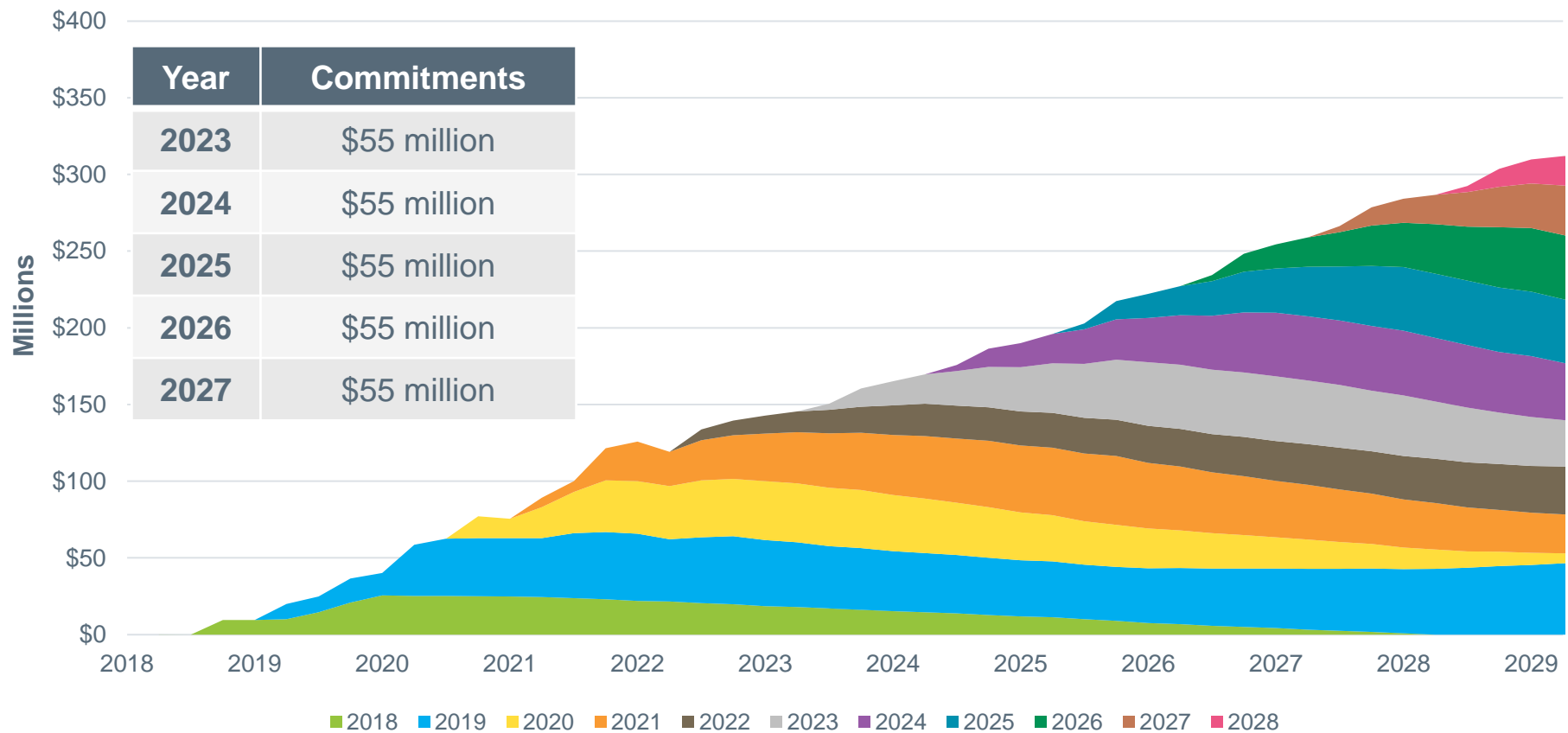
# Pacing and Vintage Year Diversification

Strategic Plan:  
Pacing

**RVK recommends the following commitment schedule, keeping in mind:**

- Vintage year concentration is a risk in private credit
- Annual commitments are likely to represent multiple funds and strategies
- Recommended commitments are approximate
- Attractive private credit opportunities may not present equally each year

**Estimated Total Valuation by Vintage Year**

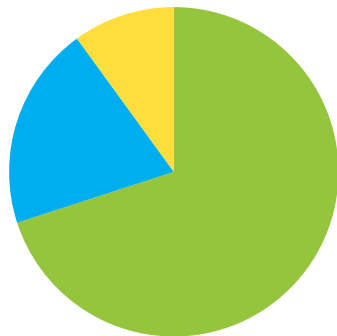




# Portfolio Targets

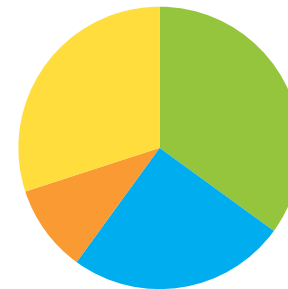
- In the initial buildout of the SBCERS Private Credit Portfolio, an emphasis was placed on strategies operating within senior secured direct lending.
- As addressed in the Private Credit Portfolio Investment Guidelines in the Investment Policy Statement, RVK would like to introduce additional private credit sub-strategies for SBCERS' consideration.
- RVK seeks to assist SBCERS build a Private Credit Portfolio diversified across several different private credit sub-strategies and collateral types.
- In the following illustration, RVK proposes to include asset-backed debt and specialty finance sub-strategies in the SBCERS Private Credit Portfolio over the long term.

**Current SBCERS Private Credit Portfolio**



■ Direct Lending ■ Multi-Strategy ■ Specialty Finance

**Long-Term Proposed SBCERS Private Credit Portfolio**



■ Direct Lending ■ Multi-Strategy  
■ Asset-Backed Debt ■ Specialty Finance

# Private Credit Sub-Strategy Profile

Strategic Plan:  
Strategic Exposure

## Asset-Backed Specialty Finance

- **Definition:** Private and highly structured loans collateralized by borrower assets, such as pools of receivables, inventory, property, equipment, royalty streams, or portfolios of investments in the consumer and commercial industries.
- **Distinguishing Feature:** The presence of specific assets as collateral is a critical defensive feature that differentiates asset-backed loans from the more prevalent cash-flow-backed loans, which make up the majority of direct lending activity.
- **Typical Target Return:** 8-10% Net IRR (Unlevered), 10-13% Net IRR (Levered)
- **Potential Fit for SBCERS Private Credit Portfolio:** RVK expects asset-backed specialty finance to be a meaningful portion of the Private Credit Portfolio to capitalize on the defensive characteristics of this sub-strategy while limiting the level of corporate cash-flow-backed debt exposure in the Private Credit Portfolio.

## Sample Asset-Backed Specialty Finance Fund

- Senior Secured Asset-Backed Specialty Finance in the US
- Target Return: 8-10% Net IRR (Unlevered)

### Key Strategy Attributes

- Significant experience and tenure of the investment team
- Defensive strategy focus through highly structured transactions
- Diversified portfolio with several underlying collateral asset types
- Strong track record performance with low loss rates

# 2023 Strategic Plan

## Identifying 2023 Private Credit Portfolio Objectives

### Manager Relationships

- Build a new relationship with at least one additional private credit investment manager to maintain manager diversification.

### Pacing Plan

- Commit \$55 million between two private credit funds in order to reach the target allocation by approximately 2027.

### Strategic Exposure

- Consider commitments to new or lessor allocated sub-strategies such as distressed, specialty finance, or asset-backed debt to achieve sub-strategy diversification.

## Forward Calendar

Date	SBCERS Private Credit Portfolio Event
April 2023	Present the 2023 Private Credit Strategic Plan
April 2023	Recommend electing AG dividend reinvestment program until AG DL Evergreen Fund is fully funded
Potential June 2023	Recommend approximately \$27.5 million commitment
2 <sup>nd</sup> Half 2023	Recommend approximately \$27.5 million commitment

# Private Credit Fund Pipeline



# RVK Private Credit Manager Pipeline

## Asset-Backed / Specialty Finance

- Ares Pathfinder II (in market)
- First Eagle Asset-Based Lending (2023)
- Schroders Focus III (in market)
- Victory Park Asset-Backed Opportunistic Credit Fund II (2023)

## Diversified Direct Lending

- Angelo Gordon Direct Lending Evergreen Fund (in market)\*
- Churchill Middle Market Senior Loan Fund (in market)\*
- Deerpath Evergreen Fund (in market)\*
- First Eagle Private Credit Fund (in market)\*
- KKR Direct Lending Evergreen Fund (in market)\*
- Owl Rock Diversified Lending Fund (in market)\*
- TCW Direct Lending Fund VIII (Early 2023)

## Distressed Debt / Special Situations

- HPS Special Situations Opportunities Fund II (in market)
- Strategic Value Capital Solutions Fund II (in market)\*\*
- Monarch Capital Partners Fund VI (in market)

## Niche Strategies

- TCW Securitized Credit Fund II (in market)

*Forward calendar will change based on market conditions, fundraising environment, general partner turnover, fund performance, and other circumstances.*

*\* Indicates Evergreen vehicles.*

*\*\* Indicates MWBE firms.*

# Appendix



# Pacing Study Outline

## OBJECTIVE

Set a reasonable 5-year target commitment allocation schedule that results in the total fund approaching the private credit allocation.

- *The commitment pacing plan should be revisited annually*

## PROCESS

RVK uses proprietary software to model the existing portfolio and expected forward commitments. A number of assumptions are made throughout this analysis and include the following:

- *Private credit investment cash flow/valuation patterns based on historical data from Preqin Alternatives*
- *A custom annualized growth rate for the overall total composite, net of spending rate*

## OUTPUT

The pacing study provides a recommended annual commitment volume to meet the total fund's private credit target.

- *Vintage commitments shown below may be made to one or more investment managers depending on the size of the commitment*
- *Likely to approach private credit target slowly to minimize vintage year risk*

# Pacing Study Assumptions

RVK utilized the following assumptions in this analysis:

The expected net growth rate assumes a compound return of 6.59%, based on RVK's most recent asset allocation study.

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Future proposed annual commitments are allocated between two private credit fund commitments annually.

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Fund cash flow projections for both existing and proposed traditional fund commitments are based on historical, weighted averages from the Private Debt – Direct Lending peer group, provided by Preqin.

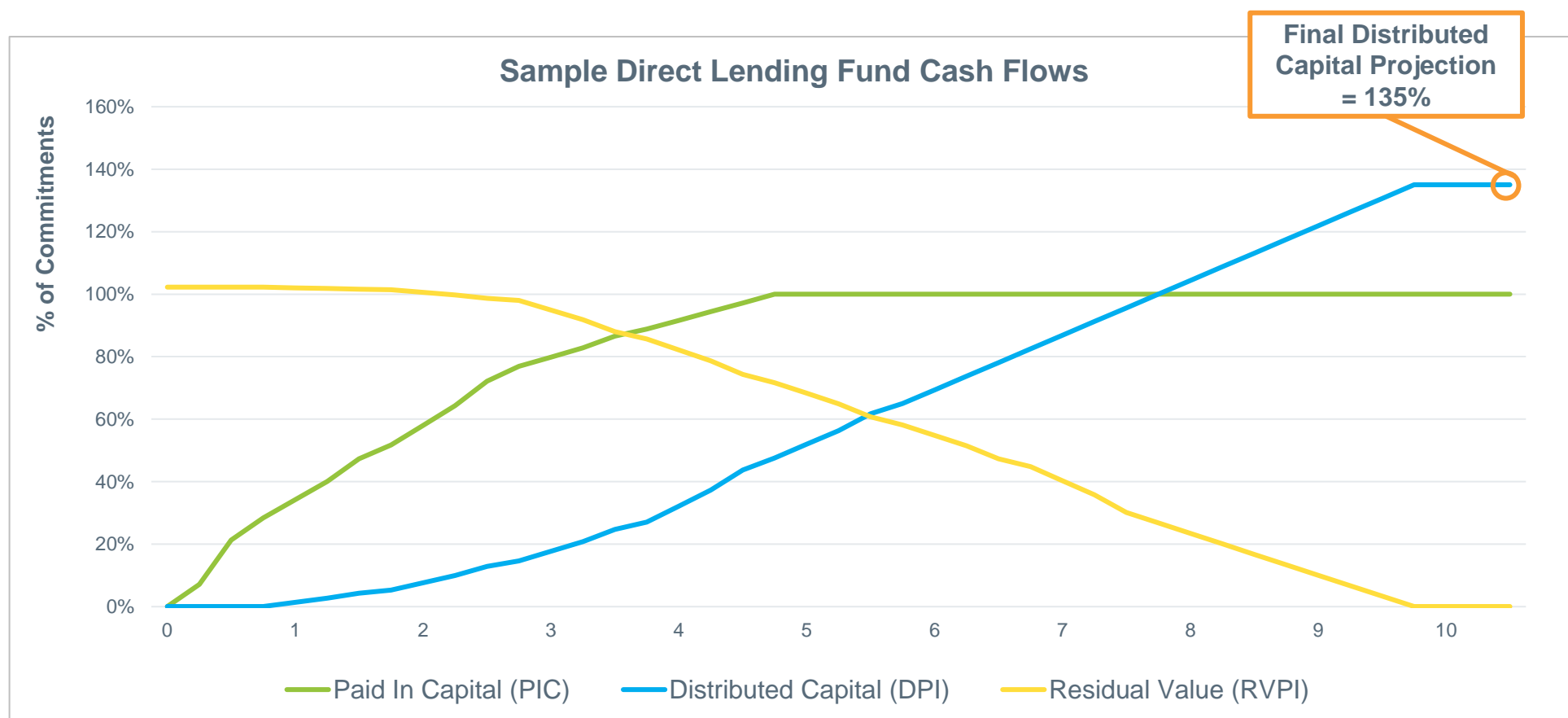
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Fund cash flow projections for both existing and proposed evergreen fund commitments assume an annual total return of 8%, derived entirely from reinvested income.



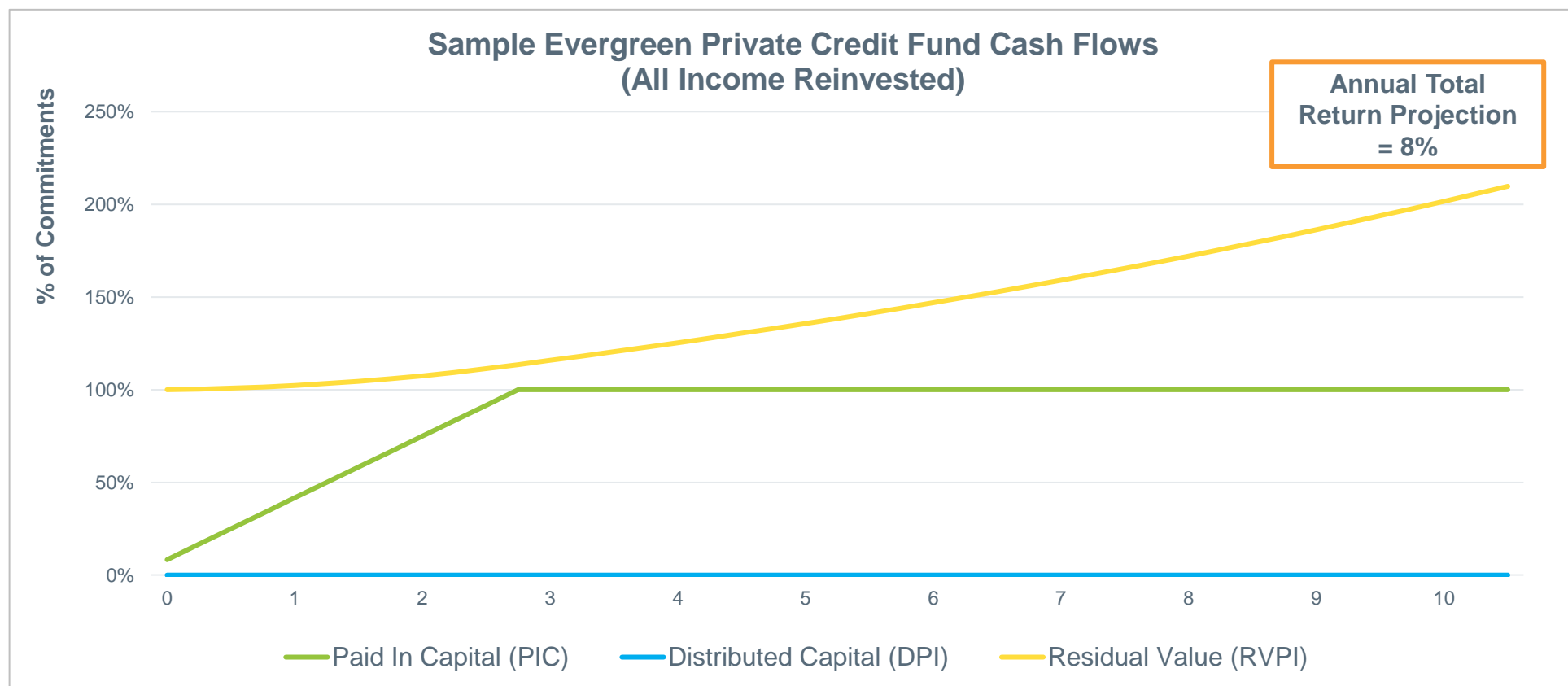
# Pacing Study Methodology – Direct Lending Funds

The purpose of the pacing study is to develop estimates based on long-term industry averages for use in general cash flow and allocation target planning. The pacing study depicts cash flow and valuation estimates utilizing average historical data. Actual cash flows and allocation percentages may vary substantially from these estimates due to market conditions. This analysis should be used for planning purposes only, and no expectations should be made that actual cash flows and allocation percentages will occur at the exact time and level depicted.



# Pacing Study Methodology – Evergreen Funds

The evergreen private credit funds assume an annual total return of 8%, derived mostly from the income that is **reinvested**. As such, the evergreen funds will project zero distributions throughout the life of the funds, with the residual value of the fund growing at 8% annually.



# Glossary

<b>Contribution</b>	A cash flow into the private market investment, sent by the investor. Also described as 'Paid In (Capital)'.
<b>Distribution</b>	A cash flow out of the private market investment, received by the investor.
<b>Commitment</b>	The maximum amount of capital an investor expects they would invest during a fund's life. Most funds call between 95% and 100% of commitments.
<b>Net Cash Flows</b>	The sum of contributions and distributions.
<b>Total Net Value</b>	$(\text{Distributions} + \text{Net Asset Value}) - \text{Contributions}$ This represents all value created by an investment, both realized and unrealized.
<b>Total Value to Paid In (TVPI)</b>	The ratio $(\text{Distributions} + \text{Net Asset Value}) / \text{Contributions}$ . This represents the total value created in a fund as a normalized value.
<b>Distributions to Paid In (DPI)</b>	The ratio $\text{Distributions} / \text{Contributions}$ . This represents the realized value created in a fund as a normalized value.
<b>Residual Valuation (RVPI)</b>	The ratio $(\text{Net Asset Value}) / \text{Contributions}$ . This represents the unrealized value created in a fund as a normalized value.
<b>Internal Rate of Return (IRR)</b>	A dollar-weighted measure of return. IRR is defined as the discount rate that reduces the net present value of an investment to zero. IRR almost always represents inception to date annualized returns.
<b>Growth Rate</b>	The assumed growth rate of the total fund. The total fund is assumed to grow at the geometric value from the client's most recent asset allocation minus any expected spending rate plus any expected contributions unless otherwise stated.

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