

ACTION SUMMARY

INVESTMENT COMMITTEE

June 22, 2017

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MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

June 22, 2017

1. a. Call to Order – Quorum Present

A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at 12:00 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. Mark Canavan, Real Estate Portfolio Manager
Mr. Alan Myers, Portfolio Manager
Ms. Kay Chippeaux, Deputy CIO, Public Markets and Credit
Ms. Marla Vigil, Investments Analyst

Others Present:

Mr. Steve Gruber, RAPM
Mr. Brent Burnett, RAPM
Mr. Allan Martin, NEPC
Ms. Dulari Pancholi, NEPC [by telephone]
Mr. Asif Hussain, Caledon
Mr. Aaron Vale, Caledon
Ms. Charmaine Clair for Judith Beatty, Recorder

b. Approval of Agenda

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

c. Approval of Minutes: April 20, 2017

Mr. Magid moved to approve the minutes of April 20, 2017, as presented. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

d. Introduction of Guests

Chairman Goff welcomed staff.

2. ONE WILLIAM STREET – Opportunistic Credit

[Presenters: Kay Chippeaux, with Alan Myers and NEPC structured credit research analyst Dulari Pancholi, who was attending by telephone.]

Mr. Myers presented staff's recommendation of a \$100 million commitment to One William Street Credit Opportunity Fund for the Opportunistic Credit portfolio. This investment fits into the structured credit category of the portfolio and is similar to PIMCO DiSCO II and Waterfall Eden; however, PIMCO invests at the top of the capital structure and has a large European exposure, while Waterfall has a smaller allocation to U.S. commercial real estate.

-- Based in New York, One William Street (OWS) invests in asset-based and Treasury credit securities with about \$3 billion under management.

-- The ERB's existing allocation to opportunistic credit is 19 percent, and the allocation in structured credit is 27 percent of the Opportunistic Credit portfolio; and if the recommendation is approved, the total allocation would be just short of 20 percent, with 31 percent invested in structured credit. Target allocation for the portfolio is 18 percent, and any excess would be used for cash needs.

Ms. Pancholi presented highlights:

-- One William Street Credit Opportunity Fund is a multi-sector credit hybrid product managed by David Sherr. It invests across a range of credit instruments, including whole loans and structured credit securities like asset backed securities, residential mortgage backed securities, commercial mortgage backed securities, collateralized loan obligations, and collateralized debt obligations. The fund takes a medium-to-long-term view for its investment horizon but anticipates making short-term tactical adjustments in reaction to existing market conditions.

-- The fund has demonstrated strong performance since its inception in January 2011. As of Q1 2017, there was an annualized return of 10.4 percent.

-- A majority of the senior investment team worked together at Lehman Brothers, where David Sherr was Managing Director and Global Head of Securities Products.

Mr. Sherr appeared before the committee and made a presentation.

Mr. Sherr left the meeting.

Mr. Myers recommended approval of staff's recommendation. He said this will fit nicely in the opportunistic credit portfolio and complement the investments in PIMCO DiSCO II and Waterfall.

Mr. Jacksha commented that one of the attractive things about their strategy is the flexibility, as they've talked about moving to different areas, supplying different amounts of leverage and adapting to what the market opportunity is. This is an attractive attribute given the changing credit markets. In addition, the team has a good deal of experience, and that is reflected in their track record.

Ms. Cameron moved that the Investment Committee approve a commitment of \$100 million to One Williams Street Credit Opportunity Fund 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. Mr. Magid seconded the motion, which passed unanimously by voice vote.

3. BROOKFIELD REIT: CONTRACT RENEWAL

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

Mr. Canavan presented staff's recommendation for a four-year investment services contract for REIT equity management with Brookfield Investment Management.

-- In 2003, NMERB authorized an allocation to real estate in order to expedite deployment into REITs and immediately gain 5 percent exposure.

-- In 2007, NMERB began investing in real estate and used the REIT bucket as a "holding tank" to add capital to private equity real estate as capital calls came in. The idea was to deplete that bucket over time and get into the private markets.

-- In 2010-2011, the NMERB commissioned a study that showed that active management of REITs would add tremendous value. After a manager search, the NMERB Board and Investment Committee approved a \$100 million investment in the Brookfield Value Income REIT, which was increased by \$60 million in 2014.

-- The four-year contract with Brookfield, which ended in 2015, was extended to July 2017. Based on research, the conclusion is that Brookfield is a very good manager and shows very good performance in the long term.

Mr. Gruber discussed the analytics RAPM used to support this recommendation. He said they reviewed 38 managers, narrowed the field down to a final four, and came back with the Brookfield recommendation. In summary, there has been no portfolio manager turnover since 2006 and no style drift, and they continue to employ a concentrated value-add approach with a relatively small portfolio when compared to their peers. In 2012, they outperformed by

800 basis points, and in 2015, they underperformed by 600 basis points. However, RAPM believes that the tradeoff for the research Brookfield is doing for a higher conviction and more concentrated portfolio will add value over time.

Mr. Jacksha said he supported staff's and RAPM's recommendation.

Mr. Magid moved that the Investment Committee approve a four-year investment services contract for REIT equity management with Brookfield Investment Management, Inc. This recommendation is subject to New Mexico state law, Educational Retirement Board policies, Educational Retirement Board approval for placement agents, negotiation of final terms and conditions, and completion of appropriate paperwork. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

4. FIVE POINT MIDSTREAM FUND III – NATURAL RESOURCES

[Presenters: Mark Canavan and RAPM consultants Steve Gruber and Brent Burnett.]

Mr. Canavan presented staff's recommendation of a \$40 million commitment to Five Point Midstream Fund III for the Natural Resources portfolio.

-- Five Point is currently raising \$650 million for this fund, which will target substantially the same strategy as the prior fund and invest in midstream energy assets that support production growth in key oil and gas basins in the continental U.S. and Canada.

-- Five Point's principals, David Capobianco and Matt Morrow, have long and successful operating histories in the North American midstream industry. Mr. Capobianco is former co-founder and co-head of the energy Private Equity Group at Vulcan Capital, and Mr. Morrow is the former President and CEO of Iberdrola Energy Holdings, Iberdrola Energy Services, and ENSTOR, one of the largest natural gas storage operators in North America.

Mr. Burnett said this is a group RAPM thinks very highly of. RAPM has been able to "get under the hood" with them on a couple of co-investment transactions with them, and have been very impressed by their ~~downside~~-structuring for downside protection and discipline in capital deployment.

-- NMERB committed \$50 million to Five Point Fund II in 2014 and has co-invested with Five Point on two separate transactions. Over the past three years, RAPM has seen Five Point build an attractive portfolio of midstream assets and generate strong risk-adjusted returns for Fund II.

--RAPM has been especially impressed with Five Point's capital discipline over the investment period in Fund II. Five Point raised Fund II in 2014, when commodity prices and midstream valuations were very high. Five Point selectively invested in a few midstream platforms with staged capital exposure and strong downside protection that has preserved investor capital over a tough cycle in the energy industry.

Ms. Cameron moved that the Investment Committee approve a commitment of \$40 million to Five Point Midstream Fund III 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. I SQUARED II – INFRASTRUCTURE

[Presenter: Mark Canavan and Caledon consultants Asif Hussain and Aaron Vale.]

Mr. Canavan presented staff's recommendation of a \$50 million commitment to I Squared Capital Infrastructure Fund II (ISQ). Fund II is targeting up to \$5 billion of investor commitments (a hard cap has yet to be established) and -will seek to invest in high quality infrastructure assets globally across the energy, utilities and transportation sectors.

Mr. Hussain noted that the current fund (Fund I)~~currently~~ has a 28.5 percent gross return and an 18 percent net return. A lot of the investments are unrealized, so this is an early days track record.

Mr. Hussain said Caledon believes an investment in Fund II is attractive for a number of reasons:

-- ISQ has a track record of successfully creating investment platforms across strategies and geographies. Platform investments benefit from aggregation of middle market assets to realize operational synergies, access debt financing on a consolidated basis, and increase exit options.

-- ISQ Fund II has developed a pipeline (about \$12.3 billion with \$2.2 billion of co-investments) largely sourced through its extensive network and joint ventures. ISQ benefits from its considerable prior experience generating exclusive transactions.

--ISQ is very good at operational value creation and risk mitigation, with a risk methodology that is quite unique and not seen in other infrastructure managers.

--ISQ believes its global strategy offers substantial opportunities across regions that are uncorrelated to each other. While a significant part of its activity will be in North America and Europe, Fund II can invest up to one-third of its portfolio in emerging economies in which they have experience and on-the-ground investment professionals. They are headquartered in New York with local teams in London, Houston, Hong Kong, Singapore and New Delhi.

Mr. Vale presented additional highlights:

--In 2014, the team was about 30 individuals, largely from Morgan Stanley. Today there are 77 staff members with plans to grow to around 100 people. Turnover is very low.

--The investment team is separated from the operations and asset management team. They use senior policy advisers who can tap into political networks and regulatory intervention, as needed. They are accessible to staff and easy to reach.

Mr. Magid moved that the Investment Committee approve a commitment of \$50 million to I Squared Capital Global 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 fund, should they become available from time to time. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

6. GOLDEN TREE: EXTENSION OF RELATIONSHIP

[Presenter: Kay Chippeaux.]

Ms. Chippeaux presented staff's recommendation of the continuation of the limited partnership agreement for GT NM, L.P., an opportunistic credit fund of one with investment management provided by GoldenTree Asset Management. The LP agreement gives the NMERB the right to terminate the partnership with 30 days' notice.

Ms. Chippeaux stated that the NMERB relationship with GoldenTree Asset Management began in 2009 as part of the fund's long-term strategic asset allocation to credit strategies, with a \$50 million allocation to the GoldenTree CLO Opportunities Fund, which was purchasing discounted CLO debt. In 2011, the fund increased the investment with GoldenTree to a total of \$100 million in a separately managed account focused on investing in CLO debt with the ability to invest opportunistically in other dislocated credit within new investment guidelines that included high yield bonds, levered loans and equity, and distressed debt. In 2013, to facilitate transactions with prime brokers, NMERB changed the separately managed account to a fund of one, renamed GT NM, L.P, with the NMERB as the limited partner and GoldenTree Asset Management as the investment manager for the fund. The most recent market value for GT NM is \$174 million.

Ms. Chippeaux noted that GoldenTree is outperforming in both the most recent one-year period as well as since inception. Cumulative since inception outperformance, net of fees, is 272 basis points over the benchmark.

Ms. Chippeaux said the recommendation is to do a four-year extension. This is not asking for a new commitment but to keep the \$174 million with GT in a continuous reinvestment program.

Mr. Jacksha said this is essentially a limited partnership structure with no end date.

Ms. Cameron moved that the Investment Committee authorize the continuation of the limited partnership agreement with GT NM, L.P. 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.

[Break.]

7. Q4 2016 REAL ESTATE AND NATURAL RESOURCES

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

Mr. Canavan discussed Hamilton Lane's purchase of RAPM. Hamilton Lane, a \$300 billion private equity generalist consultant, will acquire substantially all of RAPM's assets, and the firm's entire nine-member real asset investment team, led by Steve Gruber and Brent Burnett, will join Hamilton Lane.

Mr. Gruber said he and his team will lead Hamilton Lane's real asset business. Although they are the acquirer, this business and their staff of five will be consolidated into RAPM in Portland. He said this will allow the RAPM team to focus less on company administration and more on the investment portfolios, where client expectations continue to go up. He said Hamilton Lane is complementary to RAPM in terms of company culture and their ways of servicing clients. He said there will be no change in working with the NMERB and its other clients.

Mr. Canavan reviewed Q4 2016 returns for the Real Estate and Natural Resources portfolio.

--NMERB's long-term target allocations to real estate and natural resources at 7 percent and 4.5 percent respectively.

--Public real estate performance in the current quarter is -3.46 percent and 12.72 percent net since inception.

--Private real estate is 3.24 percent in the quarter and 10.54 percent net since inception.

--Natural resources in the quarter is 4.08 percent and 7.30 percent net since inception.

Addressing another matter, Mr. Canavan noted that the Brookfield REIT and In-House REIT combined, at 38.1 percent, exceed the 30 percent maximum allowed in the Public Real Estate Securities asset class allocation. He said the NMERB has been drawing funds from the internally managed portfolio and gradually investing in private real estate, which is part of the approved pacing plan. He said this should be back in compliance in early 2018.

Mr. Canavan additionally pointed out that, under Property Type Allocations (Core & Value Add), Multifamily is at 38.3 percent, exceeding the 35 percent maximum. He said this is because three real estate funds (Crow, Raith and Rock Point) have invested heavily in apartments, which wasn't entirely expected; however, a lot of these properties are being sold down and he expects the NMERB will be back in compliance in this allocation category in the next six to twelve months.

Mr. Canavan stated that the NMERB is non-compliant by .8 percent in the energy allocation, but that is expected to self-correct shortly.

Mr. Canavan said he plans to bring forward a proposed change to the Investment Policy to say "U.S. and non-U.S. based."

8. SMALL PURCHASE APPROVAL NOTIFICATION

Mr. Meyers stated that, in 2016, the Investment Committee changed the way it renewed small contracts. He said this is notification that the Director has approved the list of contracts. The vast majority supports operations, and the rest are about compliance or training. He said all of them fall under small investment-related purchases and are consistent with the Procurement Policy.

9. OTHER INVESTMENT REPORTS AND DISCUSSIONS

Mr. Jacksha reported that the May accounting shows a 1+ percent return for the month for a FYTD net return of around 11.3 percent.

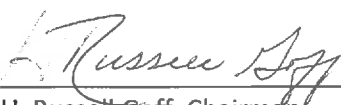
10. NEXT MEETING: THURSDAY, July 20, 2017

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, Chairman