ACTION SUMMARY

INVESTMENT COMMITTEE

January 19, 2017

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MINUTES OF THE

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

INVESTMENT COMMITTEE

January 19, 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 [by phone]
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
Ms. Rita Lopez, Investment Financial Analyst

Others Present:
Mr. Kevin Tatlow, Top Tier
Mr. Steve Gruber, RAPM
Mr. T.C. Rolfstad, RAPM
Ms. Judith Beatty, Recorder

b. Approval of Agenda

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

c. Approval of Minutes of 12/8/16

Ms. Cameron moved approval of the minutes of the December 8, 2016, meeting, as submitted. Mr. Magid seconded the motion, which passed unanimously by voice vote.

d. Introduction of Guests

Chairman Goff welcomed staff and guests.

2. MARLIN EQUITY V AND HERITAGE FUND II – PRIVATE EQUITY

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

Mr. Neel presented staff's recommendation of a commitment of up to $60 million in Marlin Equity. This recommendation is for an investment range, because Marlin Equity Fund V and their Heritage Fund II are significantly oversubscribed, and so the NMERB will be a recipient of an allocation. Staff received word yesterday from the General Partner that they have more than $4 billion in demand for both of these funds, and capacity is just under $3 billion. Staff has submitted an interest level of up to $60 million, and should know in February what the exact commitment will be.

Mr. Neel said there were no political campaign contributions. Marlin disclosed that they used Credit Suisse as their placement agent in this transaction; and because this was a universal contract, there was no opt-out provision.

Mr. Neel stated that NMERB has received representation from Marlin that the cap on the fund size will be $2.5 billion. He said Fund IV was capped at $1.6 billion. Heritage II is capped at $750 million, and the prior fund was capped at $412 million. He said these are manageable fund sizes.

Mr. Neel stated that, during 2012-2013, the NMERB held a best practices session and selected general partners they considered to be "best in breed." Two names, Marlin and KPS, were identified as "best in breed" in the distressed category. Although the NMERB was unable to gain access to KPS, it proactively sought access to Marlin, and this resulted in the NMERB's commitment to Marlin Fund IV.

-- Fund V will target equity investments from $60 million to $200 million in the US and Europe in businesses with sustainable operations, predictable revenue streams, scalable cost structures, and underutilized assets.

-- Marlin is simultaneously targeting $500 million for Marlin Heritage II, which follows the same investment approach, but is focused on smaller businesses requiring under $60 million of equity investment.

Mr. Tatlow said Top Tier does not see many funds with a realized track record; in this case, Marlin's realized track record gross is more than 4X. He commented that this was "unbelievable," noting that they have had only one realized loss in their history.

Mr. Tatlow said Marlin employs more than 42 investment professionals and 27 operational professionals.

In looking at a graphical view of all the deals and multiples over time for the Marlin funds, Mr. Jacksha noted that the deal size gets progressively larger between Funds I and IV, as can be expected. He asked Mr. Tatlow if he expects deal sizes will grow even larger with Fund V; and if so, is there any concern about that. Mr. Tatlow responded that it seems like the deal size will not be much above $200 million and they are still middle market focused. They do not see dramatic shifts to going up-market.

Mr. Jacksha asked the committee to approve staff's recommendation. This is a manager the NMERB has invested with before, and it has done as expected so far.

Mr. Magid moved that the Investment Committee approve a total commitment of up to $60 million to Marlin Equity V, L.P. and/or Marlin Heritage Fund II, 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 $20 million, in secondary partnership interests offered by other limited partners in the funds, should they become available.

Ms. Cameron seconded the motion, which passed unanimously by voice vote.

3. HAMMES PARTNERS III – REAL ESTATE

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

Mr. Canavan presented staff's recommendation of a $30 million commitment in Hammes Partners III, a Medical Office Buildings ("MOB") strategy in real estate. Hammes acquires and develops MOBs, serving the rapidly growing US healthcare system. He said strong demographics drive demand for the MOBs that Hammes acquires and develops. Given increasingly complex and burdensome regulations on one side of the equation, medical practitioners continue to leave private practice and aggregate in favor of large corporate practices with economies of scale. These larger institutions require larger facilities and a larger real estate footprint. At the same time, hospitals are moving their outpatient services to locations outside of the hospital environment and into surrounding communities, as outpatient services within the main hospital building are grossly cost inefficient due to overhead, and these outside locations are more convenient for the users.

Mr. Gruber presented highlights from RAPM's report:

-- In 2013, NMERB committed $50 million to Hammes Partners II, a $437.9 million value-add fund targeting the acquisition and development of MOB properties throughout the US.

-- The team has grown a little bit since Fund II, the property flow has been what was expected, and the investments made are consistent with their original objections. They have closed on 20 transactions in Fund II. There have been 15 realized deals with no losses.

-- As of September 30, 2016, Fund II has invested $247.3 million with a projected 14.2 percent gross IRR and a 2.4x MOIC. Given Hammes' advanced pipeline of investments, which RAPM believes will result in Fund II being fully committed in early 2017, in Q4 2016 Hammes began marketing its successor fund, Hammes Partners II, with a fundraising target of $600 million. The fund will utilize the same investment strategy as Fund II.

-- The firm used Probitas Partners as placement agent.

Mr. Jacksha commented that, in terms of pacing, while he usually advocates for larger commitments, in this case the NMERB will still be investing in Fund III for some time while Fund II will not have much in the way of realizations, so exposure will be higher. With a smaller-than-usual investment in Fund III, the NMERB will be in a better position to participate in Fund IV down the road.

Responding to Ms. Cameron, Mr. Canavan said there are risks in the medical office space given the dynamics of shifting regulations. In terms of whether this is more risky than what the NMERB normally does in this space, Mr. Gruber said the one thing that is different about Hammes is that they have affiliates; so Hammes Healthcare is an affiliate. He said there is a potential conflict where they could be advising on the buy side and the RAPM could be the investing on the "sell side" of this transaction, but RAPM thinks that it is a strategic advantage in that Hammes is in a better position to pick the winners in future markets.

Mr. Jacksha commented that, in effect, Hammes has inside information, but these are private investments and therefore do not present any legal concerns. He agreed that it is a good thing to have a competitive advantage that way. Mr. Gruber said some people see this as a risk, but RAPM sees it as a risk mitigator.

Mr. Gruber said Hammes' other affiliate is a property manager, and RAPM thinks that relationship is really important. One would not want to have a third party in the middle intermediating the private nature of this information flow that Hammes is able to capture through healthcare consulting, property management, and the fund. He added, "So we have to do a diligent job, and that's why it's important for Mark to be on the advisory board for a fund like this, where there are these affiliate relationships and conflicts of interest, and that's where those topics are addressed." Mr. Canavan commented that these are reported to the advisory committee, and added that government regulation will continue to be "a wind at their backs" as outpatient and ambulatory centers are located in local communities.

Mr. Jacksha said one of the attractive things about Hammes is that it is a specialty group in real estate, and they have demonstrated their expertise in this niche.

Mr. Magid moved that the Investment Committee approve a commitment of $30 million to Hammes Partners III, L.P. 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 fund, should they become available from time to time.

Ms. Cameron seconded the motion, which passed unanimously by voice vote.

4. Q4 2016 PROXY REPORT

Mr. Jacksha reviewed the Proxy Report.

Ms. Cameron moved for approval. Mr. Magid seconded the motion, which passed unanimously by voice vote.

5. Q4 2016 COMMISSION REPORTS

[In the packet as an informational item.]

6. OTHER REPORTS AND DISCUSSION

Mr. Jacksha stated that staff is in discussions with Foster Pepper in terms of how the NMERB's placement agent policy is to be interpreted with respect to a recently approved secondary partnership transaction.

Mr. Jacksha stated that NEPC's contract comes due in September 2017, and said he would like to place it on the February board agenda for discussion.

Mr. Jacksha said the NMERB is still actively recruiting for two positions, and SPO has said the NMERB may not post the two new positions until the first two are filled. He said the NMERB recently identified a very good candidate, but that individual said he was not interested because of the salary. Mr. Jacksha said salary continues to present an obstacle.

7. NEXT MEETING: THURSDAY, MARCH 23, 2017

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

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 2:15 p.m.

Accepted by:

H. Russell Goff

H. Russell Goff, Chairman