Arizona Heads to Asia to Set Terms in Less Settled Terrain

By DAWN LIM

The Arizona Public Safety Personnel **Retirement System** headed east this year, as the pension fund sought to seed a new crop of investment leaders.

The Phoenix-based pension fund pledged $90 million to back eight to 10 Asian investors raising their first or second dollar-denominated funds, in hopes of driving the terms of new offerings from Asia.

> ## Arizona Public Safety Personnel Retirement System
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> ### Assets
> The pension fund managed $8.3 billion in assets, of which 15.3% was in private equity, as of Aug. 31. Its target allocation to private equity is 11%.
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> ### Key Personnel
> Ryan Parham serves as chief investment officer, while Mark Steed is deputy chief investment officer and chief of staff and Shan Chen is lead portfolio manager for private equity.
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> ### Select Relationships
> StepStone Group, Charlesbank Capital Partners, TPG Capital.

The latest push isn't out of line with the $8.3 billion system's preference for smaller, nimble players, and a general industry skepticism about whether or not bulge-bracket firms in established markets will provide the best returns.

Arizona expects to deploy 75% of the pledged amount in China. It's a locale with which the pension fund is familiar, having made its first Chinese private-equity play in late 2011 with a commitment to Trustbridge Partners IV LP.

"Our view is we have to plant a flag," said Mark Steed, Arizona's deputy chief investment officer. "There are a lot of benefits of getting into groups early and watching them grow."

Shan Chen, Arizona's lead portfolio manager for private equity and a fluent Chinese speaker who grew up in Asia, will steer the program. The pension fund also will work with StepStone Group to set the economics and drive the deals out of a special vehicle, StepStone AZ China and Asia Opportunities Fund LP.

Arizona hired StepStone as a private equity consultant in 2008, when it was a relatively young shop. As it looks to commit $160 million to private equity in the year ending June 30, 2016, the pension system will continue to focus on the smaller firms for which its capital can make a big impact. The system, which made commitments ranging from $40 million to $100 million in the past year, has a preference for funds between $500 million to $2 billion. "Those groups are flexible and hungry," Mr. Steed said.

The pension fund has seized quickly on attractive opportunities when they have arisen. In its first ever secondary purchase, Arizona bought an **Abry Partners** fund stake in 2008 at 60 cents on the dollar, when an endowment offloaded a bundle of illiquid assets. That deal delivered a roughly 2.25-times multiple on invested capital by mid-2015. Although panicked and cash-strapped institutions shied away, Arizona also purchased credit and equity tranches of collateralized loan obligations during the dislocations of the 2008 financial downturn.

Arizona rotates its investment staff roughly every three years, which helps the team constantly look at its portfolio with fresh eyes.

When Ryan Parham became chief investment officer in 2008, he pushed for a rotating team to prevent anyone from having undue influence over any asset class, and to foster more debate. "If you're just stuck in one asset class, your thinking might get a little stale. You risk going native, and this clouds your decisions," said Mr. Steed, who helped launch private equity in 2008 and oversaw it until he shifted his focus to credit and fixed income in 2011.

The rotation strategy raises the bar for managers, who may have to work harder to convince new heads to pledge money to their next funds. Arizona re-upped with **Charlesbank Capital Partners** and **TPG Capital**'s special situations platform in the past year, pension documents show. **Blackstone Group** and **EQT** were two managers whose flagship funds Arizona didn't re-up with recently.

The rotating team also prevents staffers from getting too cozy with managers, said pension officials. This could keep the team vigilant when fund terms shift in favor of firms, as they have in the current fundraising cycle.

Managers have returned to market with larger funds, Mr. Steed observed. The intervals between their fundraisings are compressed and many are switching their external counsel to draft looser terms in their latest funds, he added. "Beyond the actual change in terms, their terms are getting worse even as a lot of public pensions face scrutiny from stakeholders," Mr. Steed said. "It signals that they are tone deaf."

Still, the pension system isn't afraid to push for certain terms that it cares about, including clauses that allow for removals of general partners if they violate laws or clawback provisions to allow investors to recoup losses when deals fail. Even if private equity is a relationship-based business, it's important to stay unsentimental, Mr. Steed said.

"If you name the lobster, it's harder to cook it," he added. ■