

ACTION SUMMARY

INVESTMENT COMMITTEE

April 20, 2017

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MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

April 20, 2017

1. a. CALL TO ORDER

A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at 1:00 p.m. in the Educational Retirement Board Conference Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

Members Present:

Mr. H. Russell Goff, Chair
Ms. Mary Lou Cameron
Mr. Larry Magid

Members Excused:

None

Staff Present:

Ms. Jan Goodwin, Executive Director [by telephone]
Mr. Bob Jacksha, CIO
Mr. Steve Neel, Deputy CIO, Alternative Investments
Ms. Kay Chippeaux, Deputy CIO, Public Markets and Credit
Mr. Mark Canavan, Real Assets Portfolio Manager
Mr. Aaron Armstrong, Portfolio Manager
Mr. Alan Myers, Portfolio Manager
Mr. Ian Oldham, Investment Analyst
Mr. Rod Ventura, General Counsel

Others Present:

Mr. Allan Martin, NEPC
Mr. Kevin Tatlow, Top Tier
Mr. Steve Gruber, RAPM
Mr. Brent Burnett, RAPM
Mr. Asif Hussain, Caledon
Mr. Jordan Thomson, Caledon
Ms. Judith Beatty, Recorder

b. Approval of Agenda

The agenda was reprioritized and renumbered.

Ms. Cameron moved approval of the agenda, as amended. Mr. Magid seconded the motion, which passed unanimously by voice vote.

c. Approval of Minutes of 3/23/17

Mr. Magid moved approval of the minutes of the March 23, 2017, meeting, as submitted. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

d. Introduction of Guests

Mr. Neel introduced Ian Oldham, a recent new addition to the Investment staff.

2. Z CAPITAL SPECIAL SITUATIONS FUND III – PRIVATE EQUITY

[Presenters: Steve Neel and Top Tier consultant Kevin Tatlow.]

Mr. Neel presented staff's recommendation for a \$50 million commitment to Z Capital Special Situations Fund III.

-- The NMERB committed \$40 million to Z Capital's Special Situations Fund II in 2013, and that fund has performed nicely. The NMERB added \$9 million to that commitment toward the end of the fund raise and that has also turned out very well.

-- The NMERB also committed \$40 million to Z Capital's technical opportunities fund last year, which requires a certain trigger to start calling capital. The money is set and ready to be deployed at the first opportunity.

-- Fund III is a distressed for control strategy, where Z Capital looks for opportunities in companies that are significantly underperforming or on their way to bankruptcy. The average equity check is anticipated to be between \$50 million to \$150 million, a range that NMERB prefers because of competitive advantages. Of the nine companies in Z Capital's portfolio, four were gained through the bankruptcy process and three through their proprietary software system, ZAP.

-- No specific industries are targeted. In the current fund, they have some exposure in gaming and in real estate, areas where there have been dislocations.

Mr. Tatlow discussed investment merits and concerns in this top quartile fund.

-- Of their two funds to date, there are no realized losses.

-- The target size for Fund III is 33 percent larger than Fund II. If the fundraise reaches the \$1.2 billion ceiling, it will be 60 percent larger than the prior fund, which may increase the average transaction size. However, they will continue their existing focus on the value-added area in smaller companies, which is where they do very well.

-- Staff and Top Tier expect that the active portfolio (12 companies) will experience multiple realizations in the coming 18 to 24 months, preventing a significant increase in the number of active portfolio companies.

-- Z Capital has multiple investments in the gaming industry, but they do it correctly, with a lot of operational experts in the industry working with them.

-- The team has experienced some transitions. The operating side of the firm has gone from having part time former executives acting as advisors to full-time, dedicated sector experts.

-- Z Capital Founder Jim Zenni is not listed individually as a key person in this fund, whereas he was individually named in the prior fund. While the investment team is very capable, Top Tier believes his role is very important, and their may be pressure from investors about this change.

Mr. Magid moved that the Investment Committee approve a commitment of \$50 million to Z Capital Special Situations Fund III for the Private Equity Portfolio. The commitment is subject to New Mexico State Law, Educational Retirement Board policies, Educational Retirement Board approval for placement agents and negotiation of final terms and conditions, and completion of appropriate paperwork. In addition, the Investment Committee grants staff discretion to invest an additional amount, not to exceed \$10 million, in secondary partnership interests offered by other limited partners in the fund, should they become available. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

3. 2017 PRIVATE EQUITY PACING PLAN

[Informational item.]

[Presenters: Steve Neel and Top Tier consultant Kevin Tatlow.]

Mr. Neel noted that the pacing of investments has not changed significantly from last year, and it is staff's intent to continue at the existing pace of \$325 million per year for the 2017-2018 vintage years.

Mr. Tatlow presented highlights from the pacing plan recommendations.

-- In 2016, the private equity allocation target was increased to 13 percent with a 0-22 percent range. The pacing model predicts that NMERB will reach that target allocation in 2018 and reach a peak allocation of 14.4 percent in 2020.

-- NMERB currently holds a very low weighting in Europe and will continue the process of building an allocation to the region.

-- NMERB has added a separate account for venture capital and is on pace to build a venture allocation of 10-15 percent of commitments.

-- NMERB is trading in the buyout universe at very high multiples. It should continue to emphasize managers that can add value in the current environment by investing in managers that are value oriented; growth oriented or are able to add value to companies through strategic and operational initiatives.

4. WATER PROPERTY INVESTORS II – NATURAL RESOURCES

[Presenters: Mark Canavan and RAPM consultant Steve Gruber.]

Mr. Canavan presented staff's recommendation of a \$30 million commitment to Water Property Investors II.

Highlights from RAPM's report to the NMERB:

-- In 2014, NMERB staff and RAPM identified Water Asset Management (WAM) as a specialist firm in with the requisite expertise to identify, acquire, convert and ultimately monetize water-rich agriculture and related water resources.

-- In late 2014, NMERB committed \$30 million to WPI I, a private equity fund managed by WAM and raised to invest in water resources, including water rights, water effluent credits, water storage assets and water-rich agricultural properties. WPI I is now fully committed to 17 assets throughout Arizona, California and Colorado.

-- WAM is currently raising \$250-\$350 million for WPI II, which will focus on acquiring water-related assets, primarily in the Western U.S. that can be improved through conversion of excess water rights into higher and better uses. The fund expects that 70 percent of the capital will be invested in water-rich agricultural properties and 30 percent will be invested in water-related assets. WPI II will target a net IRR of 17-22 percent with a 1.5 to 3x multiple. WAM uses no leverage in its transactions.

Mr. Gruber said this investment will complement the investments made by NMERB in Halderman and Hancock, each of which are farmland strategies where returns are from farming

and farmland and not farmland and water; and the investment with Blue Road, which is involved in midstream investments.

Mr. Gruber said WAM has a dedicated asset manager within each region that is responsible for building up communications and network with the water districts, farmers and other landowners in the region. He added that RAPM feels the established positions in Fund I will serve to benefit Fund II.

Mr. Canavan stated that, although this is a re-up, the managers are available to respond to questions should the committee have any. [The committee had none.]

Ms. Cameron moved that the Investment Committee approve a commitment of \$30 million to Water Property Investors II for the Natural Resources Portfolio. The commitment is subject to New Mexico State Law, Educational Retirement Board policies, Educational Retirement Board approval for placement agents and negotiation of final terms and conditions, and completion of appropriate paperwork. In addition, the Investment Committee grants staff discretion to invest an additional amount, not to exceed \$10 million, in secondary partnership interests offered by other limited partners in the fund, should they become available from time to time. Mr. Magid seconded the motion, which passed unanimously by voice vote.

5. STONEPEAK CREDIT – INFRASTRUCTURE

[Presenters: Mark Canavan and Caledon consultants Asif Hussain and Jordan Thomson.]

Mr. Canavan presented staff's recommendation of a \$25 million commitment to Stonepeak Infrastructure Credit Separate Account ("Credit SMA"), which will seek to build a portfolio of North American infrastructure secondary credit investments.

Mr. Hussain commented that this is an interesting strategy for doing publicly traded debt that would provide NMERB with a complementary strategy to its existing, predominantly private equity portfolio. It would enhance yield and provide downside protection through its focus on credit.

Highlights from Caledon's summary of the Credit SMA investment strategy:

-- The Credit SMA will primarily invest in secondary market bonds and loans, and to a lesser extent in opportunistic loan origination in infrastructure sectors including (a) energy and utilities (e.g., gas storage and distribution, electricity transmission and distribution, water and wastewater, renewable waste collection and disposal); (b) transportation (e.g., roads, airports, rail, ports, urban mass transport, on and off street parking, fixed base operations); (c) communications infrastructure; and (d) other assets and businesses that exhibit infrastructure characteristics.

Stonepeak team members Michael Dorrell and Ryan Roberge introduced themselves and made a presentation.

Responding to Ms. Goodwin, Mr. Dorrell said that, while they don't have a formal limit by sector in their portfolio, it is just understood among their LPs that they are a diversified fund, and they discuss this extensively. He said they do not exceed 40 percent in any particular sector nor do they exceed 20 percent in any single investment.

[Representatives exited the meeting.]

Mr. Canavan noted that three senior members of the team (including co-founders Michael Dorrell and Trent Vichie) would be investing \$5.4 million of their own funds alongside the NMERB.

Mr. Jacksha said this is an area where the NMERB does not have much exposure, and he thought the manager had made a good point in stating that if the NMERB is going to have a focus in this area, it wants someone who can go in and value the asset and is more of an infrastructure manager than a bond manager. He said he thought Stonepeak was a good choice for this space.

Mr. Magid moved that the Investment Committee approve a commitment of \$25 million to Stonepeak Credit Infrastructure Fund I, L.P. for the Infrastructure portfolio. The commitment is subject to New Mexico State Law, Educational Retirement Board policies, Educational Retirement Board approval for placement agents and negotiation of final terms and conditions, and completion of appropriate paperwork. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

[Break.]

[Agenda was reprioritized.]

7. Q1 PROXY VOTING REPORT

Ms. Cameron moved to accept the Proxy Voting Report, as presented. Mr. Magid seconded the motion, which passed unanimously by voice vote.

8. Q4 2016 INFRASTRUCTURE REPORT

[Presenters: Mark Canavan and Caledon consultant Asif Hussain.]

Mr. Canavan presented highlights from this report (as of December 31, 2016):

- Portfolio fair value: \$299.2 million
- Unfunded commitment: \$211.7 million

- Total number of fund investments: 8
- Total number of direct investments: 10
- Net IRR since inception (July 2008): 5.4 percent; gross IRR, 9 percent
- Total portfolio: \$531.9 million

Mr. Canavan noted that the portfolio has outperformed the benchmark for the 3-year, 2-year and 1-year periods by 2.8 percent, 3.9 percent and 7.6 percent respectively. He said he anticipated that this trend of outperformance would continue for at least the next couple of years.

Mr. Hussain added that while no commitments were made last year, 2017 would be a busy year with additional commitments anticipated in the June-September timeframe.

9. Q1 2017 COMMISSION REPORTS

[Informational.]

10. OTHER REPORTS AND DISCUSSION

Mr. Jacksha reported that March returns are about .9 percent, and the month closed at \$12,075 billion, putting the quarter at about 4.2 percent and the fiscal year to date at 9 percent.

Mr. Jacksha discussed a secondary private equity transaction that he planned to bring to the Board of Trustees in the near future as part of a discussion on a potential policy change.

Mr. Jacksha said that, at tomorrow's board meeting, he would discuss scheduling a session with the board on hedging, as well as an educational session on CLOs, both moderated by NEPC.

Mr. Jacksha distributed a list of recent buys and sells.

6. NON-US EQUITY MANAGERS CONTRACT RENEWALS

[Presenters: Bob Jacksha, Kay Chippeaux, and NEPC advisor Allan Martin.]

Mr. Jacksha presented staff's recommendation that the NMERB extend the investment manager contracts or approve the continuation of limited partnership agreements for four non-U.S. equity managers, with the right to cancel or withdraw with 30 days' notice. The four managers are:

Developed Markets:

- Fidelity Institutional Asset Management, formerly known as Pyramis Global Advisors Trust Company (4-year contract began 6/14/2013);
- BlackRock Institutional Trust Company, N.A. (4-year contract began 7/3/2013)

Emerging Markets:

- Neuberger Berman Emerging Markets, doing business as NB Equity Management GP LLC (LPA signed 7/11/2013);
- Mondrian Emerging Markets Small Cap Equity Fund, L.P. (LPA signed 7/9/2013)

Mr. Jacksha noted that, under the NMERB Investment Services Procurement Policy, contracts for investment managers of publicly traded assets are limited to an initial term of four years with a single contract extension of up to two years, granted by the Investment Committee. All four of the managers will be completing their initial four-year term either in June or July of 2017, and staff believes it is in the best interests of the fund to extend each of the agreements for a two-year term.

Mr. Jacksha and Mr. Martin stated that, depending on performance, staff and NEPC may return with recommendations to issue an RFP for one or two of these managers before the two-year term is up.

Ms. Cameron moved that the Investment Committee authorize the continuation of the limited partnership agreements for an additional two years with Neuberger Berman and Mondrian, subject to and contingent upon New Mexico State Law and Educational Retirement Board policies. Mr. Magid seconded the motion, which passed unanimously by voice vote.

Mr. Magid moved that the Investment Committee approve two-year extensions of the investment manager contracts with BlackRock and Fidelity, maintaining the provision for termination of the contract with thirty day's advance written notice. The contract extensions are subject to and contingent upon New Mexico State Law, Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

Staff promotion

Ms. Chippeaux announced that Alan Myers has accepted the position of portfolio manager, and would be working with her in public securities and opportunistic credit.

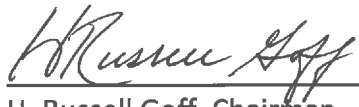
11. NEXT MEETING: JUNE 22, 2017

The meeting was scheduled at 12:00 p.m.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 2:30 p.m.

Accepted by:

A handwritten signature in cursive script, appearing to read "H. Russell Goff", is written above a horizontal line.

H. Russell Goff, Chairman