ACTION SUMMARY

INVESTMENT COMMITTEE

December 7, 2017

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MINUTES OF THE

NEW MEXICO EDUCATIONAL RETIREMENT BOARD

INVESTMENT COMMITTEE

December 7, 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 (by telephone)
Mr. Bob Jacksha, CIO
Mr. Mark Canavan, Real Estate Portfolio Manager
Mr. Steve Neel, Deputy CIO, Alternative Assets
Mr. Mark Canavan, Real Assets Portfolio Manager
Mr. G. Alan Myers, Public Securities & Debt Portfolio Manager

Others Present:
Mr. Allan Martin, NEPC
Mr. Kevin Tatlow, Top Tier
Mr. Steve Gruber, Hamilton Lane
Mr. Brent Burnett, Hamilton Lane
Ms. Charmaine Claire for Judith Beatty, Recorder

b. Approval of Agenda

The agenda was reprioritized.

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

c. Approval of Minutes: November 9, 2017

Ms. Cameron moved approval of the November 9 minutes, as submitted. Mr. Magid seconded the motion, which passed unanimously.

d. Introduction of Guests

Chairman Goff welcomed staff and advisors and recognized Fred Rose, UNM Retirement Association.

3. BP ENERGY II – NATURAL RESOURCES

[Presenters: Bob Jacksha and consultant Brent Burnett, Hamilton Lane]

Mr. Jacksha said the NMERB made a previous investment with BP Energy's first fund, and it has been performing very well.

Mr. Burnett stated that BP Energy Fund II has a unique strategy, in that it is oriented around identifying companies that can lower operating costs from switching their fuels (from oil, diesel or recycled food oil) to natural gas. He said this is a nice complement to the other allocations in the Natural Resources portfolio because the strategy does well when commodity prices are low.

Mr. Burnett noted that the team, comprised of five very skilled individuals with strong private equity backgrounds, has been together for five years since forming BP Natural Gas Partners I. He noted that the fund is marked at a net IRR of 49 percent, but because of the active secondary capital that it has, New Mexico was able to purchase an additional share of the limited partnership and also a piece of the general partnership of this investment manager. The blended performance in this position has been very beneficial to the NMERB.

Mr. Burnett said that, since preparation of its report, Hamilton Lane has collected all of the required placement agent and campaign contribution disclosures from BP. They disclosed that there is no placement agent affiliated with their fundraise in Fund II. They had a placement agent in Fund I that retained a small residual payment in successive re-ups in the NMERB. This was disclosed in Fund I and was again disclosed in Fund II. He said they have not made any relevant campaign contributions.

Mr. Jacksha said staff and the consultants recommend approval of a $35 million investment in this fund, which has done very well.

Mr. Magid moved that the Investment Committee approve a commitment of $35 million to BP Natural Gas Partners II, 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. Ms. Cameron seconded the motion, which passed unanimously.

2. RAITH FUND II – REAL ESTATE

[Presenters: Bob Jacksha and consultant Steve Gruber, Hamilton Lane]

Mr. Jacksha said this fund has done well for the NMERB. The team remains intact.

Mr. Gruber said this is a re-up to a US diversified opportunistic real estate manager at a recommended commitment of $50 million. Raith has been investing in deep value, or opportunities that they think are mispriced, across all property types. He said sellers are often banks that have either foreclosed on the property already, or they're banks that have a non-performing or sub-performing loan, and before they take title back to the asset, they sell it to funds like Raith. The last avenue of property opportunities for them is either dysfunctional or undercapitalized investment.

Mr. Gruber said Fund II has a $400 million target. While this is nearly twice the target amount for Fund I, the team has also nearly doubled from 10 to 18 people, which Hamilton Lane feels is appropriate for this larger fund size. He noted that most of their growth has been in asset management.

Mr. Gruber said the fund is targeting returns of 12 to 14 percent at 20 percent leverage on cash on cash terms.

Mr. Gruber stated that all disclosure forms have been submitted. While Raith has used a placement agent in the past for new investors, this does not apply to New Mexico.

Mr. Jacksha said staff and Hamilton Lane are recommending an investment in Raith Fund II of $50 million.

Ms. Cameron moved that the Investment Committee approve a commitment of $50 million to Raith Real Estate Fund II 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. Mr. Magid seconded the motion and the motion passed unanimously.

4. EIG ENERGY FUND XVII – DIVERSIFYING ASSETS

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

Mr. Neel stated that, since preparation of the reports, EIG has submitted additional compliance documents disclosing that they utilized Credit Suisse as a placement agent, and also indicated that they had not made any campaign contributions.

Mr. Neel said this would be the first investment in the newly created diversifying assets class (Diversifying Assets-Other). In August 2016, the NMERB approved an allocation of 5 percent to this asset class, which is anticipated to be between $600 million and $700 million. He said the hallmark of this asset class is very low correlation to equities, but accretive to the NMERB's overall return, which is in excess of its actuarial rate of return. For this investment, staff is looking at expected returns of 11 to 13 percent.

Mr. Neel recommended a commitment of $100 million to EIG Energy Fund XVII. The NMERB has a long history with EIG, committing to Funds XV and XVI in the private equity portfolio. The NMERB also has a co-investment with EIG in the infrastructure portfolio. In total, the NMERB has more than $100 million invested with EIG. He said EIG can invest across the energy platform and they also have the flexibility to invest across the capital structure, which served them very well during the last dislocation.

Mr. Neel said EIG has investments in more than 36 countries, with deep domain expertise. They also have good corporate government and all employees partake in the carry pool.

Mr. Tatlow commented this is the third time he has worked on underwriting this firm, so is very familiar with them. He said their strategy has evolved over time, starting out as a mezzanine style lender in the energy markets but more recently (in the last two funds) focusing on larger deals with stronger partners. This is a positive trend and reduces risk. In the time the NMERB has invested in them, the team has more than doubled in size to 60.

Mr. Neel said staff and the consultants thoroughly reviewed the performance figures on both funds. Fund XVI has one fairly substantial investment in Brazil (PRUMO) for about $1 billion. It is publicly traded, and EIG is in the "ninth inning" of taking the company private. Brazil has been significantly out of favor, and that was one of the impairments in the fund's performance, which is at about 8 percent. He said the fund started out with a significant J-curve, which they have pulled out of, and it is anticipated that they will take the company private in the first quarter. During 2018, there should be a very nice step-up in valuations and performance. Mr. Tatlow agreed.

Mr. Martin said an important attribute of this allocation bucket is to provide uncorrelated returns to the portfolio that aren't available elsewhere. NEPC has talked with Mr. Jacksha, Mr. Neel and Top Tier about the strategies that might qualify for this bucket. This one is probably a little bit of a "forced fit" because it has some exposure to interest rates and some exposure to oil, which could be argued isn't directly correlated with equities, but it is a well-researched and well-returning investment. He said the hedging on the commodities side, the project nature and the shorter duration give NEPC comfort that it generally falls within the category definition.

Ms. Cameron commented that it seemed that EIG had been involved in an unusual amount of litigation. Mr. Neel responded that the vast majority of that litigation has been settled; that being said, they are operating in energy internationally, and some of it is distressed corporations and projects, and there tends to be more litigation in this kind of strategy.

Mr. Magid moved that the Investment Committee approve a commitment of $100 million to EIG Energy Fund XVII, 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.

5. ILS – DIVERSIFYING ASSETS

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

Mr. Neel presented staff's recommendation of a $100 million commitment to ILS Capital Management 1609 Fund Ltd. under the Diversifying Assets-Other category. This will consist of $65 million to their flagship fund with an additional $35 million committed to a fee advantaged co-investment vehicle. He said ILS is a specialist in the insurance industry that has managed a diversified book of insurance products. The team has been in this space for 40 years.

Mr. Neel said the NMERB has been looking at reinsurance for the past five years. In the private equity portfolio, 10-15 percent is historically dedicated to strategies that were agnostic to the public equity markets, e.g., project-based energy (EIG) and royalty strategies have traditionally resided in this part of the private equity book. As part of this, staff looked very closely to the reinsurance sector.

Mr. Neel said that, in August 2016, the NMERB approved an allocation of 5 percent to Diversifying Strategies-Other. This change in asset allocation, in conjunction with this year's series of hurricanes and natural disasters, has made reinsurance an interesting investment option. He said pricing in the insurance market has gapped out recently. He noted that pricing has increased between 15 and 20 percent across the ILS platform.

Mr. Neel stated that reinsurance is "insurance to insurance," where insurance companies will manage their risk appetite across their books of business, and they have the ability to reduce exposures. Reinsurance managers provide insurance for those exposure reductions, and today, the reinsurance market accounts for about $350 billion in assets.

Mr. Neel discussed the credentials and experience of team members Don Kramer (founder and chairman) and Paul Nealon (co-founder and managing partner). He noted that ILS has a strategic relationship with Berkshire Hathaway. He said ILS would be managing a fund of approximately $400 million. He said NMERB could expect annual returns of 8-11 percent.

Mr. Neel said no placement agents or campaign contributions were reported.

Mr. Tatlow described collateralized reinsurance, which is a regulated industry and refers to a reinsurance contract or program that is fully collateralized by investors or third party capital providers to cover potential claims that could arise from the reinsurance contract. Collateralized vehicles are attractive to insurance companies because they do not have to worry about the reinsurer going out of business, and it allows the insurance company to spread the risk as much as possible. For the ILS team, these markets take place in Bermuda and London, with some in Connecticut, and most policies are for one year only.

[Break.]

ILS managing partners Paul Nealon and Tom Libassi appeared before the committee and made a presentation.

[Messrs. Nealon and Libassi left the room.]

Mr. Martin said the committee needs to understand that there will be times when money may be lost; it doesn't happen very often, but it happens when many things are going wrong at the same time, so there is no correlation. He commented that this is only 8 percent of the time, however, versus 92 percent of the time when returns are very good.

Mr. Neel said this is a three-year asset class, and the $35 million co-investment will be subject to annual renewal.

Mr. Jacksha said the diversification aspect is obvious and this fits in with the expected return aspect. The group is very experienced and is a good choice if NMERB wants to be in this space.

Mr. Magid moved that the Investment Committee approve a commitment of $100 million to the 1609 Fund of which $65 million is dedicated to the flagship series and $35 million dedicated to a co-investment series. 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.

6. Q3 2017 PROXY VOTING REPORT

Mr. Jacksha said he had nothing to report out of the ordinary.

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

7. Q3 2017 COMMISSION REPORTS

[Informational item.]

8. OTHER REPORTS AND DISCUSSIONS

Mr. Jacksha noted that the board would be voting tomorrow on changes to the Investment Policy. Under Diversifying Assets, the benchmark is a 60/40 equity bond, which is equity and interest rates. He noted that the goal is to diversify and be additive to the NMERB's return target, which is 7.25 percent. He said the board could make the benchmark at 7.25 percent. He said other options could be setting the benchmark at LIBOR + 200 basis points; making the benchmark what the actual return is; or using a GTAA or risk parity index.

Mr. Martin said he thought 7.25 percent was a high return for an asset class that is so broadly diversified. He said he liked LIBOR + 200. Mr. Jacksha said he thought that was acceptable and would discuss it at the board meeting tomorrow.

9. NEXT MEETING: THURSDAY, JANUARY 18, 2018

The meeting was scheduled for 2:00 p.m.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 3:40 p.m.

Accepted by:

H. Russell Goff, Chairman