

ACTION SUMMARY

INVESTMENT COMMITTEE

March 23, 2017

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MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

March 23, 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
Ms. Kay Chippeaux, Deputy CIO, Public Markets and Credit
Mr. Mark Canavan, Real Assets Portfolio Manager
Mr. Aaron Armstrong, Portfolio Manager
Ms. Marla Medina, Investment Financial Analyst

Others Present:

Mr. Allan Martin, NEPC
Ms. Alexandra Adam, NEPC [by telephone]
Mr. Steve Gruber, RAPM [by telephone]
Mr. TC Rolfstad, RAPM [by telephone]
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 1/19/17

Mr. Magid moved approval of the minutes of the January 19, 2017, meeting, as submitted. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

d. Introduction of Guests

Chairman Goff welcomed staff and guests.

2. CROSS OCEAN PARTNERS – OPPORTUNISTIC CREDIT

[Presenters: Kay Chippeaux, and NEPC consultants Allan Martin and Alexandra Adam (on phone).]

Ms. Chippeaux presented staff's recommendation for a new investment manager for the opportunistic credit portfolio. She stated that Cross Ocean is a European direct lending investment manager based on London, and staff is recommending an investment of \$100 million in their European Special Situations Fund II.

Ms. Chippeaux said Cross Ocean focuses in countries in Europe that have better creditor protection. The fund invests primarily in existing debt from distressed bank. Staff believes there is still an illiquidity premium to collect in direct lending, and that this opportunity is better expressed in Europe than in the U.S.

Ms. Chippeaux discussed how this investment would fit into the NMERB's overall portfolio strategy. A year ago, the board changed the asset allocation in opportunistic credit from 20 percent down to 18 percent. Although the allocation is currently at 19 percent, distributions are expected soon from investments made by the NMERB three and four years ago. In addition, the NMERB will "tweak" the portfolio by reducing U.S. credit and increasing European exposure. Current U.S. exposure is about 57 percent, European exposure is 30 percent and the rest is in Asian and Emerging Markets.

Ms. Chippeaux said she met with Cross Ocean in Santa Fe, and was also able to visit them in their London office when she was there for an advisory committee meeting for another one of the NMERB's fund portfolio managers.

Ms. Adam discussed NEPC's view of Cross Ocean, the due diligence performed, and fund terms. She noted that NEPC initially performed due diligence on Cross Ocean's predecessor firm, Capula Investment Management. The entire Cross Ocean team was separated from Capula during the summer of 2015, when Cross Ocean was formed. NEPC came away from its due diligence work on Capula with a good feeling about the team and its ability to source deals. The Cross Ocean Fund II strategy is identical to the predecessor fund.

Cross Ocean Partners representatives Graham Goldsmith, Steve Zander and Mark Berry appeared before the committee and made a presentation.

[Representatives left the meeting.]

Ms. Chippeaux clarified that April will be the last close of the fund, and the NMERB would come in at net asset value. She said she went through the portfolio with them line by line to review where the investments are right now, their mark-to-market value, and their exit strategy. She said she is comfortable with this approach.

Ms. Chippeaux commented that Cross Ocean fits very well into the NMERB's portfolio strategy. She also likes that the NMERB is moving from direct lending in the U.S. and more into Europe. In addition, she thought staff was very knowledgeable and professional "and on top of what they are doing." Their deep experience in Europe is also a great benefit.

Ms. Cameron moved that the Investment Committee approve a total commitment of \$100 million to Cross Ocean European Special Situations Fund II 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. REIT MANAGER SEARCH – REAL ESTATE

[Presenters: Mark Canavan and (on phone) RAPM consultants Steve Gruber and TC Rolfstad.]

Mr. Canavan stated that, in June 2011, the NMERB hired Brookfield Investment Management. The contract was originally for four years with an ability to extend for four years, but the NMERB's policy changed in the interim to allow for only one two-year extension, and that will expire in June 2017.

Mr. Canavan stated that the Investment Committee originally committed \$100 million to Brookfield in 2011, and in 2014 committed another \$60 million. At the end of 2016, the \$160 million had grown to \$248.9 million, or \$89 million of gain. The net IRR since inception is 10.8 percent, which compares favorably against peers and its benchmark. While performance is below what NMERB would like to have seen, the original search and RFI showed that Brookfield outperformed in the long term by hundreds of basis points. He said the subsequent underperformance to expectations was due to Brookfield's decision in 2015 to eliminate exposure to self storage REITS, a sector of the market that did extremely well that year. At the time of Brookfield's decision, however, the sector was overvalued on a net asset value basis by 28 percent, so it was an issue of timing.

Mr. Canavan presented staff's request for approval to conduct a Request for Information (RFI) from a prescreened list of qualified REIT managers. With the Investment Committee's approval, staff and RAPM would perform additional due diligence on the list and present the results of the RFI process, which may include a specific manager recommendation.

Mr. Gruber stated that RAPM maintains active coverage of the U.S. REIT manager universe. He discussed RAPM's process that narrowed down an initial database of 49 separate strategies in order to identify a semifinalist group of five managers that would be subject to RAPM's due diligence process.

Mr. Magid moved that the Investment Committee authorize staff to conduct a Request for Information search process for an equity REIT manager using a prescreened list of qualified managers. The results of the search would be brought to the committee at a future date for final selection of one or more managers. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

[Break.]

4. ECOSYSTEM INVESTMENT PARTNERS UPDATE – NATURAL RESOURCES

Ecosystem Investment Partners (EIP) partners Nick Dilks, Adam Davis and Heath Rushing appeared before the committee and presented an update, which included a short video.

Mr. Dilks stated that EIP II closed in May 2012, with eight investments and a total of 62,203 acres of property. He said 28,000 acres of wetlands and 405,000 linear feet of streams have been fully restored. These projects are now fully permitted and are all cash flowing, with \$34 million distributed to date from the fund, \$5.7 million of which is to New Mexico on a \$30 million commitment.

Mr. Dilks stated that EIP III, which had a final close in February 2016 with a total of \$303 million, has a total of three investments to date, with a total of about 8,000 acres of property owned. At this time, 428,000 linear feet of property are in the permitting process.

Mr. Dilks discussed the new regulatory environment under the Trump Administration and efforts being made by EIP to communicate its concerns with EPA Secretary Scott Pruitt.

5. OPTIONS PRESENTATION

PIMCO representatives Taylor Alan-Lee, Michael Chandra, and Michael Connor appeared before the committee and made a presentation on portfolio hedging solutions, with an emphasis on tail risk hedging.

6. INTERNAL AUDIT DISCUSSION

Mr. Jacksha reported that internal auditors with REDW would begin the audit process for the Investment Division in May. He reviewed a memorandum outlining the areas that REDW would be expected to cover within the division.

7. OTHER REPORTS AND DISCUSSION

Mr. Jacksha distributed a list of recent buys and sells as of March 22, 2017.

Mr. Jacksha reported that returns are up 1.9 percent for February. The month was closed at slightly over \$12 billion in assets, the first time the fund has broken \$12 billion. Fiscal year returns to date are at about 7.9 percent.

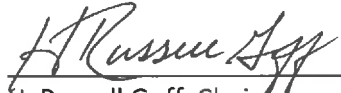
8. NEXT MEETING: THURSDAY, APRIL 20, 2017

The meeting was scheduled at 12:00 p.m.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 4:10 p.m.

Accepted by:



H. Russell Goff, Chairman