MINUTES OF THE

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

INVESTMENT COMMITTEE

January 16, 2020

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. at the Educational Retirement Board, Suite A-319, 8500 Menaul Boulevard, N.E., Albuquerque, New Mexico.

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

Members Excused:
None.

Staff Present:
Mr. Bob Jacksha, CIO
Mr. Steve Neel, Deputy CIO, Alternative Assets
Ms. Kay Chippeaux, Deputy CIO, Public Markets & Credit (by telephone)
Mr. Pete Werner, Fixed Income Portfolio Manager (by telephone)
Mr. Aaron Armstrong, Portfolio Manager

Others Present:
Mr. Allan Martin, NEPC
Mr. Brad Rowbotham, NEPC [by telephone]
Ms. Jessica Archibald, Managing Director, Top Tier
Mr. Gavin Gruenberg, Voya Financial
Ms. Charmaine Clair for Judith Beatty, Recorder

b. Approval of Agenda

Ms. Cameron moved approval of the agenda, as published. Mr. Magid seconded the motion, which passed unanimously.

c. Approval of Minutes: December 6, 2019

Mr. Magid moved approval of the December 6, 2019, minutes, as submitted. Ms. Cameron seconded the motion, which passed unanimously.

d. Introduction of Guests

Chairman Goff welcomed guests and staff.

2. BLACKROCK CO-INVESTMENT – PRIVATE EQUITY

[Presenter: Steve Neel]

Mr. Neel presented staff's two-part recommendation to 1) approve a commitment of $100 million to the BlackRock/ERB Co-Investment Fund, which would be the fifth $100 million tranche of capital the ERB has had with BlackRock, the ERB's largest partner in the private equity portfolio; and 2) approve a strategic partnership.

Co-Investment mandate

Mr. Neel said BlackRock has generated first and second quartile IRR performance across three of the four pools of capital, with the 2013 fund in the third quartile. This relationship is economically very compelling for the ERB; the savings in management fees on today's recommendation will be $5 million.

Mr. Neel said each tranche is managed like a separate investment fund, diversified by vintage year, industry, and general partner.

Mr. Neel said the one noteworthy concern is around a few staff changes. A widely publicized recent departure was Mark Wiseman, a former senior managing director who was terminated due to an inappropriate relationship with a colleague; however, he was not on the ERB's account. There was also turnover at the team, with the departure of three managing directors and one director over the past 18 months. He pointed out that there are more than 100 investment professionals at BlackRock, however, and in fact, the amount of face time given to the ERB since those departures has actually increased.

Mr. Neel said staff would like to change the fund structure, shifting it from a Delaware partnership agreement to an evergreen fund, so the vast majority of the profits off the platform will be reinvested into opportunities in the platform.

Mr. Jacksha added that, at the staff level, there is discussion about looking at more permanent capital vehicles with the option to distribute capital in the event the ERB needs additional cash flow.

Strategic partnership

Mr. Neel said staff has been discussing better ways of managing the private equity program and gain better access, and receive better information than many of its peers. With "centers of excellence," they plan to disaggregate the private equity portfolio based on areas of expertise: Venture; Buyout and Growth; Distressed; and Europe. In each silo, they will seek to have different advisor relationships, as follows: continuing with Top Tier in venture and high quality growth; BlackRock in Buyout; Banner Ridge (formerly Siguler Guff) for Distressed; and Aberdeen Standard in Europe.

Top Tier Managing Director Jessica Archibald made a presentation.

Blackrock Managing Director Steve Kelly and Senior Product Strategist Tom Dharte made a presentation on the NMERB-BlackRock private equity strategic partnership.

Messrs. Kelly and Dharte left the meeting.

Mr. Neel said that, on the co-investment side, this is a ten-year relationship that has done very well, and the strategic partnership will allow the ERB to become closer to the marketplace and allow even more opportunity. He commented that this is a very compelling opportunity.

Mr. Jacksha added that it makes a lot sense to structure this as Mr. Neel has, taking advantage of the expertise and the relationships that BlackRock, Top Tier and Banner Ridge have, including with GPs of these funds that the ERB wouldn't see otherwise.

Ms. Cameron said she read recently that BlackRock invests in private prisons and that there is a lack of control not by BlackRock, but by others. She wondered if this would have a negative impact on the strategic partnership. She said she was speaking to the issue of protecting the fund.

Mr. Jacksha responded that the ERB has no exposure through BlackRock to any prisons, and he would doubt that they have investments in prisons on their private equity side. Mr. Neel added that the ERB has authority to veto any investments in the co-investment portfolio. With regard to an individual fund that the ERB might underwrite that is not in the co-investment program, it doesn't have the ability to veto any investments. Mr. Jacksha added that everything the ERB does is as a limited partner, which limits our legal liability. If a private company through a fund or separate account does something undesirable, the general partners such as BlackRock hold board seats and can take action on those companies. On the public side Blackrock manages a number of U.S. equity index funds. That would most likely be where they have exposure. ERB has no exposure to Blackrock's US index funds.

Ms. Archibald added that headline risk usually goes to who made the first investment, which would be the buyout fund or the venture fund. She added that the ERB's ownership, if there were any, would be very small.

Mr. Magid moved that the Investment Committee approve a commitment of $100 million to BlackRock/ERB Co-Investment Fund III for the Private Equity portfolio. This approval includes the enhanced NMERB/BlackRock Private Equity Strategic Partnership. 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.

3. PIMCO CREDIT OPPORTUNITIES FUND III – OPPORTUNISTIC CREDIT

[Presenters: Kay Chippeaux (on phone with NEPC Research Analyst Brad Rowbotham. Also present: Allan Martin, NEPC]

Ms. Chippeaux presented staff's recommendation of a $150 million commitment to PIMCO Corporate Opportunities Fund III (COF III) for the Opportunistic Credit portfolio. She noted that the ERB is currently invested in PIMCO Distressed Senior Credit Opportunities Fund II, one of the two DiSCO funds that did very well for the ERB. Staff feels that the investment piece for COF III is more compelling, and staff wants to switch the investments from one PIMCO product to another.

Ms. Chippeaux said there would be very little impact on the Opportunistic Credit portfolio overall, but the types of holdings would change from senior structured credit to corporate credit. PIMCO's focus would be in four areas: capital solutions (rescue financing/lending), as well as stressed, distressed and idiosyncratic opportunities in the public and private markets.

Ms. Chippeaux discussed why staff believes that current market conditions have a greater momentum for higher risk, a trend they are seeing in the ERB's internally managed investment grade portfolio, which may create opportunities for the COF III fund.

Mr. Rowbotham discussed the due diligence process, team, and investment thesis.

-- NEPC had several phone and in-person meetings with the PIMCO team in Boston at the NEPC offices, and at PIMCO's headquarters in Newport Beach.

-- PIMCO has been focused on building out the team over the past few years with a number of investment professionals from well-known credit firms.

-- The performance of the first fund in the series (Distressed Credit Fund) has done well and ranks above median relative to funds with a similar strategy in that vintage year.

-- If the firm sees a broader opportunity set, they have the ability to extend the investment period from three to five years. Although the total term of the fund will remain the same, they will be able to invest longer, which is a good thing with a distressed opportunity because such deals are expected to have a higher rate of return.

In discussing the length and scale of the track record, Mr. Rowbotham stated that Fund I (2010) was only $220 million, which is quite small relative to the amount being raised for COF III, but did well. COF II, a $1.5 billion 2016 vintage fund, is still very young but is moving in a positive direction. COF III will be larger than that at $2.5 billion with a $3 billion cap. With this fund, they will be able to employ .5x leverage, whereas with COF II, they were able to employ .25x leverage.

Ms. Chippeaux said she had changed staff's recommendation from a $120 million commitment to $150 million.

Mr. Jacksha said PIMCO is a very good firm with smart staff and the resources and infrastructure to look at deals in detail. Ms. Chippeaux added that they are always willing to come in and do educational pieces for the staff and the Board and are always willing to take calls and to work with the ERB in ways beyond just marketing their products.

Mr. Magid moved that the Investment Committee approve a commitment of $150 million to PIMCO Credit Opportunities Fund III for the Opportunistic Credit 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.

4. <u>ALADDIN CONTRACT APPROVAL – CORE BONDS FUND</u>

[Presenters: (by telephone) Kay Chippeaux and Pete Werner]

Mr. Werner said the Aladdin system is the externally hosted platform that provides portfolio management tools and performs attribution, risk analytics, and some modeling functionality to the portfolio management team of the core bond fund. The ERB contracted initially for this service in 2015 after an extensive research and evaluation process involving the top half dozen providers, and determined that the Aladdin system best met the ERB's needs. That was a three-year contract with the option of an extension for five years. In 2018, the Investment Committee approved a two-year extension, and that term is now up.

Mr. Werner requested approval of a contract extension of the BlackRock Aladdin Risk Services Agreement for an additional three years, which would complete the term of the contract.

Ms. Cameron moved that the Investment Committee approve the extension of the BlackRock Aladdin Risk Services Agreement for an additional three years 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. Mr. Magid seconded the motion, which passed unanimously.

5. <u>Q4 PROXY VOTING REPORT</u>

Ms. Cameron moved acceptance of the Q4 Proxy Voting Report. Mr. Magid seconded the motion, which passed unanimously.

6. <u>PRIVATE EQUITY PERFORMANCE REPORT Q2-2019</u>

[Presenter: Steve Neel.]

Mr. Neel presented this report, with the following highlights:

-- The portfolio experienced a Q2 return of 1.69 percent and a 1-year return of 10.13 percent.

- The return since inception was 12.62 percent with a 1.42x multiple.

-- At quarter end, the portfolio had $3.63 billion in net commitments to 87 private equity funds managed by 50 different managers.

-- The total value-add is about $1.2 billion, which is an all-time high.

7. REAL ESTATE PERFORMANCE REPORT Q2-2019

[Presenter: Steve Neel]

Mr. Neel presented this report, with the following highlights:

-- The portfolio experienced a Q2 return of 2 percent, and for the year, 12 percent.

-- A huge driver in the Real Assets portfolio has been energy. Five Point Energy is up 37 percent for the year in one of their funds, and up 98 percent in a second fund.

-- The co-investment program, which is housed in opportunistic real estate, is doing very well with a 10+ percent return for the year and about 20 percent since inception.

8. Q4 COMMISSION REPORTS

[Informational]

9. NEXT MEETING: THURSDAY, FEBRUARY 13, 2020

The meeting was scheduled for 1:00 p.m. in the Santa Fe investment office.

ADJOURN

The meeting adjourned at 3:25 p.m.

H. Russell Goff

H. Russell Goff, Chairman