

ACTION SUMMARY

INVESTMENT COMMITTEE

August 24, 2017

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MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD

INVESTMENT COMMITTEE

August 24, 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
Mr. Bob Jacksha, CIO
Mr. Steve Neel, Deputy CIO, Alternative Investments
Mr. Mark Canavan, Real Assets Portfolio Manager
Mr. Aaron Armstrong, Portfolio Manager
Mr. Ian Oldham, Investment Analyst
Ms. Kay Chippeaux, Deputy CIO, Public Markets and Credit
Mr. Alan Myers, Portfolio Manager
Ms. Rita Lopez, Financial Analyst
Mr. Rod Ventura, General Counsel

Others Present:

Mr. Kevin Tatlow, Top Tier
Mr. Steve Gruber, RAPM
Mr. Howard Kaplan, RAPM
Mr. Allan Martin, NEPC
Mr. Chris Hill, NEPC
Mr. Asif Hussain, Caledon
Mr. Pav Lamba, Caledon
Ms. Judith Beatty, Recorder

b. Approval of Agenda

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

c. Approval of Minutes of 7/20/2017

Ms. Cameron moved approval of the July 20 minutes, as submitted. Mr. Magid seconded the motion, which passed unanimously by voice vote.

d. Introduction of Guests

Chairman Goff welcomed staff and guests.

2. REAL ESTATE AND REAL ASSETS POLICY REVISION

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

Mr. Jacksha said the NMERB previously had three policies, one covering infrastructure, a second covering natural resources, and a third real estate. Mr. Canavan, Mr. Gruber and Caledon have worked together to do some consolidating.

Mr. Canavan described formatting changes, and highlighted the real estate and real assets investment policy changes.

These included:

Real Estate

-- The RE target exposure was updated to 7 percent from 5 percent, and policy range to 0-14 percent from 0-10 percent.

-- Core, Value Add and Opportunistic Property Type descriptions were expanded for "residential" investments. In the revised policy, the residential term is eliminated and two separate categories for "multifamily" and "senior housing" were created.

-- "Commercial Mortgages" was eliminated as a Risk Type category. Categories in the new version are Core, Value Add, Opportunistic, and Public Real Estate Securities.

Real Asset

-- Consolidation of the Natural Resources and Infrastructure investment policy statements into Real Assets Investment Policy Statement.

-- A provision for staff and the consultant to reconcile discrepancies between ERB internal and/or external records and manager reports was revised.

- Consolidation into a single Real Assets CPI+4% benchmark. [Note: the consultant's report reflected CPI+5%. Mr. Martin pointed out that the board had approved a benchmark of CPI+4% instead of 5% because of shrinkage in the lower markets.]
- Property type exposure range maximum for energy was raised from 40 percent to 50 percent to better accommodate the range of opportunities (upstream and midstream) in this investment type.
- Geography references to northern and southern hemisphere was changed to U.S. and non-U.S.

Ms. Cameron moved that the Investment Committee recommend the board approve the revised Real Estate and Real Assets policies as revised in today's discussion. Mr. Magid seconded the motion, which passed unanimously by voice vote.

3. FOLIUM AGRICULTURE – REAL ASSETS

[Presenter: Mark Canavan and RAPM consultant Howard Kaplan.]

Mr. Canavan presented staff's recommendation of a \$30 million investment in Folium Agriculture Fund. He said several macroeconomic themes make global agriculture an attractive investment sector in the current environment:

- Ongoing economic growth of emerging market economies supports long-term, fundamental demand for sustainable food supplies.
- Permanent crops have a fundamentally different supply dynamic than row crops that makes them more attractive for long-term investment.
- There is an opportunity to provide either growth or redevelopment capital to undercapitalized farming operations worldwide.
- Global supply chains are becoming increasingly important as consumers demand year-round access to their favorite produce.

Mr. Canavan said Folium Capital is a strong manager with a global agriculture strategy that will effectively complement NMERB's existing exposure in the ag space. The firm is seeking to raise \$250 million for its first institutional fund, which will focus on opportunities around the world in jurisdictions where the team has experience. Folium was founded by Alvarro Aguirre, Andy Wiltshire and Oliver Grantham. The majority of the team worked together at Harvard Management Company, where they invested directly in 35 global platforms with local operators, and the team has deep experience across many crop types.

Mr. Canavan said Folium's primary focus would be on assets in premier growing geographies that are suffering from financial or operational distress. Folium will primarily focus on 12 preferred crop types that they expect to benefit from attractive supply and demand dynamics over a 10-15 year investment horizon. The fund is targeting a 10-13 percent net IRR.

Mr. Kaplan added that the key strategic themes being employed are that they recognize the importance of being the low cost per-unit producer in the commodity production business; the strategy recognizes that emerging economy growth and desire for healthy diet is driving more demand into

higher value add products; the climatic conditions necessary for producing permanent plantings is a very scarce resource; and because of their experience from the Harvard Management days, the management team has the experience, contacts and expertise to execute.

Chairman Goff noted that this is their first fund, and asked what staff and the consultants considered in the due diligence process. Mr. Canavan responded that they spoke to business partners they had and investment groups they have dealt with.

Mr. Kaplan stated that, when the team was at Harvard, they retained him through Farmvest, Inc., of which he is founder and president, to look at their properties in Chile and to how to improve them to the best permanent plantings. In doing so, he met with their property management there and spent several days with them. At that time, he was able to observe their approach and how they evaluated and executed, and was very impressed with their team in Chile. He said Folium would be working with this same team as part of their first time fund strategy.

Folium management team members Alvaro Aguirre, Andy Wiltshire and Oliver Grantham appeared before the committee and made a presentation.

Mr. Jacksha asked how Folium approaches the issue of water rights, inasmuch as they are dealing in foreign jurisdictions. Mr. Aguirre responded that water is considered a public good in most countries, and is essentially owned by governments. In those countries, a government will approve a long-term concession on the use of water provided it is used as intended. There are a handful of countries, including the Western U.S., that allow private ownership of water. Australia and Chile are two other key examples of this. In the case of long-term concessions, returns come from optimizing the value of the water, which is granted for very little cost. In Peru, for example, water is very inexpensively leased because it is largely desert, the government wants to see it used, and they are currently creating an irrigated valley with infrastructure. In the case of countries where water is private property, there are also opportunities to optimize the use of water. Most opportunities are in areas where rainfall is sufficient to have a crop, so the water is not as efficiently priced as in Southern California, for instance. Folium is mostly concentrated in areas where rainfall is sufficient and can improve yield reliability over time.

Ms. Cameron asked what involvement Folium has in conservation requirements. Mr. Grantham responded that Folium feels it is very important to be third party certified, and will work with Global Gap and Rain Forest Alliance to get agricultural certification. This allows them to have someone do checks on the local operators and companies Folium has set up to see that standards are being met.

Responding to Mr. Jacksha, Mr. Aguirre said they have current investments in Chile, and plan to remain there. They are also working on projects in California. He said they will likely be in Australia, as they have been there in the past, and in Portugal and Spain.

[Representatives left the meeting.]

Mr. Jacksha said he finds this team to be very impressive. As far as a first time fund, it is the first time they have done this in a fund format, but this is not the first time this team has executed these strategies. He added that this is a long-term fund, as is the NMERB. His biggest concern is the J-curve, but that is somewhat mitigated by buying producing properties. He said he was quite satisfied with their responses to his question about water.

Ms. Cameron moved that the Investment Committee approve a commitment of \$30 million to Folium Agriculture Fund I, L.P. for the Real Assets 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.

4. STONEPEAK INFRASTRUCTURE PARTNERS III – INFRASTRUCTURE

[Presenters: Mark Canavan and Caledon consultants Asif Hussain and Pav Lamba]

Mr. Jacksha said the NMERB was one of the foundational investors in Stonepeak I, and subsequently invested in Stonepeak II. Both investments have gone very well for the NMERB along with providing some very good co-investment opportunities. Because this is a repeat investment, the manager is not present.

Mr. Canavan and Mr. Hussain presented staff's recommendation of a \$50 million investment in Stonepeak Infrastructure Partners III. He said the NMERB helped anchor and restructure their first fund so they could raise capital in their first offering in 2012.

-- Stonepeak III is targeting \$5 billion of investor commitments with a \$7 billion cap.

-- The fund will focus on control positions in attractively priced downside-protected transactions with equity tickets between \$100 million and \$1 billion per investment in infrastructure assets, predominantly in the U.S. and Canada.

-- This is a 12-year fund with three one-year extensions possible, with a five-year investment period. They are targeting a gross IRR of 15 percent and a net of 12 percent. Fund I currently has a 13.4 percent net IRR, and Fund II is at a 32.7 percent net IRR, although these initially high numbers are expected to fall back into the targeted range.

Responding to Mr. Jacksha, Mr. Canavan said this fund is relatively bigger partly because Stonepeak didn't have enough capital to execute on some of their bigger deals and had to bring in partners to complete them.

Mr. Hussain said the fund is very highly in demand, and while their target is \$5 billion, Caledon is reasonably confident that they will reach \$7 billion based on the size of some of their institutional commitments. Caledon was concerned about strategy drift, investment pacing, and co-investment potential; but after working with the team and looking at the historic transactions they've done, Caledon became comfortable with this larger fund size. In terms of strategy drift, while Stonepeak originally marketed themselves as a midmarket fund, Caledon doesn't see this as being in one particular bucket. Stonepeak is a very opportunistic buyer; while the market will pay 15 to 20 times for an infrastructure asset, Stonepeak will not go above 10. Caledon sees this as downside protection because it is easier to maintain targeted returns. With respect to investment pacing, Mr. Hussain said NMERB made its last commitment to Fund II in late 2015, and because Stonepeak was able to find transactions

of \$500 million to \$700 million each, they were able to deploy the entire fund and return to the market with Fund III. In terms of the co-investment potential, the larger fund size will help them to do deals and syndicate down as co-investment to their LPs.

Mr. Hussain also said Stonepeak has only had two realizations in their portfolio, but the valuations are fairly consistent with what they should be on a multiple basis and return basis, and they do expect to start selling assets. By the time Fund III is deployed, Fund I should be mostly returned.

Mr. Lamba discussed investment returns in the Fund I and Fund II portfolio.

Mr. Jacksha said Stonepeak has been a good partner for NMERB and he would like to continue that relationship.

Mr. Magid moved that the Investment Committee approve a commitment of \$50 million to Stonepeak Infrastructure Fund III, 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. 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. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

[Break.]

5. BRIDGEWATER CONTRACT – GTAA AND RISK PARITY

[Presenters: Steve Neel and NEPC advisor Allan Martin.]

Mr. Neel said the Investment Services Procurement Policy requires staff to bring open-ended contracts back to the Investment Committee every four years. In September 2017, two Bridgewater commitments, their All Weather and Pure Alpha products, will reach the four-year threshold.

Mr. Neel said the NMERB has had a long and productive history with the Bridgewater organization, with its original commitment dating back to 2009. At the current time, the NMERB has \$700 million in committed capital to Bridgewater products, with \$421 million in the All Weather strategy. He said the All Weather strategy is to construct a diversified portfolio with allocations to four economic environments (rising growth, falling growth, rising inflation and falling inflation). Risks across the platform are equally allocated to all four environments, and the strategy does not rely on correlation between asset classes, and its target rate of return is 600 basis points above cash.

Mr. Neel said the NMERB has \$276 million invested in Pure Alpha, which is a fundamental systematic global macro hedge fund that trades a diversified universe of over 125 liquid markets on both a directional and spread basis. In general, Pure Alpha is attempting to capitalize on material mispricing in value rather than small deviations from fair value.

Mr. Neel said staff is recommending the NMERB approve the continuation of the investment contract with Bridgewater under both contracts. The investment structure provides for liquidity with a 30-day notice.

Mr. Martin said Bridgewater is the largest firm in the industry and NEPC is very comfortable with them.

Ms. Cameron moved that the Investment Committee authorize the continuation of the Bridgewater All Weather and Pure Alpha contracts for an additional four years, 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.

6. TPG GROWTH FUND IV & RISE FUND I

[Presenters: Steve Neel, Aaron Armstrong and Top Tier advisor Kevin Tatlow.]

Mr. Neel reviewed an NMERB peer group analysis for TPG Growth. He said NMERB has established a cohort group for all of its core relationships, which it has found far more efficient than the past practice of holding very time-consuming workshops when considering re-ups with existing funds. With a cohort, they are able to determine whether they have the “best in breed” general partner among the cohort groups; if not, they step back and undergo a detailed analysis. He commented that this has streamlined the process and deepened the engagement that the NMERB has in the marketplace, as well.

Mr. Neel presented staff’s recommendation of a \$100 million commitment to TPG Growth Fund IV, which is a recommitment to an existing relationship; and \$25 million to TPG Rise, which the NMERB views as an extension of TPG Growth platform. Rise is a social impact fund and is underwritten and managed by the TPG Growth team, which is one of the best investment teams in the business.

Mr. Neel commented that there are other social impact funds out there; for instance, Bain Capital has a social impact fund. He added, though, that TPG Growth has already done this type of investing in the past, and it has had companies with Rise Fund characteristics in their portfolios; so they are not actually doing anything new other than adding some additional metrics to it. He added that, while Rise is under a separate banner, staff views this as a way to get more exposure to one of the NMERB’s best-performing GPs.

Mr. Neel noted that NMERB has committed about \$525 million to growth-focused general partners to date, which has generated an 18+ percent IRR since inception. It is the NMERB’s best performing subsector and it has added over \$160 million in value since inception.

-- TPG is raising \$3.0 billion for Fund IV to serve as the primary TPG investment vehicle for small and middle-market growth equity and buyout investment opportunities requiring an equity commitment of \$50 million to \$125 million.

-- TPG is also raising \$1.5 billion for Rise, L.P. to serve as the primary TPG investment vehicle for early and growth-stage businesses that produce goods or services that help address significant societal challenges and that have a measurable positive social impact. Average equity commitment for Rise will be \$50 million to \$75 million.

-- Both funds are targeting competitive private equity returns and will seek the most attractive opportunities on a global basis. Both funds expect to benefit from the diverse investing and operational skills across a team of 39 investment and 14 operational Growth platform professionals.

-- Rise will source and invest globally but is expected to include more exposure to developing markets than Fund IV. Rise will primarily target investments in education, energy access, financial services and healthcare. Secondary areas of focus may include food and agriculture, growth infrastructure, and information and communications technologies.

-- Rise will use the Growth team's expertise, an advisory board comprising global thought leaders and strategic partners that include Elevar Equity Management Ltd., a premier human-centered venture capital firm with a long track record of successful impact investing. Rise will have the opportunity to co-invest alongside Elevar's early stage transactions with equity investments of less than \$10 million, but will retain full investment discretion with respect to Elevar investment and will apply operational resources as deemed appropriate to support the growth of these businesses.

Mr. Armstrong discussed TPG Growth's track record. Net returns to date for TPG Growth II (2011) are 28.1 percent, and for TPG Growth III (2015) are 17.5 percent. With respect to Rise, there have been three investments to date totaling \$150 million. Each of these investments is within the Impact mandate and is performing as expected.

Mr. Tatlow commented that it is unusual to see this much operational resource and team applied to investments of this size. In addition to TPG's impressive track record, there is tangible value creation. In Fund II, nine of the deals are currently realized above 2x invested capital and four are held above 5x.

TPG Growth founder and managing partner Bill McGlashan, Jr. joined the meeting by telephone. Also present was Impact partner Maya Chorengel and TPG Growth representative Katie Brill, who made a presentation.

[Mr. McGlashan signed off and Ms. Chorengel and Ms. Brill left the room.]

Ms. Cameron moved that the Investment Committee approve a commitment of \$100 million to TPG Growth Fund IV, L.P. 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 from time to time. Mr. Magid seconded the motion, which passed unanimously by voice vote.

Mr. Magid moved that the Investment Committee approve a commitment of \$25 million to The Rise Fund, L.P. 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 from time to time. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

7. SMALL/MID-CAP EQUITY MANAGEMENT

[Presenters: Alan Myers and NEPC advisor Allan Martin.]

Mr. Myers presented staff's recommendation to terminate the investment management contracts with the two small/mid-cap investment managers and to begin internal passive management of those assets against the S&P 400 Index. He noted that, while the Investment Services Procurement Policy does not specifically address this type of recommendation, staff is seeking approval for the change in strategy to manage these assets.

-- The current portfolio has two active investment managers in the SMID asset class: Lord Abbett, which runs a value oriented strategy, and Pinnacle, which invests based on a growth oriented strategy. Both approaches are based on the Russell 2500 Index.

-- Lord Abbett and Pinnacle manage approximately \$300 million, divided almost equally, which is 2.4 percent of the total portfolio.

-- After an extensive evaluation of the pros and cons of being active or passive in this space, staff has determined that moving from active management to a passive investment is a prudent decision. Both managers have not generated consistent excess returns over the passive benchmark. Additionally, the fees associated with these investments have not justified their use.

Mr. Martin reviewed the performance of Lord Abbett versus the 2500 Value Index, reflecting significant underperformance for a fairly long period of time. While Pinnacle has done a little better than Lord Abbett, the outperformance has not been consistent. He said NEPC has generally felt that it is very difficult for large cap managers to outperform. While mid-cap and small-cap is a less efficient market, it is possible find managers who outperform. However, that has not proven out with the NMERB; and with fees, it has not proven to be a value added strategy. He said NEPC is very supportive of staff's recommendation to look for other areas where the NMERB can add value and indexation in this space.

Mr. Myers noted that the current cost for management of the portfolio, along with the fee paid for custody services, is about \$1.5 million annually. Staff looked at two management options for passive management. An external manager will cost \$60,000 to \$240,000 per year, while the cost for internal management, including benefits, would be about \$25,000. This expenditure will cover the time required of the portfolio manager and the financial analyst. The fee paid to the custody bank for either option would be slightly less.

Mr. Myers said that, after analyzing possible indexes, NEPC and staff feel that the S&P 400 Index would be the best index because it requires fewer stocks to invest in and has less volatility.

Mr. Magid moved that the Investment Committee approve the termination of the Small/Mid Cap equity investment management contract with Lord, Abbett & Co., LLC, in accordance with the terms of the contract. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

Ms. Cameron moved that the Investment Committee approve the internal passive management of the current U.S. Small/Mid Cap equity allocation against the S&P 400 Index. Mr. Magid seconded the motion, which passed unanimously by voice vote.

Mr. Jacksha said no motion was needed to terminate the Pinnacle contract, as it expired on November 7.

8. OTHER REPORTS AND DISCUSSION

CLOs

Ms. Chippeaux stated that, at the June board meeting, Amanda Karlsson from NEPC did a presentation on CLOs and CLO equity investments. Following that, the board generally agreed that the Investment Committee should have further discussion and then report back to the board. She noted that staff is interested in discussing CLO equity investments with some of the existing opportunistic credit managers who are also CLO managers, and also wants to use the resources from NEPC with Ms. Karlsson, who has a lot of current information on that market and knows a lot of other CLO managers the NMERB is not in contact with.

Ms. Chippeaux said staff also wants to start looking at risk retention vehicles in the CLO space. Under Dodd-Frank, CLO managers are required to retain some of the risk in every deal by holding 5 percent of the value of the deal in some form. Because of this, an increasing number of CLO managers are retaining the CLO equity in these risk retention vehicles and are now the primary source of investing in CLO equity.

Ms. Chippeaux said GoldenTree, of the CLO managers, has also done a lot of work in risk retention and believes the risk retention rules have made CLO managers and their structures more efficient and stronger. In talking with GoldenTree, GoldenTree specifically addressed the NMERB's separately managed account, which does not authorize them to invest in CLO equity. If the NMERB wants to pursue this, GoldenTree suggested that the NMERB consider changing the investment guidelines or else investing in shares of risk retention vehicles. GoldenTree marketed their risk retention vehicles last year and raised \$600 million, which they use for warehousing the loans before they go into the CLO, to help with the structure of the CLO, for risk retention, and to help market some of the debt of the CLO.

Committee members agreed that staff should investigate more CLO equity investing, the different vehicles and managers that are available, and to leverage the resources of NEPC to move forward on this. At a later date, staff will bring managers to the committee, perhaps changing the mandate of a current manager or bringing a new manager into this space. The Investment Committee would then give final approval.

Mr. Jacksha said GoldenTree would be invited to address the committee and respond to questions later this year.

LFC

Mr. Jacksha distributed a paper he had prepared in response to a question raised at a recent LFC hearing in Taos regarding whether the ERB invested in any New Mexico businesses and projects. He noted that the ERB's external investment managers have invested nearly \$1.3 billion, the majority in energy-related sectors. Of that total, \$82.62 million is from ERB capital: \$38 million in oil and gas pipelines, \$26 million in banking, and \$9.5 million in oil and gas production.

Diversifying assets – “other”

Mr. Jacksha reported that he and Mr. Neel, along with NEPC advisors Allan Martin and Chris Hill, met today to talk about the diversifying assets “other” category, and Mr. Neel is leading the effort on looking at strategies and managers.

Mr. Neel said that, in August 2016, assets were added to the GTAA portfolio. This was an additional 5 percent; and in conjunction with NEPC and another consultant, staff has done a lot of legwork in bringing some commitments forward. The first should be brought forward at the October meeting.

Mr. Neel discussed litigation financing, a new category that staff is looking into.

Retreat

The committee and staff discussed possible topics for the retreat. Dr. Ben Hunt (Salient) will be invited to give a talk.

9. NEXT MEETING: THURSDAY, OCTOBER 19, 2017

The September 21 meeting was canceled.

The next meeting was tentatively scheduled for 1:00 p.m.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 4:20 p.m.

Accepted by:



H. Russell Goff, Chairman