



« STRATEGY »

SHIFT INTO DRIVE

Michael Nobrega explains why OMERS is changing gears from public to private market assets

By Neil Faba / Photography by Daniel Ehrenworth

In recent years, many pension plans have looked to private investments to mitigate some of the risk of public markets. For OMERS, this shift began in 2004. At the time, the fund—which has pension commitments to more than 400,000 members in Ontario—had an investment mix of 82% public market and 18% private investment holdings. But a new strategy adopted that February started OMERS on the road toward an asset mix goal of 53% public markets and 47% private holdings.

“The principal reason it was done was to reduce our exposure to the volatility of the capital markets, especially public equity. The second reason was to acquire assets that would give us as predictable as possible long-term cash returns to fund the pension plan,” says Michael Nobrega, president and CEO of OMERS since 2007. (He previously headed Borealis, OMERS’ infrastructure investment entity founded in 1998.)

Of course, says Nobrega, the decision to change the asset mix was the easy part. Actually putting the wheels in motion has meant transferring about 35% of the fund’s \$53 billion in assets to private markets—and making sure the investment choices are ones that management can live with for the long haul.

“It’s not an easy exercise. You want assets you can live with for 25 years,” says Nobrega. “To do that, you have to keep your investment criteria in place. It’s easy to go and buy assets, but it’s a question of buying them at the right price, managing them properly and adding value to them later on.”

In the Driver’s Seat

Once OMERS management had adopted the new investment strategy, the next decision it made was to use what Nobrega calls a “direct-drive” approach: actively managing its assets in-house where possible. This meant getting the right people and expertise in place to find

suitable assets for the fund and establishing the HR capability and technology needed to manage it all.

According to Nobrega, much of the fund’s success comes from the organization’s “horizontal structure.” Separate internal groups manage the plan’s assets—Oxford Properties (real estate), Borealis Infrastructure, OMERS Private Equity and OMERS Capital Markets—each with its own CEO, investment team and results targets.

“A pension fund makes money in two ways: it leverages its capital, and it leverages its people. And the best leverage is to have people with ownership responsibility [to leverage the capital].”

But even with strong investment teams at home, he believes that finding the best investments requires “boots on the ground” worldwide. To that end, OMERS has opened two branch offices. The London office opened in 2008 and now has a staff that speaks seven languages and gives the fund a foothold to explore investment



Q&A

MICHAEL NOBREGA'S VIEWS ON PENSION INVESTING AND ASSET ALLOCATION

How much significance will foreign investment have in OMERS' overall asset mix in the coming years?

We're in the U.S. and the U.K., and we've bid on projects in other parts of what I call the developed world—the G7 countries plus Australia. We're now doing above-the-ground due diligence on about 12 countries that we'd like to invest in. But if you go outside the country, you need to make sure you can hedge the currency properly, have credible partners in those places and can protect yourself against regulatory [regimes]. You want to do it carefully, and that takes some time. So, in the near future, I don't see us falling below 40% to 45% [in Canadian investments].

When and where will OMERS open its next global office?

We'd like to look at Asia and Latin America. We invest in these markets now through public markets and funds. But we don't like the idea of funds, because they have two fiduciary responsibilities [to fund holders and financial institution shareholders] and we'd like to have one [OMERS members.]

The next one to come will be in Asia, if [the board] allows us to do it, but we have to demonstrate the business case for it. And that won't come before 2014 at the earliest. In the meantime, we'd look to partner with serious well-known, well-established partners out there.

What has OMERS learned in the process of bidding for private assets?

Do not expect to win every bid; otherwise, you are likely overpaying. Stick to your investment criteria, leverage and pricing. OMERS has stuck to its limits rather than overreaching for assets, which we believe could cause us problems later. While we have lost projects based on pricing, we have developed a lot of business intelligence just by doing the bids.

opportunities across Europe. A formal New York office (OMERS Private Equity and Oxford Properties previously had small individual teams in the city) followed in the fall of 2011.

"I think we made a good decision to open our offices in New York and London. That has really helped us in terms of sourcing investments," he comments. "To get to where we want, we need to do two things: find the right people, and deploy the capital. Those two offices have helped us attract people we couldn't attract to Toronto, because they want to live in New York or London. And they're also part of the networks in those locations, which gives us an advantage in getting to the assets."

The assets, of course, are the key. OMERS' asset mix is now about 60/40 in favour of public markets. And while Nobrega says he's less concerned about the exact mix than making sure that the assets held are right for the fund, he does see areas where OMERS can continue to grow its private holdings.

For one, Nobrega is bullish on Western Canada. He points out that Canada ranks at or near the top in global production of potash, uranium and oil and gas, and many of those commodities come from west of Ontario. In addition, business is booming in the region, and OMERS already holds a significant piece of that growth. The fund's holdings include about 25% of Class A office space in Calgary; in Edmonton, that figure is 10%.

"Between now and 2015, assuming the world continues as it is, the GDP of Western Canada will be approximately that of the rest of Canada," says Nobrega, adding that OMERS' investment in the region—which he already estimates is higher than that of any other Canadian pension fund—is bound to increase as that GDP share grows.

Long Road Ahead

Nobrega likens the shift in OMERS' strategy—and the building of a strong investment team and technology base—to the development of a luxury vehicle, which requires time and attention to bring it to a successful market launch.

"I think OMERS is well positioned today, after building this thing for about 10 years. I believe we're very far ahead of many plans. I think we've gone past the design stage to building the team and test

driving the car," he says. "Now we're in the production stage."


So far, that production has been good, though not without its struggles. Since 2004, the plan has earned average annual returns of 8.11%. Despite this, the plan is only 92% funded, and the funding deficit tripled in 2010 to \$4.5 billion. But Nobrega is confident that the current strategy will generate average annual returns of between 7% and 11%, returning the fund to surplus as early as 2016.

OMERS also sees opportunity for follow-on investments coming out of its holdings in Western Canada. As the country works to meet its 2020 emissions targets of 17% below 2005 levels, for example, corporations in the oil and gas sector will be increasingly in the spotlight.

"As political pressure builds, [Western Canada] will have to look at its environmental record. [With] growth in the commodity business, there will be opportunities for growth in the environmental business," through new technology, Nobrega adds.

That need for technology will be addressed, in part, by entrepreneurs with new ideas. OMERS Ventures launched earlier this year with \$180 million to invest in new companies over the next three years. While that allocation represents just a drop in the bucket of OMERS' overall asset holdings, it's not insignificant when compared with the roughly \$1 billion that the Canadian Venture Capital Association estimates is invested in Canada annually.

Nobrega says that while venture capital investments would typically be on the riskier end of the spectrum, many of the companies that OMERS will look to invest in will already have benefited from the initial seed investments offered through governments and university funding, and will be established enough to align with the fund's goals for global growth and sustained returns.

"It's our intention to be the parent for some of the serious innovation in the country. And we hope the [venture capital investment] ecosystem will go from \$1 billion to \$10 billion annually over the next five years. That's what we need in this country. Our intention in making this step is to encourage others to join us." 

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