New Mexico Educational Retirement Board

Real Estate and Natural Resources Portfolio Quarterly Board Report

December 31, 2011

Presented By

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Portfolio Summary

Portfolio Review

As of December 31, 2011, New Mexico Educational Retirement Board ("NMERB") had a total portfolio value of $8,995,514,439. NMERB's long-term target allocations to real estate and natural resources are 5% ($449,775,722) and 3% ($269,865,433), respectively. As of December 31, 2011, net asset value ("NAV") of the real estate portfolio was $519,528,811 and NAV for the Natural Resources portfolio was $23,477,398.

As of December 31, 2011, NMERB had $121,645,197 of committed but uncalled allocations to private real estate managers and $13,674,167 of committed but uncalled allocations to Natural Resources managers. Not included in the numbers above are allocations to additional real estate funds of $45 million and an agriculture fund of $50 million, which were approved by the Board but not yet closed as of the end of the quarter.

Returns Summary

	Time Weighted Returns		
	Current Quarter	Since Inception	Net Internal Rate of Return Since Inception
Public Real Estate	15.82%	8.52%	12.75%
Wilshire REIT Index	15.42%	8.90%	n/a
Private Real Estate	2.74%	-0.66%	0.77%
NCREIF Property Index	2.96%	-0.29%	n/a
Natural Resources	2.78%	0.96%	1.67%
NCREIF Timber	0.51%	-1.51%	n/a
CPI (All Consumers)	-0.54%	2.17%	n/a

Portfolio Highlights

The real estate portfolio is expected to generate returns in excess of the National Council of Real Estate Investment Fiduciaries Index ("NCREIF Index") over rolling five year investment time horizons.

Key Private Asset Ratios as of 12/31/2011

Paid in Capital (PIC) 0.61 x

Distribution Paid in Capital (DPI) 0.19 x

Residual Value Paid in Capital (RVPI) 0.83 x

Total Value Paid in Capital (TVPI) 1.02 x

Trailing Period Time Weighted Returns

	QTR.	1 YEAR	3 YEAR	5 YEAR	SINCE INCEPTION
Public Real Estate Composite	15.82%	8.82%	21.46%	-1.70%	8.52%
In-House REIT	15.33%	9.16%	21.59%	-1.64%	8.57%
Wilshire REIT Index	15.40%	9.20%	21.76%	-1.98%	8.90%
Brookfield U.S. Value REIT	17.10%	n/a	n/a	n/a	-2.90%
MSCI US REIT Index	15.30%	n/a	n/a	n/a	-1.50%
Private Real Estate Composite	2.74%	8.36%	9.65%	n/a	-0.66%
NCREIF Property Index	2.96%	14.26%	2.43%	n/a	-0.29%
Natural Resources Composite	2.78%	2.89%	n/a	n/a	0.96%
NCREIF Timberland Index	0.51%	1.57%	n/a	n/a	-1.51%
CPI (All Consumers)	-0.54%	2.96%	n/a	n/a	2.17%

Calendar Year Time Weighted Returns

	YEAR TO DATE	2011	2010	2009	2008
Public Real Estate Composite	8.82%	8.82%	28.77%	27.89%	-38.31%
In-House REIT	9.16%	9.16%	28.77%	27.89%	-38.31%
Wilshire REIT Index	9.20%	9.20%	28.60%	28.60%	-39.20%
Brookfield U.S. Value REIT	-2.90%	n/a	n/a	n/a	n/a
MSCI US REIT Index	-1.50%	n/a	n/a	n/a	n/a
Private Real Estate Composite	8.36%	8.36%	22.97%	-1.05%	n/a
NCREIF Property Index	14.26%	14.26%	13.11%	-16.86%	n/a
Natural Resources Composite	2.89%	2.89%	7.41%	n/a	n/a
NCREIF Timberland Index	1.57%	1.57%	-0.15%	n/a	n/a
CPI (All Consumers)	2.96%	2.96%	1.50%	n/a	n/a

Portfolio Statistics

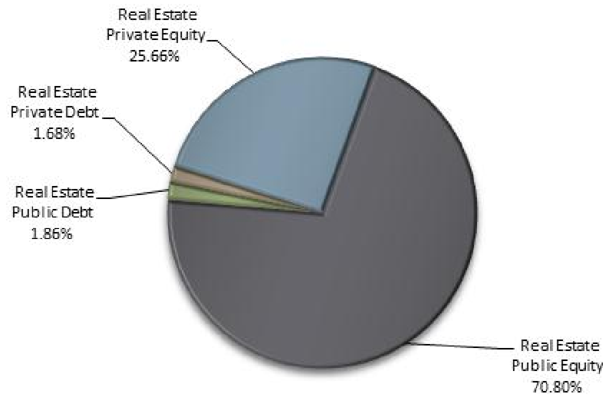
	12/31/2011	12/31/2010	12/31/2009	12/31/2008
Portfolio Market Value	$543,006,209	$476,599,485	$390,763,308	$298,239,466
Committed Uncalled	$135,888,329	$31,375,528	$50,752,104	$17,813,753
Portfolio Market Value + Committed Uncalled	$678,894,538	$507,975,012	$441,515,413	$316,053,219
Total Number of fund Investments	13	8	8	6
Total Number of Managers	11	7	7	5

Private Asset Multiples

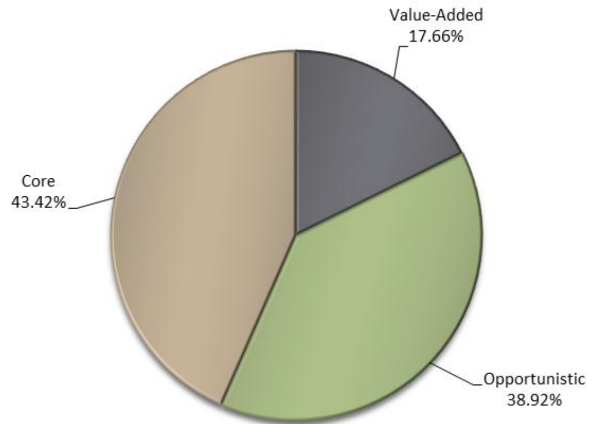
	12/31/2011	12/31/2010	12/31/2009	12/31/2008
PIC Multiple	0.61x	0.53x	0.48x	0.86x
Distribution Multiple	0.19x	0.11x	0.09x	0.02x
Residual Value Multiple	0.83x	0.85x	0.71x	0.76x
Total Value Multiple	1.02x	0.97x	0.80x	0.79x

Portfolio Diversification as of December 31, 2011

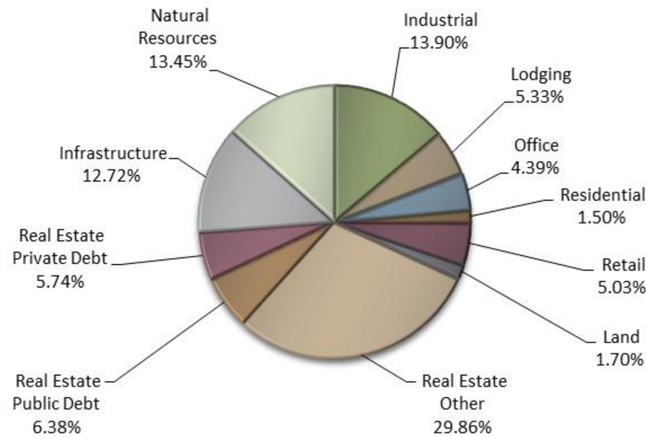
Diversification by Investment Class



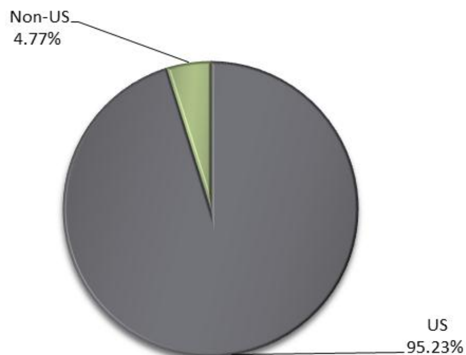
Private Asset Risk Category



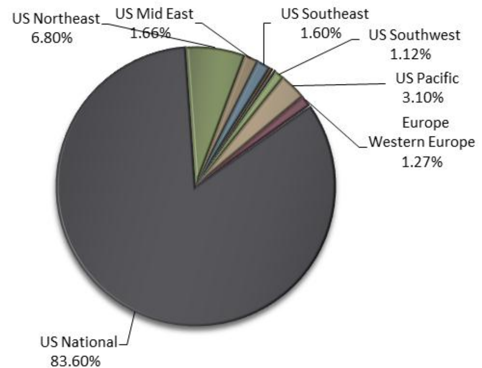
Private Asset Diversification by Investment Type



Private Asset US vs. Non-US Diversification



Private Asset Global Diversification



Real Estate Capital Market Conditions

2011 will mark the year institutional investors increased the intensity of their search for current and safe income streams. Institutional real asset investors demonstrated this interest through purchases of treasuries, corporate bonds, cash, farmland and core, major market real estate. The high level of interest in core real estate drove returns for the year higher and drove yields for new acquisitions to new lows. The NCREIF NPI one-year total return was 14.26% (unleveraged, gross of fees) on a national basis, with total returns by property type tightly grouped around this index (Apts 15.29% and Hotels at 11.79% bracket the property type performance for 2011). The focus and flow of capital to core real estate has in our view created a wide pricing gap between "institutional grade" real estate and value-add / opportunistic transactions. As a result, we believe the risk-return trade-off in core is asymmetrical to the risks and returns offered in value-add and opportunistic strategies.

In general terms:

- Core real estate appears to be trading in the range of 65 - 80% of replacement cost. Value-add / opportunistic transactions trade in the range of 40 – 60% of replacement cost.
- Positive leverage and forecast rent growth are required to generate core total returns north of 8% annually. Core investments are typically leveraged to 50% of acquisition costs. Value-add opportunistic portfolio acquisitions and one-off transactions are priced at 8-9% current yields on an unleveraged basis on 70-80% occupancy. Value-add and opportunistic transactions, based upon the funds we are reviewing, we are finding to be levered about the same at 50% -60% LTC ratio, but on a significantly lower basis.
- As a result of high bids to win competitively auctioned core real estate, cash yields from leveraged core appear to be in the range of 4–7% (the Q4 national average cap rate was 7.0%). Value-add and opportunistic portfolio acquisitions and one-off transactions are generating a leveraged cash yield of 9-10%.
- On the quality front, although the call is subjective, core real estate quality is high (relative score A) while value-add opportunistic quality is good to high (A- to B-). In our view, value-add and opportunistic quality is often higher than many market participants' expectations.
- When core is aggressively priced, investors are forced to place greater reliance on terminal value to generate 8%+ total annual returns. High cash flow from opportunistically acquired property greatly diminishes terminal value exposure.
- Value-add and opportunistic portfolio investments flowing from distressed banks, gov't agencies and other investors represents diversified exposure to differing geography, tenants, industry and credit versus a single "core" investment in a major "gateway" CBD market. This diversification we believe generates higher risk-adjusted returns.

The points above lead RAPM to favor value-add and distressed opportunities in the current environment. We believe that by carefully combing through the large universe of funds in the market that are pursuing value-add and opportunistic transactions, our clients will be rewarded through cash flow and dampened volatility due to lower reliance on terminal value.

Sources: Urdang Q4 2011 Performance Review; Morgan Stanley Q4 Global Real Estate Securities Conference Call; NCREIF Q4 2011 Detailed Quarterly Performance Report

Market Conditions by Property Type

Apartments

- National apartment vacancy rate decreased 40 bps to 5.2% at the end of Q4; net absorption increased to 50,600 units, a gain of over 40% from Q3
- 8,900 apartment units were delivered in Q4 for a yearly total of 37,700 units (lowest rate of completions since REIS started tracking data in 1980
- Asking and effective rents rose again during the quarter with effective rents rising by a cumulative 2.3% for 2011; Northern California markets with growing high-tech jobs posted highest rent growth
- Transaction volume was $16.6 billion in Q4, an increase of 24.0% from the same period in 2010; Total transactions for 2011 were $53.9 billion, an increase of 54% over 2010
- Cap rates for mid and high-rise apartments in major cities compressed to 5.2% and 5.8%, respectively
- Apartment sector generated highest NCREIF property type performance for second consecutive year

Industrial

- National industrial vacancy declined 20 bps to 13.5% during Q4
- Q4 was the sixth consecutive quarter of declining industrial vacancy
- For the year 2011, over 114.7 MSF of industrial space was absorbed including 27.7 MSF during Q4
- Leasing activity was led by demand for large warehouse space of over 200,000 SF
- Rents for industrial space appear to have stabilized and remained unchanged during second half of 2011
- Transaction volume was $7.9 billion during Q4, a 19% increase over Q3 although a decline of 6% over the same period in 2010; cap rates fell slightly to 7.8%

Office

- Leasing momentum in the office sector lead to vacancy declines of 20 bps to 16.0% in Q4; CBD and suburban office vacancy dropped by 30 bps and 20 bps respectively
- Markets with significant exposure to the high-tech industry including Austin, San Jose, San Francisco and Seattle were some of the best performers
- Markets with the largest Q4 increases in vacancy include Newark, Tucson, West Palm Beach and Las Vegas
- Rents stabilized in the first half of 2011 (after falling in 2009 and 2010); rent growth was 0.6% in Q4, and 3.1% over the full calendar year
- Transaction volume for the quarter was $19.7 billion, 5% lower than the same period in 2010; Total sales reported for 2011 was $63.5 billion, an increase of 37% over 2010
- Sales in the office sector continue to be driven by major market CBD properties, although investors are increasingly targeting Class A suburban office with higher yields; cap rates remained unchanged at 7.3%

Retail

- Neighborhood and community shopping center vacancies remained at 11.0%, while regional mall vacancy declined by 20 bps to 9.2% in Q4
- Necessity and high-end retailers have performed well, while retailers such as Sears and JC Penny have shown decreasing revenues
- Higher quality malls, neighborhood-necessity, and value-oriented centers continue to outperform
- During the quarter, 3.2 MSF was absorbed, the largest quarterly absorption since the first quarter of 2008

- Transaction volume across the retail sector totaled $10.9 billion, an increase of 26.6% over Q3; cap rates decreased by 20 bps to 7.4%

Hotel

- On a Y-O-Y basis, occupancy increased by 4.4% to 60.1%; Average Daily Rate (ADR) rose by 3.7% to $101.64; and Revenue Per Available Room (RevPar) jumped by 8.2% to $61.06
- For 2011, room demand increased by 5.0% while new supply only grew by 0.6%
- Transaction volume totaled $4.4 billion in Q4, up 22.2% from the same period in 2010; cap rates declined by 60 bps to 7.1%

Source: Clarion Partners; National Market Update Q4 2011

Natural Resources Capital Market Conditions

Timber Market Commentary

An analysis of University of Michigan's Survey of Consumer Attitudes by the Research Institute for Housing in America finds consumer sentiment towards home buying is unchanged from long-term averages, while home selling sentiment is at an historic low. Foreclosures and financial mortgage constraints will continue to limit transaction activity until troubled mortgages are cleared. These findings support the position that long-term demand for housing was not damaged by financial market difficulties and that with low levels of new supply, housing should recover from current depressed levels.

Annual lumber production in North America has ranged from a peak of 75 billion board feet (bbf) in 2005 to a low of 43 bbf in 2009. In 2011, the market increased to 48.8 bbf due to rising demand for Pacific Northwest logs and lumber from Asian markets including China. The rate of increase has recently slowed as the global economy adjusts to what we believe is a more moderate but sustainable rate of growth. However, supply and demand are forecast to achieve 64.5 bbf in 2016. We believe a forecast recovery in new US housing demand, combined with continuing demand growth in Asia, and supply constraints from Canada will cause price increases. Higher volume and pricing should allow forestland owners to return to profitability sometime in the next several years.

Sources: International Wood Markets Group, Inc., Yamhill News Register, and Research Institute for Housing in America.

Mitigation Banking Market Commentary

It takes time for a large organization like the Environmental Protection Agency (the "EPA") to implement policy changes. While EPA headquarters staff is working to implement the agency's preference for larger mitigation banks, many mitigation bank specific issues are determined at the Regional level. For this reason, the National Mitigation Banking Association representatives held meetings during 2011 with Regional EPA staff to build understanding about the 2008 Rule preferring larger banks over other forms of mitigation.

At the end of 2011, across the USA there are now over 900 permitted banks with 735 actively operating.
As the mitigation banking industry matures, mechanisms for providing financial assurances for the completion of mitigation activities also matures. There are now primarily four ways for a proposed bank to demonstrate the financial capability to complete proposed bank activities: 1) cash in escrow, 2) letter of credit, 3) performance bond, and 4) casualty insurance. Two banks have now utilized an insurance product for financial assurance requirements and several more are proposed. Mitigation banking finance is an emerging industry in itself.

Agriculture Market Commentary

US farmland values increased again in 2011. According to broad based USDA data, farmland value increased by 6.8% while NCREIF indicated an increase of 8% for institutional quality farms. NCREIF also reports income of 7% bringing total return for 2011 to 15%. High commodity prices and large farming profits support highly competitive land purchase and rent markets.

After thirty years, the tax credit for ethanol expired on 1/1/2012. Also expiring is the import tariff on ethanol. However, the mandate for blending one part ethanol into 9 parts of gasoline continues. Ethanol prices are now expected to reflect the btu equivalence to gasoline. Since ethanol has 70% of the btu content of gasoline, the price of ethanol should approximate 70% of the gasoline price. Ethanol production and trade will likely be driven by the price of oil, the price of corn, and the cost to convert corn to ethanol.

Global 2010/2011 grain production declined 1.8% from 2009/2010. Total use, however, increased by 1.2% resulting in a 5.7% decrease in ending stocks (carryover). For the 2011/2012 crop year, the latest forecast is

for a production increase of 4.3%, total use increase of 2.8%, and a 1.6% increase in ending stocks. Estimates are subject to significant change as new crop prospects develop.

Sources: National Mitigation Banking Association, USDA, NY Times.

Appendix A

Summary of Portfolio Cash Flows

Quarter	Contributions	Distributions	Redemptions	Total
Q4 2003	51,000,000	-	-	51,000,000
Q1 2004	140,000,000	-	-	140,000,000
Q2 2004	125,450,000	-	-	125,450,000
Q4 2004	720,438	-	(720,438)	0
Q4 2005	-	-	(8,918,532)	(8,918,532)
Q1 2006	200,000	-	(92,452,388)	(92,252,388)
Q3 2006	-	-	(20,189,000)	(20,189,000)
Q4 2006	500,000	-	(51,495,881)	(50,995,881)
Q1 2007	-	-	(59,700,000)	(59,700,000)
Q2 2007	-	-	(77,400,000)	(77,400,000)
Q3 2007	277,650,000	-	(77,410,778)	200,239,222
Q4 2007	-	-	(58,200,000)	(58,200,000)
Q1 2008	82,200,000	-	(23,500,000)	58,700,000
Q2 2008	25,500,000	(446,462)	(50,454,058)	(25,400,520)
Q3 2008	44,852,570	(1,019,994)	(4,400,000)	39,432,576
Q4 2008	85,979,025	(1,223,450)	(79,450,000)	5,305,575
Q1 2009	55,122,204	(1,142,560)	(2,650,000)	51,329,644
Q2 2009	3,720,837	(2,831,451)	(2,200,000)	(1,310,614)
Q3 2009	2,182,090	(3,883,030)	(52,000,000)	(53,700,940)
Q4 2009	7,213,749	(1,450,747)	(2,400,000)	3,363,002
Q1 2010	4,451,516	(846,291)	(1,350,000)	2,255,226
Q2 2010	767,315	(1,188,459)	(500,000)	(921,144)
Q3 2010	1,174,065	(853,205)	(27,600,000)	(27,279,140)
Q4 2010	13,741,534	(1,926,081)	(2,600,000)	9,215,454
Q1 2011	3,250,560	(4,011,073)	(2,050,000)	(2,810,513)
Q2 2011	17,910,020	(4,020,435)	(800,000)	13,089,585
Q3 2011	106,849,228	(7,392,249)	(98,633,186)	823,793
Q4 2011	23,924,425	(5,283,605)	(2,634,867)	16,005,953
Total	$ 1,074,359,576	$ (37,519,090)	$ (799,709,128)	$ 237,131,358

Appendix B

Notes to the Performance Report

Multiples are calculated net of fees using private investments only.

The PIC Multiple is the cumulative contributed amount divided by committed capital. This multiple indicates how much of committed capital has been paid in.

The Distribution Multiple ("DPI") measures the portion of fund returns distributed to investors. When DPI is the equivalent of 1, the Fund has broken even. A DPI of greater than 1 indicates that the Fund has generated profit to the investors.

The Residual Value Multiple ("RVPI") measures the portion of returns that are unrealized.

The Total Value Multiple ("TVPI") provides information regarding the value of the investment relative to its cost basis, not taking into consideration the time invested.

Paid in Capital Ratios reflect all contributions made divided by the total commitments, without making adjustments for contributions that may be offset by recallable or true-up distributions.

Consistent with calculating Paid in Capital, Distributions to Paid in Capital Ratios reflect all distributions received divided by the aggregate total of contributions.

RAPM believes this is the most accurate way to reflect the cash flows experienced during the investment, though Paid in Capital and Distributed to Paid in Capital ratios may not exactly equal those values shown on manager-provided capital statements if the manager is adjusting for recallable distributions or true-up distributions for the Fund. All managers treat these classifications differently and therefore, RAPM utilizes actual cash flows experienced for calculating key ratios as of the quarter end.

Diversification statistics are based on net investment value.

All indices are gross of fee indices.

REIT returns and and Private Asset returns are calculated using different methodologies. The REIT returns are based on the monthly returns as reported by the Custodian and are calculated in accordance with accepted standards for daily liquid securities that require interim period monthly calculations for months in which large external cash flows occur. Private Asset returns are also calculated in accordance with accepted standards for these components using time weighted total rate of return that considers the timing of external cash flows; however, it does not distinguish between large and small cash flows and therefore does not utilize interim period performance to mitigate the impact of significant cash-in and outflows.

All performance numbers reflect data as reported to RAPM by the investment managers. RAPM has made an effort to verify the integrity of the data, including cross referencing what was reported for performance with fund financial and investor capital statements. However, RAPM serves as a data aggregator and reporter of fund level performance data and, therefore, cannot guarantee the accuracy of the underlying data reported by fund managers.