Date: September 18, 2024
To: Board of Retirement
From: F. Robert Reveles, Retirement Financial Investment Officer
Subject: Second Quarter Infrastructure Update and Manager Characteristics

Recommended Action:

Receive and file.

Fiscal and Financial Impacts:

There is no financial impact to receiving this informational item.

Strategic Plan Importance and Risk Assessment:

This report pertains to Goal 1 – Protect the Plan's long-term financial health and Goal 2 – Strengthen Risk Oversight.

Background and Discussion:

Manger Strategy Highlights:

Over the past year the IFM GIF strategy returned a net positive 3.23%. During the final quarter of fiscal year 2024 the strategy returned positive 0.98%. MCERA's total net return with IFM since our capital call in December 2021 is 21.44%. Like the Real Estate asset class, the strategy has been impacted over the past year by the rise in the U.S. 10-year Treasury rate (Or the equivalent risk-free tenor in other geographies.), putting downward pressure on valuations. Nonetheless the strategy continues to display low return correlations with U.S. stock market indices and low return volatility.

Highlights over the past year include the airports, seaports, Aqualia, and Aleatica. Air travel demand remains strong over the past year despite higher energy costs, services inflation, and increased geopolitical tensions. In the U.K., Manchester Airports Group recorded 61.3 million passengers, outperforming their budget by 3%, while overall traffic levels continued to surpass pre-pandemic figures, reaching 106% of 2019 levels in May 2024. There is high demand for leisure travel. In Australia, the Sydney Airport has seen a slower recovery. Total domestic passenger volumes are 92% of 2019 levels. The lower passenger volumes are due to lower business travel to Hong Kong, New Zealand, U.S., and China. Despite this, financial outperformance was driven by higher service agreements, commercial contracts, and lower than budgeted operating expenses.

In the seaports sector demand rebounded from lower global trade volumes experienced in the prior year. The strategy has three seaport assets in Poland, Turkey, and Canada. Unsurprisingly, the Turkey port volumes, approximately 6-7% of total container volume, have been impacted by the Red Sea conflict and the Gaza conflict. (Turkey has suspended trade to Israel.) Container volumes there are below budget and the prior comparable periods. Despite the lower container volume, revenues are trending above the prior periods due to tariff increases implemented over the past 12 months. In Poland, volumes and revenue are outperforming the prior year but remain under budget. The Red Sea conflict is causing ships to go around the Cape of Good Hope instead of through the Mediterranean creating longer shipping times which feeds into lower shipping volumes. The outperformance versus the prior period is mainly driven by growth in volume (Greater than prior year but less than expected.) and higher tariffs linked to inflation. The port is the only year-round ice-free, deep-water container port of the region. Lastly, in Vancouver, Canada, North American demand is recovering strongly compared to last year. Like the other ports, increased volume and tariffs are contributing to greater revenues. Volumes in the Canadian port have not been impacted like the Turkish or Polish ports. The port distributed over $22M ($30.1M Canadian) to the strategy during the quarter.

Aqualia is a Spanish water company serving water to 45 million people throughout 18 countries, primarily in Spain, Czech Republic, and Georgia (Country). The company provides all types of essential water services from collection, purification, and treatment of drinking water to the distribution and collection of wastewater. Notably, during the year the company closed on a controlling stake in Municipal District Services, a Houston, Texas, water utility company. This is the company's first entry in the U.S. water market. Water volumes have increased between 1.8% - 3.1%, depending on region, over budget. S&P recently reaffirmed the company's BBB- rating citing its resilient financial performance and proven ability to pass through tariff increases on its Spanish concessions. Following the increasing frequency of regional drought occurrences in Spain, Sicily, and Colombia the company is sponsoring a range of environmental campaigns to promote the responsible use of water.

Aleatica owns a network of toll roads across Mexico, Peru/Chile/Columbia, Spain, Italy, and the U.K. Traffic on the Aleatica network is 12% above 2019 levels driven by outperformance across the Mexican and Italian roadways. Mexican outperformance is supported by greater economic activity that demands more heavy vehicle traffic and congestion on competing roadways. In June the company entered into an agreement to sell an 18.2% stake in its Grupo Autopistas Nacionales, S.A. (GANA) concession to FIRBAeMX. GANA is a concessionaire of the toll road that provides the most direct route from Mexico City to Xalapa, connecting the central region of the county with the Port of Veracruz. FIBRAeMX is an energy and infrastructure investment trust registered in Mexico with expertise in investing in toll road networks across Mexico. Aleatica retains majority shareholder ownership at 51%. Though the transaction is contingent upon regulatory/government approvals the company expects the transaction to be approved. Proceeds will help fund construction of Aleatica's Atizapan-Atlacomulco toll road.

Over the past year the J.P. Morgan Infrastructure Investments Fund had a net return of 11.87% In the most recent quarter the fund returned a net 2.40%. MCERA's total net return with the strategy since our capital call in April 2021 is 36.82%. The fund has seen strong fundraising, with the fund's current Net Asset Value (NAV) at $38.4B. Consistent with the funds governing documents when the fund's NAV reaches $40B, which is expected by the end of the calendar year 2024, the management fee will drop by 5 basis points. MCERA currently pays an 86-basis point management fee and with the change we expect around $10,000 - $11,000 savings per year.

The GDP-Sensitive portion of the strategy had an excellent year, and three assets stand out: Enstor, Third Coast, and BWC Terminals.

Enstor is a natural gas storage operating company owning approximately 110 billion cubic feet of storage capacity across six storage facilities across Alabama, Texas, and New Mexico. There is limited new natural gas storage development in the U.S. and the company has been able to capitalize on high customer demand driven by extreme weather events, replacement of coal-fired power generation and increased LNG export capacity. The company is focused on expanding its customer relations and gaining new firm storage contracts. One such project is a new storage hub in Mississippi. The project is working its way through the Federal Energy Regulatory Commission (FERC) approval process, with FERC providing a notice of schedule for the preparation of the Environmental Assessment. Construction is expected to start in 2025.

Third Coast is a midstream company operating in the Gulf of Mexico. Headquartered in Houston, Texas, the company operates 1,900 miles of onshore and offshore pipelines and three Floating Productions Systems (FPS). FPS are large ships, or platforms, that operate in deep water areas where pipelines are deemed uneconomical. The company is focused on strategic acquisitions and divestitures. Early last year the company acquired a 27% stake in another FPS (Perdido oil platform) that is operating in the Great White, Silvertop, and Tabago oil fields. The interest expands Third Coast's geographic diversity to the Western Gulf. The company also closed on the acquisition of additional Class A and Class B shares of another oil platform – bringing total ownership to 98% and 63% of the share classes respectively. In the final quarter of last year (December) the company sold a 25% stake in the none-core asset Wilprise Natural Gas Liquid pipeline at a premium to NAV. Third Coast expects to continue to pursue growth opportunities through buyouts of minority stakes, strategic acquisitions, and a variety of expansion projects that will augment their current pipeline system.

BWC Terminals, another bulk liquid storage operator in the portfolio, also had a strong year. The company operates 22 terminals with more than 20 million barrels of capacity across multiple states including Texas, Louisianna, Florida, New Jersey, California, and Washington. (Not a complete list.) Gross revenues for the company are up over the prior year by 43%. The increase is driven by inflation escalation in commercial contracts, new commercial contracts, and growth projects. Customer renewal rates have been favorable and new customer contracts have allowed the company to fill vacant storage capacity across the network. Vacancy is low at less than 5%. Notable acquisitions include three terminals near Mobile, Alabama. The Mobile facility added 2.5 million barrels of storage capacity. In Georgia, an acquisition added 1.6 million barrels. Management has stated they will continue to assess acquisition targets. Finally, the company recently closed on the refinancing of its credit facilities through a combination of bank and private placement debt. As part of that process, BWC obtained an investment grade credit rating from the largest credit rating agency in Canada Morningstar's DBRS.

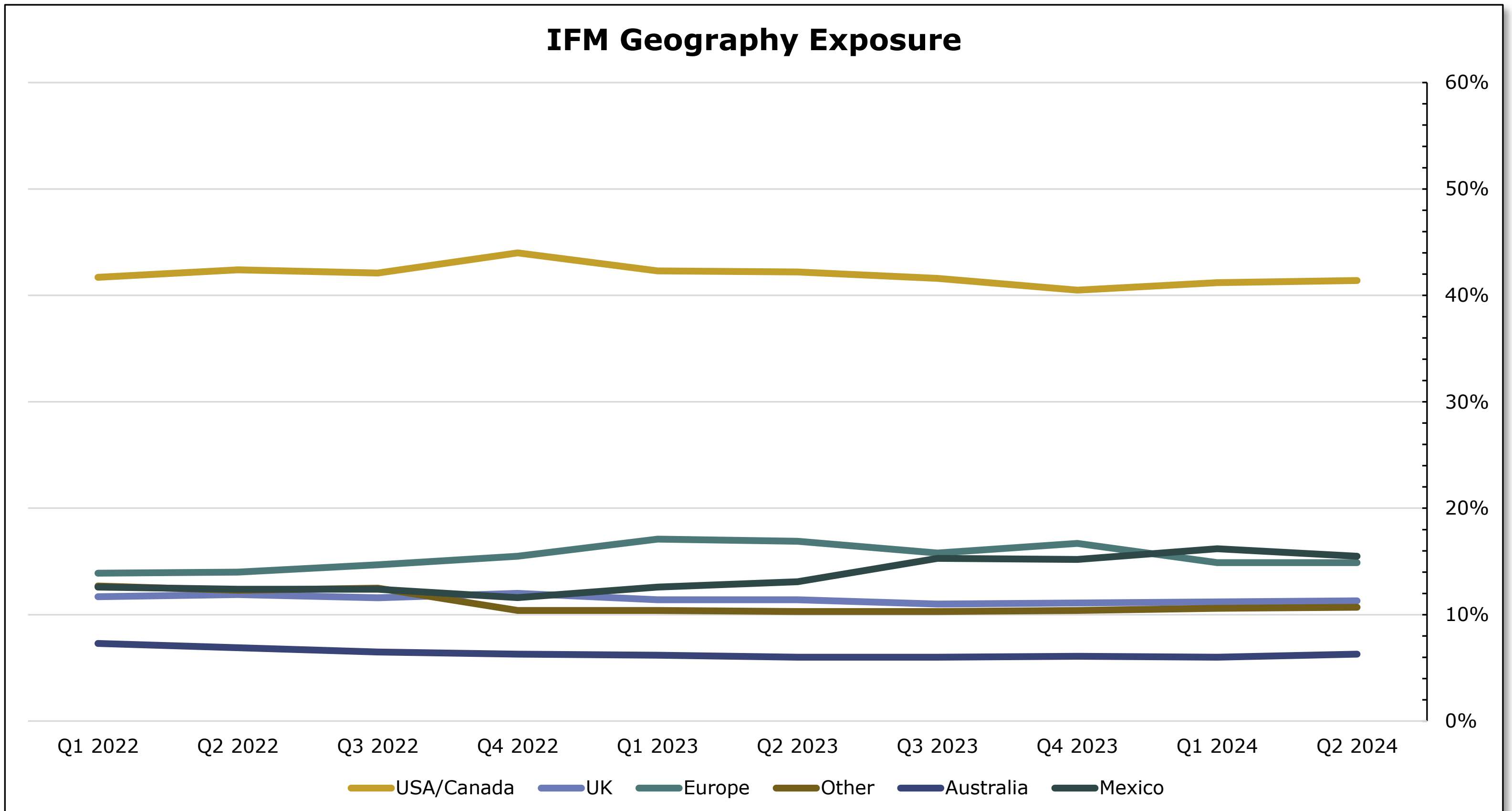
Attachment(s):

1. Infrastructure Portfolio Characteristics – 6/30/24

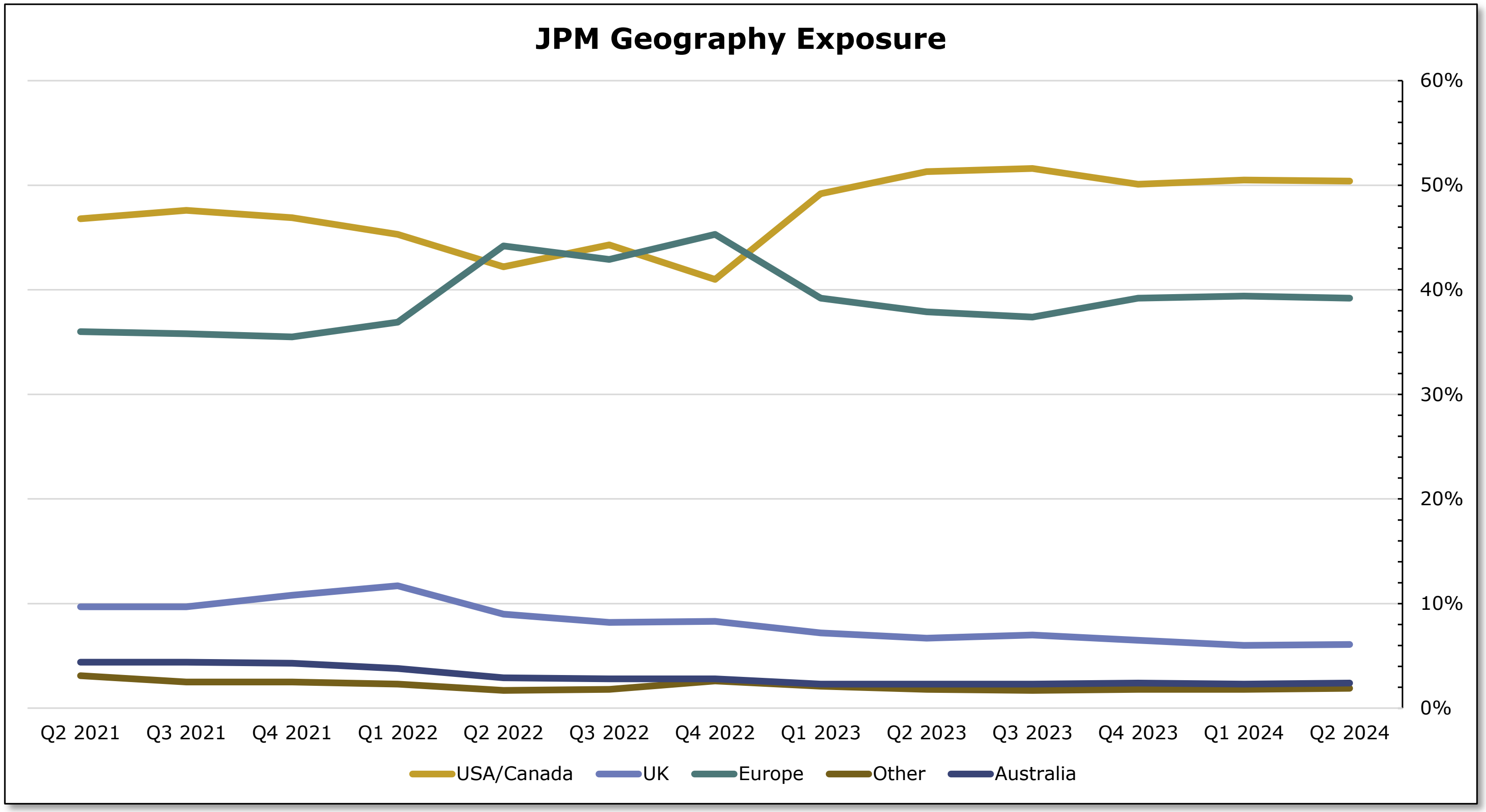
Mendocino County Employees Retirement Association

Infrastructure Characteristics

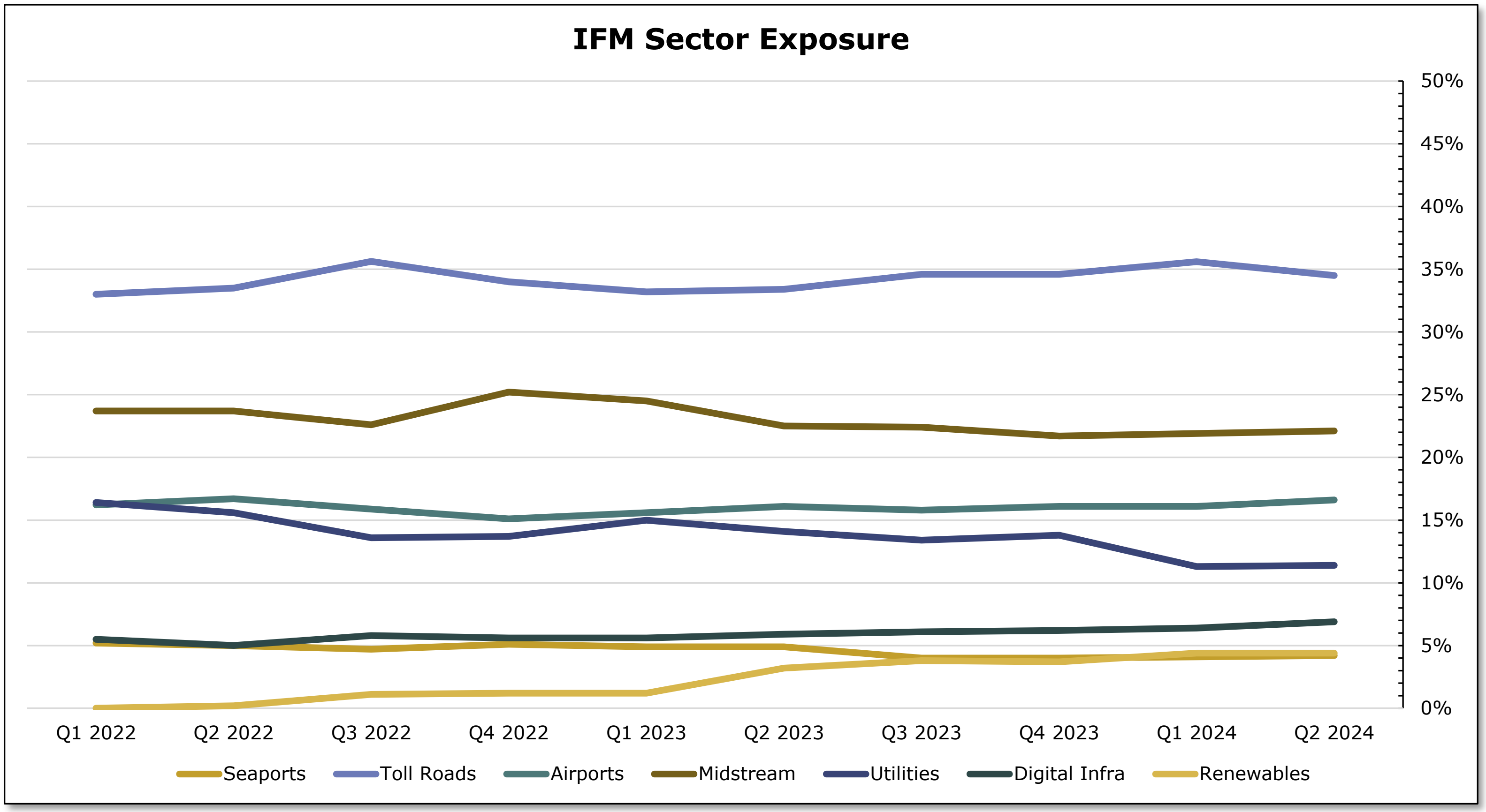
IFM Geographies – 6/30/24



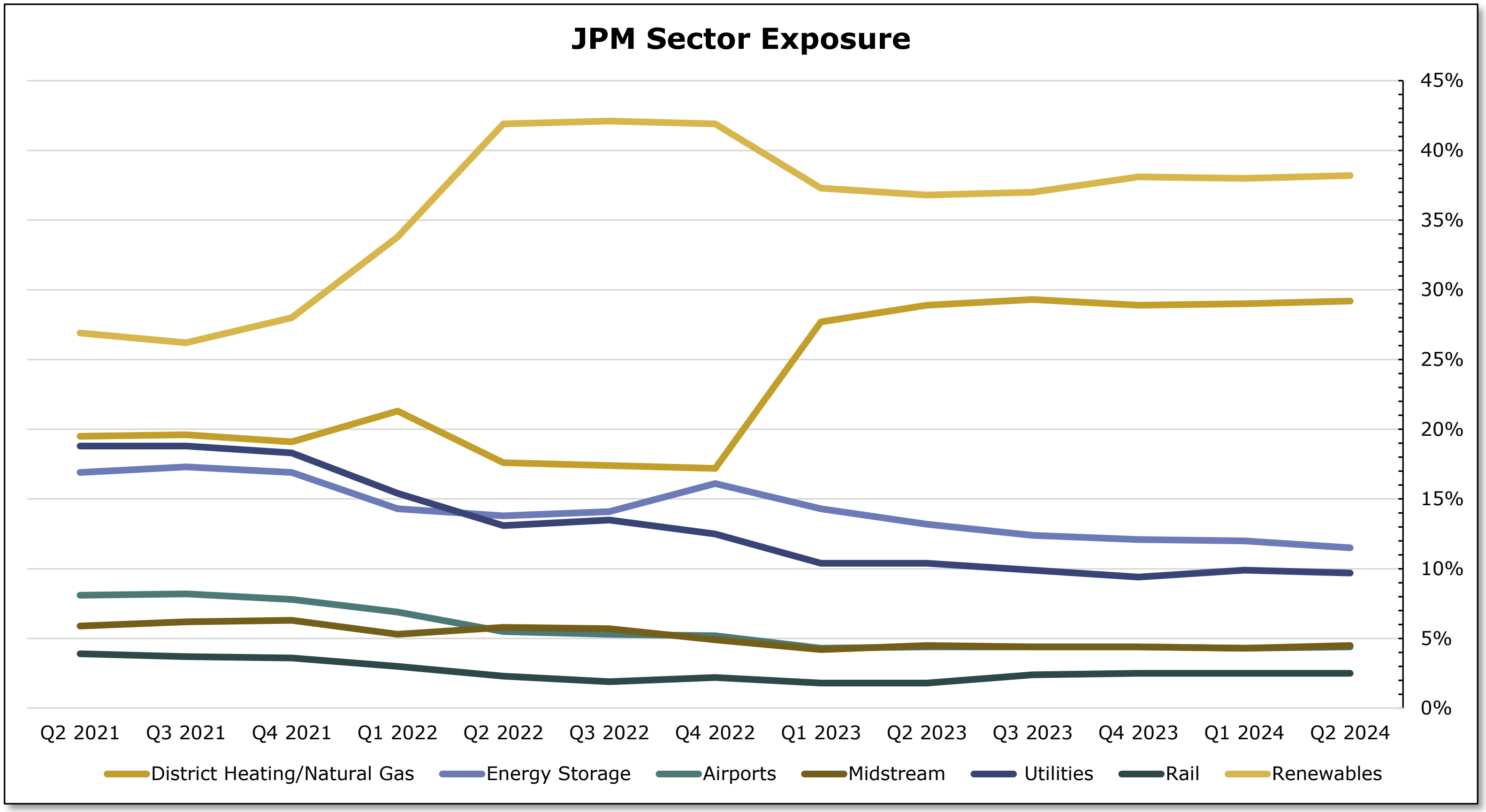
JPM Geographies – 6/30/24



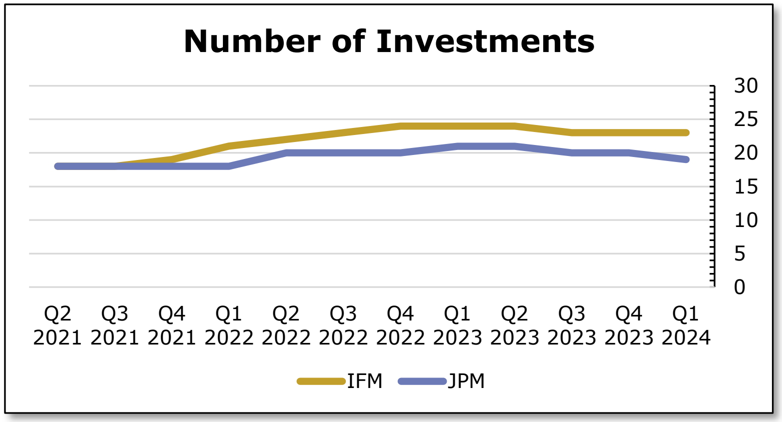
IFM Sectors – 6/30/24

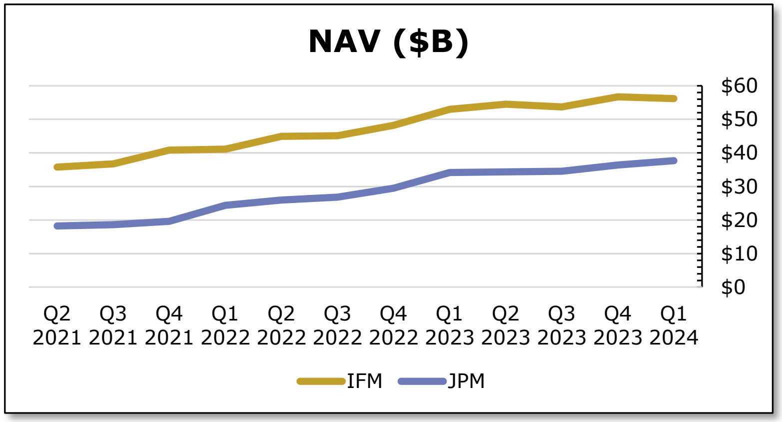


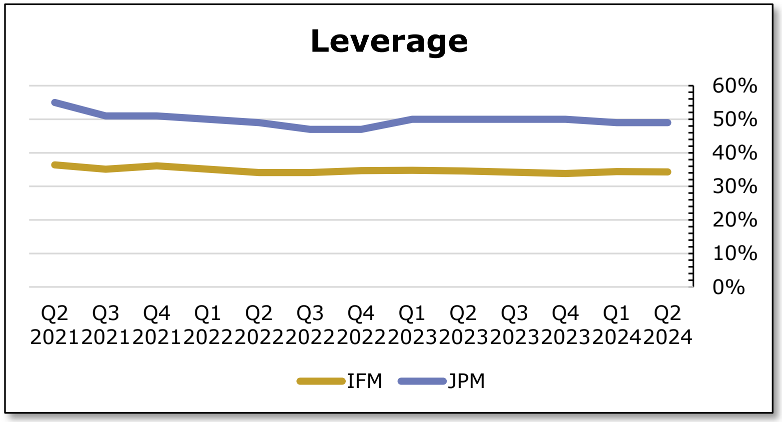
JPM Sectors – 6/30/24



Investments, Leverage, NAV – 6/30/24







Other Metrics– 6/30/24

For the period Q2 2021 through Q2 2024	IFM GIF	JPM IIF	Composite
Net Asset Value ($B)	$ 55.9	$ 38.4	
Leverage	34.3%	49.0%	
Fiscal YTD Net Return	3.22%	11.87%	7.52%
Inception Net Return	21.44%	36.82%	31.53%
Average Annualized Net Return	7.36%	10.14%	8.81%
Trailing 12 Month Distribution Yield	0.85%	6.43%	3.67%
Annualized Standard Deviation	2.79%	1.32%	1.58%
Correlation with S&P 500	0.1667	0.3012	0.1969

Mendocino County Employees Retirement Association

Thank you