NEW MEXICO EDUCATIONAL RETIREMENT BOARD

INVESTMENT COMMITTEE

March 19, 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.

[NOTE: Because of COVID-19 virus concerns, all meeting participants were present by teleconference.]

Members Present:
Mr. H. Russell Goff, Chair
Mr. Larry Magid

Members Excused:
Ms. Mary Lou Cameron

Staff Present:
Ms. Jan Goodwin, Executive Director
Mr. Rod Ventura, Deputy Director
Mr. Bob Jacksha, CIO
Mr. Steve Neel, Deputy CIO, Alternative Assets
Mr. Mark Canavan, Real Estate & Real Assets Portfolio Manager
Mr. Aaron Armstrong, Portfolio Manager
Mr. Casey Poe, Portfolio & Compliance Manager

Others Present:
Mr. Allan Martin, NEPC
Mr. Steve Gruber, Hamilton Lane
Ms. Judith Beatty, Recorder

b. Approval of Agenda

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

c. Approval of Minutes: January 16, 2020

Mr. Magid moved approval of the January 16 minutes, as submitted. Chairman Goff seconded the motion, which passed unanimously.

d. Introduction of Guests

Chairman Goff welcomed staff and guests.

2. TENEX CAPITAL PARTNERS FUND III

[Presenter: Steve Neel]

Mr. Neel presented staff's recommendation for a $50 million commitment to Tenex Capital Partners Fund III. This will be the third commitment from the ERB across this platform, following Fund I in 2011 and Fund II and 2016. He commented that this is the first underwriting with BlackRock, and staff's initial experience has been extremely positive.

Mr. Neel commented that, in terms of committing to a private equity partnership in the midst of so much market volatility, the ERB must maintain discipline in private markets, and the funds that the committee will be asked to commit to today may be among the best future performers in the portfolio as evidenced by their past performance during market disruptions such as the GFC and 9/11. He also pointed out that Tenex's capital would be deployed over multiple years in the future with investment periods of up to five years. In addition, the committee will be seeing a series of commitments going forward to top tier general partners, many of which will be focused on distressed, special opportunities, and all weather strategies, which are well suited for the markets today.

Mr. Neel said Tenex would be investing in underperforming companies, elevating them to average, and in the process generating outsized returns. Four of the managing directors have worked together for over 15 years at Cerberus and Tenex, and the combined managing team has over 175 years of experience, including prior roles as part of General Electric's management team.

Blackrock representatives Stephen Kelly, Tom DeHart, Andrew Farris, and Autumn Learned made a presentation.

Mr. Jacksha stated that staff has liked this fund and this strategy from the beginning because it is somewhat unique in the buyout space with its focus on bringing underperforming companies up to average performance. They have done quite well, and have been good partners to the ERB.

Mr. Neel said staff finds their operational focus most compelling. This type of domain expertise is very differentiating, and that is a huge contributor.

Mr. Jacksha noted that staff has recently seen financing for buyouts in the leveraged loan market drying up. He said he recalled that Tenex does not use a lot of leverage, being operationally focused. He asked what the outlook would be if this drying up of leverage continues.

Mr. Kelly agreed that Tenex isn't a big user of leverage, and while it would impact them, on the broad scale of sponsors from the small and lower medium middle market deals that they look at, versus the mega-cap deals that other managers are looking at, it would affect them less. The bigger impact is that until sellers' expectations for prices reset, the real threat to them is that transactions don't happen. He said a resetting is happening right now across the portfolio, with some deals hitting the pause button, some deals moving ahead, and others backing out and waiting for the dust to settle.

Mr. Magid moved that the Investment Committee approve a commitment of $50 million to Tenex Capital Partners 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 Tenex Capital Partners Fund III should they become available from time to time. Chairman Goff seconded the motion, which passed unanimously.

3. <u>PROSTAR ENERGY INFRASTRUCTURE II -- INFRASTRUCTURE</u>

[Presenters: Mark Canavan and Noi Spyratos and Allison Williams, CBRE Caledon Capital Management]

Mr. Canavan presented staff's recommendation for a $50 million commitment to Prostar Energy Infrastructure Fund II, which invests in global, mid-market midstream energy infrastructure.

Mr. Canavan stated that, with the temporary reduction in energy demand due to the COVID-19 virus, the Saudi Arabian and Russian oil price war, and the related sell-off in midstream master limited partnership markets, now would be a good time to invest in midmarket midstream energy infrastructure. He said the Saudis would not be able to sustain this price war indefinitely without eventually expending their foreign reserves in the process; and while this is a tragic time in history given the amount of disruption in everyone's lives, there are opportunities that will arise in the next 12-24 months because of Saudi behavior.

Mr. Canavan said two of its founders, Steve Bickerton and Dave Noakes, lead Prostar. Mr. Bickerton is former Chief Executive of Challenger Infrastructure Fund and has a long history with energy investments.

Ms. Spyratos stated that this investment would be the eighth GP relationship in the Infrastructure portfolio and the 14th fund commitment, including re-ups with existing managers. ERB staff and Caledon have spent time reviewing the pacing plan for Infrastructure allocation, and this fund commitment will allow them to maintain that allocation level in the plan as some of the earlier fund investments reach maturity and begin to return investor capital.

Ms. Spyratos stated that Prostar is an independent firm headquartered in Sydney, and the founders have extensive experience in this space. Prostar began investing in 2015, and while it is still a bit early, Fund I is showing very strong performance. Prostar II intends to invest in 8-10 global midstream energy assets (through 3-4 platform investments). Consistent with the Fund I strategy, it will focus on investments located in key energy and logistics hubs. They invest across the midstream value chain, namely in gathering/processing, transmission, storage, LNG, and distribution. The fund is targeting a gross IRR in the 15-18 percent range, a 2x MOIC, and a 4-6 percent annual cash yield.

Ms. Williams provided an overview of Prostar, the team, operating partner model, and due diligence process.

Chairman Goff asked if there is any impact from the Saudi Arabia-Russia oil price war and the challenge of fracking in the American Southwest. Ms. Spyratos responded that what differentiates

Prostar's strategy from that of typical midstream assets in the U.S. is that Prostar is extremely flexible in terms of being in very critical locations across global energy hubs where the flows of some of these hydrocarbons are taking place. As an example, if they have a storage terminal, they have the flexibility to accept and store hydrocarbon flows from all different places; so to the extent that the energy demand around the globe continues, these infrastructure assets are the method by which these flows happen. She said the natural gas coming out of the U.S. would be flowing into Asian markets, which is where the next demand is expected to come from.

Cofounders Steve Bickerton and Dave Noakes introduced themselves and made a presentation.

Mr. Jacksha asked how much of the return typically comes from the proceeds of a sale. Mr. Dickerson responded that, once they have delivered their value-add strategy, they would expect their yield to be between 5 and 7 percent.

Mr. Jacksha noted that, in the near term, leverage hasn't been as available as it has been previously. He asked Mr. Dickerson how that would affect their fund should this continue. Mr. Dickerson responded that their portfolio is about 50 percent leveraged right now, and for the core infrastructure funds they would expect to be at the very low end of leverage. They always look to ensure that they have long-term debt in place so they don't expose themselves to refinancing an asset during a difficult time.

[Messrs. Bickerton and Noakes signed off.]

Mr. Jacksha stated that, as was the case in 2008, some of the best companies or opportunities come out of very bad markets and a bad environment. That is the case here where as assets re-price, the ERB wants somebody who is experienced in this market and knows how to take advantage of that.

Mr. Magid moved that the Investment Committee approve a commitment of $50 million to Prostar Energy Infrastructure Fund II 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. 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 Prostar Energy Infrastructure Fund II should they become available from time to time. Chairman Goff seconded the motion, which passed unanimously.

4. <u>CROW HOLDINGS REALITY PARTNERS IX – REAL ESTATE</u>

[Presenters: Mark Canavan and consultant Steve Gruber, Hamilton Lane]

Mr. Canavan presented staff's recommendation for a $50 million commitment to Crow Holdings Realty Partners Fund IX. The ERB is invested in Funds VI and VII, and skipped Fund VIII in lieu of making an investment in Crow's Retail (strip center) strategy. Since-inception net returns for the three funds are, respectively, 10.82 percent, 13.06 percent, and 6.47 percent. He stated that Crow is seeking to raise $1.5-$2.0 billion in Fund IX and the general partner (Crow Family and Crow Holdings) is investing $100 million alongside investors, an impressively large GP commitment that would be 5 percent of a $2 billion fund.

Mr. Canavan said the Fund IX portfolio will target multifamily housing, industrial properties, grocery-anchored retail centers and niche property types, including manufactured housing, convenience & gas centers, car washes, self-storage, student housing, and senior living. While Crow has the ability to acquire land, hotel and traditional office assets, such exposure is expected to be minimal, with the primary focus on acquisition and repositioning of well-located multifamily properties and development of Class-A warehouses. He said Crow believes it can add value working with operating partners to execute various active, yet light, asset-repositioning initiatives that grow and stabilize property-level income and through development at attractive relative yields.

Mr. Gruber stated that Hamilton Lane likes Crow's focus and bias toward acquisitions in this current fund, which focuses at properties that are less affected after the current environment reverts to the new normal. Less-affected properties include industrial and multifamily. Crow focuses on small properties in the $10-$50 million range with an average deal equity commitment of roughly $15-$20 million, creating a highly diversified portfolio with 100+ properties. He commented that the small property focus is a key differentiator – coincidentally this was not planned – given that institutions recently have been using less leverage on acquisitions. As an example, core real estate funds are financed in the 20-25 percent range, but the majority of people who own these small assets are retail investors who tend to use higher leverage, which was never calibrated for the downside scenario being experienced today. This could create more distress for the owners and result in a favorable acquisition environment for Crow.

Mr. Jacksha said this is the fourth investment in Crow for the ERB, and Crow is a group that Mr. Canavan and Mr. Gruber know very well. Mr. Canavan noted that, because of its prior relationship with Crow, the ERB will continue to have a seat on its limited advisory committee at the $50 million level, although the breakpoint is $100 million. He added that Crow Fund is seen as a "steady Eddie" in the industry that isn't designed to hit home runs but rather to consistently make singles and doubles in investments with a level of lower risk and less volatility. This lower more diversified, lower risk profile offsets some of the higher returning, higher volatility investments in the portfolio.

Mr. Magid moved that the Investment Committee approve a commitment of $50 million to Crow Holdings Realty Partners IX for the Real Estate 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 Crow Holdings Realty Partners Fund IX should they become available from time to time. Chairman Goff seconded the motion, which passed unanimously.

5. <u>NEPC INVESTMENT CONTRACT – PRIVATE EQUITY</u>

Mr. Neel said this is the next step in the ERB's Centers of Excellence initiative, which was designed to disaggregate the private equity consulting construct the ERB has in place and to focus with groups that have deep domain experience in different strategies or geographies. These opportunities are growth and leverage buyout (BlackRock Private Equity Partners); distressed and special situations (Banner Ridge); venture (Top Tier Capital Partners); and European (Aberdeen Standard).

Mr. Neel reviewed his memorandum to the committee, recommending a contract of $100,000 with NEPC for private equity consulting services. NEPC will provide strategic planning and performance reporting, which were duties the firm provided for the ERB from 2009 to 2015.

Mr. Neel reviewed a high level pro forma with regard to the expenses associated with the Centers of Excellence initiative, which reflected significant cost savings for the ERB.

Mr. Martin presented slides detailing NEPC's proposal.

Mr. Jacksha commented that NEPC has been a good partner for the ERB, and he was certainly in favor of this contract.

Mr. Magid moved that the Investment Committee approve a contract with NEPC for Private Equity consulting services. The annual cost of the contract is $100,000 with a 2 percent annual inflation adjustment. The contract is 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. Chairman Goff seconded the motion, which passed unanimously.

6. OTHER REPORTS AND DISCUSSION

Bob discussed recent volatility in the market because of the COVID-19 virus. He stated that, on June 30, the fund had $13.8 billion in assets, which is now down about $1.4 billion after discounting about $330 million made in contributions during that period, which equates to a drawdown of about 10 percent. In the same time period, equity markets are down about 20 percent, the S&P 18 percent, and emerging markets 22 percent. The priority is to pay benefits to the members every month, which the fund is well positioned to do. He discussed strategies and buying opportunities under current market conditions.

Ms. Goodwin said a notice would be posted on the ERB webpage stating that, even in this volatile investment time, all members' retirement benefits are safe and will be paid.

7. NEXT MEETING: THURSDAY, APRIL 16, 2020

The meeting was scheduled at 1:00 p.m.

ADJOURN

The meeting adjourned at 3:35 p.m.

H. Russell Goff, Chairman