

ACTION SUMMARY

INVESTMENT COMMITTEE

October 22, 2015

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MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

October 22, 2015

1. a. Call to Order

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
Dr. Beulah Woodfin

Members Excused:

Mr. Larry Magid

Other Board Members Present:

The Hon. Tim Eichenberg, State Treasurer [Present 1:30-3:00 p.m.]

Staff Present:

Ms. Jan Goodwin, Executive Director
Mr. Bob Jacksha, CIO
Mr. Mark Canavan, Real Estate Portfolio Manager
Mr. Steve Neel, Deputy CIO
Ms. Kay Chippeaux, Fixed Income Portfolio Manager
Ms. Christine Ortega, Investment Financial Analyst
Mr. Aaron Armstrong, Portfolio Manager

Others Present:

Mr. Allan Martin, NEPC
Mr. Craig teDuits, State Street Bank
Mr. Brent Burnett, RAPM
Mr. Kevin Tatlow, Top Tier
Ms. Judith Beatty, Recorder

b. Approval of Agenda

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

c. Approval of Minutes: September 21, 2015

Ms. Cameron moved approval of the September 21, 2015 minutes, as submitted. Dr. Woodfin seconded the motion, which passed unanimously by voice vote.

d. Introduction of Guests

Hanseatic Management Services representatives Brian Stangel and Russ Sanderson introduced themselves to the committee.

Fred Rose, member of the UNM Retiree Association, introduced himself.

2. SELECTION OF INFRASTRUCTURE CONSULTANT

[Presenter: Mark Canavan.]

Mr. Canavan stated that, on July 6, staff issued a Request For Information (RFI) for infrastructure consultant services. Five firms were chosen to receive the RFI based on feedback from fellow participants on industry trade journal editorial boards, other public infrastructure investors, and fund general partners. Of the five invited firms, four submitted and one declined due to having been a non-finalist respondent in NMERB's prior infrastructure RFP. All submissions were received by August 7, 2015, and review of materials and scoring of responses was completed by September 30, 2015. Two finalists were chosen, Caledon Capital Management and Stepstone Group.

Stepstone Group

Stepstone representatives Brenden Woods, Tom Keck and David Altshuler appeared before the committee and made a presentation.

Dr. Woodfin noted that Stepstone acquires partnership interests in funds three to six years after their formation at a substantial discount in net asset value. She said that would seem to imply they are moving into funds that have apparently been mismanaged, and asked why they would want to go into funds that are essentially hurting.

Mr. Woods responded that, in some instances, there is an element of distress that drives the discount; but often it's a case of being a liquidity issue. He commented that, while at one time the secondary market was very inefficient and was an advantage for buyers, it is now much more efficient. He said a distressed portfolio will have at least one asset that is underperforming relative to expectations, and this provides the advantage for Stepstone.

Mr. Jacksha commented that, these days, private equity is often selling at premiums to net asset value. He asked Stepstone what the secondary market in infrastructure looks like these days, and is Stepstone able to buy at significant discounts. He noted that there are a lot more facilities and middle men than there were in the early days.

Mr. Woods responded that the market is significantly more competitive, but there are still opportunities for Stepstone in terms of better understanding a portfolio than others are prepared to. On the supply side, the selling pressure is less today than it was a few years ago.

Mr. Keck added that it is critically important not to have capital just dedicated to secondaries no matter what the market looks like.

Mr. Jacksha asked how Stepstone normally executes on secondaries. Mr. Woods responded that it depends on the client. He said the Stepstone model is about customized solutions, and they have clients who prefer a comingled structure while others prefer to retain decision-making control, while others prefer a separately managed account. He said this applies to secondaries as well as co-investments.

[Stepstone representatives left the room.]

Caledon Capital Management

Caledon representatives David Rogers, Asif Hussain and Noi Spyrtos appeared before the committee and made a presentation.

Responding to Mr. Canavan, Mr. Hussain said he began his career doing direct investments in infrastructure. Ms. Spyrtos stated that she was doing direct investments in infrastructure before she joined Caledon.

[Caledon representatives left the room.]

Discussion

[Mr. Eichenberg joined the meeting.]

Staff reviewed the differences between the two companies' structures, percentage of revenues coming from infrastructure, experience of individual team members, fees, and access to deals. In addition, staff discussed levels of satisfaction in working with Caledon.

Committee members discussed personnel and experience, underwriting experience and consulting philosophy and experience.

Committee members filled out and turned in their scoring sheets. Caledon was the winner by unanimous decision.

Dr. Woodfin moved that the Investment Committee approve a four-year investment services contract for infrastructure consulting services with Caledon Capital Management. This recommendation 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 by voice vote.

3. SELECTION OF EMERGING MARKET DEBT MANAGER

[Presenters: Kay Chippeaux and NEPC consultant Allan Martin.]

Ms. Chippeaux said the NMERB approved the emerging market debt asset allocation in 2011, at 2 percent of the total portfolio. In September 2011, NMERB funded Pictet and EMSO, purposely selecting two managers that would fit well together. Pictet acted as the beta oriented exposure to local currently denominated debt, and EMSO, a hedge fund, complemented Pictet with an absolute return focus to emerging markets debt investing.

Ms. Chippeaux said NMERB approved the extension of EMSO's contract a couple of months ago, and changed the format from their regular hedge fund to their Saguaro Fund. At the April Investment Committee meeting, the committee approved a change in the mandate for emerging market debt to a hard currency and local currency blended strategy. An RFP was issued in June, with 25 different responses from 23 managers. With the assistance of NEPC, the field was narrowed down to two managers, BlueBay and Prudential.

Ms. Chippeaux noted that Pictet was hired to execute on a local mandate, and in fact have done better in their performance against the local mandate index benchmark. She said they did not make the finalist list for this RFP because they had less experience with the blended mandate than other managers.

BlueBay Asset Management

Representatives David Dowsett and Tom Heflin appeared before the committee and made a presentation. Mr. Heflin stated that he was with RBC and was the new business development person for BlueBay Solutions in New Mexico, and Mr. Dowsett was a partner with BlueBay Asset Management and co-head of the emerging market debt team.

[Representatives left the meeting.]

Prudential

Representatives David Bessey and Peter Taggart appeared before the committee and made a presentation.

Dr. Woodfin commended Prudential on their commitment to diversity and inclusion.

Responding to Mr. Martin, Mr. Bessey said the only Petrobras paper that Prudential owns in its portfolio is paper that matures in nine months. He said Prudential owns none of the longer-dated paper in Petrobras.

[Representatives left the meeting.]

[Break.]

Chairman Goff asked if travel would prove a problem for staff with BlueBay in terms of traveling to London. Ms. Chippeaux responded no. She said that the current managers visit the NMERB regularly, and staff has also met them in New York.

Mr. Martin reviewed investment performance.

Committee members discussed investment style, resources, performance, and other factors.

Committee members filled out and turned in their scoring sheets. Prudential was the winner by unanimous decision.

Dr. Woodfin moved that the Investment Committee approve a four-year contract with Prudential Fixed Income for the emerging market debt manager, selected as a result of the request for proposal #2015-07-01 (INV), subject to and contingent upon New Mexico State Law, Educational Retirement Board policies, negotiation of final terms and conditions, and completion of appropriate paperwork. Initial funding for the mandate will come from the assets currently managed by Pictet. Ms. Cameron seconded the motion, which passed unanimously by voice vote.

4. WARBURG PINCUS PRIVATE EQUITY XII, L.P. – PRIVATE EQUITY

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

Mr. Neel reviewed staff's recommendation of a \$75 commitment to Warburg Pincus Fund XII, the successor fund to Fund XI, in which the NMERB invested in 2012. He noted that Fund XI has a net IRR of 21.87 percent to date. In reviewing an individual manager breakdown of the NMERB's growth managers since inception, he pointed out that the growth strategy has added over \$81 million in value to the portfolio since 2007 and is the most successful sub-strategy in the NMERB private equity portfolio.

Mr. Neel stated that Warburg Pincus is a diversified global growth manager that focuses across the private equity spectrum. The firm operates as an integrated investment firm investing out of one pool of capital and will continue the same strategy as in prior funds, focusing in five core sectors: energy; financial services; healthcare and consumer; industrial and business services; and technology, media and telecommunications. The fund will target growth-oriented investments, with larger transactions to include equity investment from co-investors.

Mr. Neel stated that Fund XII would include portfolio companies across the private equity spectrum from growth to buyout.

Mr. Neel noted that the NMERB has driven over \$20 million in co-investments in the Warburg Pincus co-investment portfolio.

Mr. Neel stated that the NMERB surveyed the market and met with three of Warburg Pincus's closest competitors before arriving at this recommendation.

Dr. Woodfin noted that former U.S. Treasury secretary Tim Geithner is President of Warburg Pincus, and asked what role he plays. Mr. Neel responded that the NMERB posed this question to the team and was told that Mr. Geithner adds value on a macro level based on his senior level relationships.

Mr. Neel stated that no campaign contributions or placement agents are associated with this investment.

Chairman Goff noted that the firm has relatively high professional turnover, with 4-5 managing directors leaving each year. He asked if this is a concern.

Mr. Tatlow responded that Warburg Pincus has 70 managing directors, which amounts to 16-20 managers over the life of a fund. Percentagewise, it would be as though they were losing 1.5 to 2 managing directors over the life of the fund. He said it also points to the culture of the firm, which does an in-depth review of everyone annually. Mr. Neel added that some turnover at the middle level is healthy, whereas at the top level it would be much more of a concern.

Mr. Tatlow stated that Warburg will make at least a \$300 million investment in the fund. He said they typically invest 5 percent, so it will likely be more than \$300 million.

Mr. Neel noted that Fund XII is oversubscribed, so whether or not the NMERB will be able to invest the full \$75 million will not be known for a few weeks.

Warburg Pincus principal Gregory Baecher appeared before the committee and made a presentation. He said he appreciated the NMERB's investment in Fund XI and interest in Fund XII.

[Mr. Baecher left the meeting.]

Mr. Jacksha said Warburg is a very solid organization and the NMERB likes the group a lot.

Ms. Cameron moved that the Investment Committee approve a commitment of \$75 million to Warburg Pincus Private Equity XII, L.P. 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, staff will be granted discretion to invest an additional amount, not to exceed \$10 million, in secondary partnership interest offered by other limited partners in the fund, should they become available from time to time, under the Right of First Refusal of the limited partnership agreement for this fund. Dr. Woodfin seconded the motion, which passed unanimously by voice vote.

5. BP FUND I – NATURAL RESOURCES

[Presenters: Mark Canavan and RAPM consultant Brent Burnett.]

Mr. Canavan stated that, in April 2015, RAPM and NMERB staff recommended a \$30 million investment in BP Natural Gas Opportunity Partners. The Investment Committee approved a motion to commit \$30 million with the caveat that the fund had to raise at least \$230 million for the commitment to kick in. At this point in time, BP is just shy of \$230 million, including the NMERB commitment, and staff and RAPM are requesting that the original motion be amended to allow the closing to occur immediately. He explained that a couple of assets in the fund have done extremely well, and BP expects to write up the value of these investments very soon. If the NMERB does not close on its commitment now, it will be entering the fund at a higher cost basis. He added that he

was confident that BP would reach the \$230 million goal at some point after the earlier closing, noting that the NMERB's commitment would bring the fund to \$215 million.

Mr. Canavan stated that he had asked Mr. Burnett to prepare an analysis on the economic viability of the fund should they not raise more capital. Mr. Burnett is extremely comfortable that they have sustainability at the current level.

Mr. Burnett stated that RAPM initially put the \$200 million requirement in place because they were concerned that, without raising at least that amount, BP Capital would lack the firm resources to retain the key investment members of the team and be able to draw a sufficient management fee to meet their G&A expenses. Second, they were concerned about being a large position in an overly concentrated portfolio. Mr. Burnett stated that, over the last six months, they have been able to watch the companies in the existing portfolio, and all of them are performing in line or above expectations despite a low commodity price environment.

Dr. Woodfin noted that the NMERB has made some infrastructure investments in the midstream sector of the oil and gas industry. Given what she has read in the media about decreased activity in the oil and gas industry, with the shutting down of rigs, etc., she asked if this will ultimately be a problem in terms of investing in this general area. She said this was a general question, as she realized the investment in BP Fund I was based on the differentials between oil and gas and was not so much a specific investment in the midstream sector.

Mr. Jacksha responded that, when the price initially fell, there was a lot of press about oil rigs being "tipped over," or having their use suspended; however, more recently, he has been reading about more efficiency in hydraulic fracturing with the use of walking rigs, creating more production per rig. He said information coming from NM State Government budget projections is that production has actually increased more than expected.

Mr. Burnett said there has been some decreased production at the national level because two things have happened: drilling efficiencies have improved; and there were a large number of wells that had been drilled and weren't completed. Once these wells are completed, production is expected to go up, so production activity is still coming on line.

To Dr. Woodfin's point, Mr. Burnett added that the takeaway capacity in midstream, in aggregate, is overbuilt; there is too much capacity for takeaway in midstream than there is product flowing through the pipelines today. He said that is very basin-specific, however. For midstream systems in the most prolific and most economic basins, there is still a very high need for more midstream infrastructure capacity. In the fringes of some of those basins, though, there is probably too much capacity.

Regarding the April 23, 2015 Investment Committee motion that approved an investment in BP Fund I, Ms. Cameron moved that the Investment Committee amend the motion to remove the requirement that the Fund have at least \$230 million in committed capital. Dr. Woodfin seconded the motion, which passed unanimously by voice vote.

6. Q2 2015 PRIVATE EQUITY PERFORMANCE REPORT

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

Mr. Neel and Mr. Tatlow presented this report, with the following highlights:

- The NM ERB Private Equity Portfolio experienced a positive second quarter return of 6.8 percent and a one year return of 17.7 percent.
- Since inception, the portfolio has achieved a return of 13.4 percent (and all-time high for the portfolio) and a multiple on invested capital of 1.37x.
- At year-end, the Plan had \$2.08 billion in net commitments to 54 private equity funds managed by 39 different managers.

Mr. Neel highlighted individual commitments.

7. OTHER INVESTMENT REPORTS AND DISCUSSIONS

Ms. Goodwin noted that the Government Finance Officers Association states that it is a best practice to always try to pay the lowest investment fees possible. Although the NMERB already does this, the Investment Committee may want to consider taking the extra step of memorializing this in writing and adding it to the Investment Policy or else having it as a separate statement.

8. NEXT MEETING: THURSDAY, NOVEMBER 12, 2015 AT 1:00 P.M.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 4:45 p.m.

Accepted by:



H. Russell Goff, Chairman