

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

August 23, 2018

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:

Mr. Steve Neel, Deputy CIO, Alternative Assets
Mr. G. Alan Myers, Public Securities & Credit Portfolio Manager
Ms. Norma Henderson, CFO
Ms. Kay Chippeaux, Deputy CIO, Public Securities & Credit
Mr. Rod Ventura, General Counsel
Mr. Aaron Armstrong, Portfolio Manager

Others Present:

Mr. Allan Martin, NEPC
Mr. Oliver Fadly, NEPC [on phone]
Mr. Kevin Tatlow, Top Tier
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.

c. Approval of Minutes: June 28, 2018

Mr. Magid moved approval of the June 28 minutes, as submitted. Ms. Cameron seconded the motion, which passed unanimously.

d. Introduction of Guests

Chairman Goff welcomed staff and guests.

2. BREVET DIRECT LENDING INTERMEDIATE DURATION FUND – OPPORTUNISTIC CREDIT

[Presenters: Alan Myers, Kay Chippeaux, NEPC advisor Allan Martin, and NEPC senior analyst Oliver Fadly (on the phone)]

Mr. Myers presented staff's recommendation for a \$100 million commitment to Brevet Direct Lending Intermediate Duration Fund ("Fund I").

-- This investment fits in the opportunistic credit portfolio because it is uncorrelated with the other direct lending investments, and will add to the ERB's exposure in the U.S. and Canada, and possibly Australia.

-- Brevet Capital began as an investment advisory business in 1998 (FCS Advisors), cofounded by Douglas Monticciolo and Mark Callahan. FCS expanded into investment management in 2006 and rebranded as Brevet Capital Management and created a joint venture with investment advisor Highbridge-DBZ. In 2007, the firm launched a \$165 million special opportunities fund, and two years later established the Short Duration Fund, focused on secured direct lending to middle market companies. Since 2009, Brevet has raised separately managed accounts and Brevet Holdings, LLC is the parent company with three subsidiaries: Brevet Capital Management (providing investment management services), Brevet Asset Solutions (providing collateral-related administration services) and FCS Advisors ((negotiating loan terms with potential borrowers and providing loan and collateral administration services to certain borrowers).

-- There are 36 dedicated professionals on the Brevet team.

-- Brevet is raising Brevet Direct Lending Intermediate Duration Fund to provide investors with current income and long-term capital appreciation by primarily originating senior secured loans for middle- and lower-middle market companies in the U.S. The majority of these companies will have EBITDA less than \$50 million.

-- The strategy will target non-sponsored companies, Brevet will directly originate, structure and hold all investments. The strategy is similar to its predecessor fund, the Short Duration Fund, except with loan durations of two to four years versus 18 months.

-- The GP is seeking aggregate capital commitments of at least \$500 million. The fund will not use leverage (except for bridge financings) and is targeting a net IRR of 12-15 percent and a net MOIC of 1.4x-1.5x.

Mr. Martin noted that the ERB has an 18 percent allocation to private debt and is currently at 18.7 percent; however, many of the investments made over time are returning cash and it is necessary to move forward with additional investments to continue exposure.

Mr. Martin commented that an increasing number of investors are attracted to this space because what was originally thought to be a short-term opportunity is proving to be a much longer opportunity,

particularly given financial distress situations being seen around the world. The ERB has made 8.5 percent year in debt investing over the last ten years and 7.3 percent a year over the last five years, well above the assumed rate.

Mr. Fadly said this is a very opportunistic, unique and interesting strategy. He commented that Mr. Monticciolo and Mr. Callahan are very sharp people, and Mr. Callahan has been doing this strategy for the last 25-30 years. He said this is a very one-off strategy, where Brevet is taking advantage of a unique period in the current market cycle in an area that is largely being overlooked. He said he did not know of anyone who could actually compete with this strategy that Brevet is executing.

Brevet representatives Doug Monticciolo, Brian Lippey and Matt Lucas appeared before the committee and made a presentation.

Mr. Lippey stated that, over the last 20 years, Brevet has structured, executed and advised on over \$20 billion in client transactions. Today, they consist of 36 professionals headquartered in New York, with a regional office in San Antonio. They are engaged in direct loan sourcing, structuring, and documentation.

Mr. Lippey said that, unlike most direct lending funds, Brevet is focused on the government sector, i.e., the U.S. federal government, state governments and other sovereigns (Canada and Australia), that have substantially similar legal and program specifications as the U.S. In the government sector historically, the credit risk has been very low, but payment timing delays to vendors and suppliers to the government are very common. Many government programs are inefficient, and these delays happen all the time. Simply put, Brevet provides bridge financing to these vendors with government contracts. This is a strategy with very high barriers to entry. It is difficult for competitors to enter the market because most traditional lenders simply don't have the experience, focus, expertise and the infrastructure to compete in this sector, which is large and complex.

[Representatives exited the meeting.]

Mr. Neel said he finds this a very compelling and interesting inefficient niche in the market that the ERB is stepping into in an abbreviated fashion.

Mr. Martin added that direct lending these days is generally returning 8-10 percent, with some credit risk involved. In the case of this commitment to Brevet, the return is expected to be 12-15 percent with a lower risk profile.

Mr. Magid moved that the Investment Committee approve a commitment of \$100 million to Brevet Capital Direct Lending Intermediate Duration 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. Ms. Cameron seconded the motion, which passed unanimously.

3. INVESTMENT POLICY STATEMENT REVISION

Mr. Neel stated that there has been one additional change to the Investment Policy Statement since the June Investment Committee meeting, when the committee recommended approval:

-- Page 3, under Sudan policy restrictions, the name of the service provider was changed to EIRIS Conflict Risk Network.

-- Page 3, under Investment Committee, asset allocation reviews must occur at least every three years instead of every two years.

-- Page 3, Investment Division staff will be required to pass a self-administered ethics exam every two years instead of periodically.

New change:

-- Page 7, under Asset Allocation, changing the benchmark for Real Assets from CPI + 5% to CPI + 4%. This makes the policy statement congruent with the performance report and also the asset level policy.

-- Page 8, under Public Equities, Domestic Equity, it previously said the NMERB believes the large cap market is efficient but the smaller cap market is inefficient; therefore, small and midcap would have active managers. It now states that the midcap market is efficient as well, and it has been indexed.

Mr. Magid moved that the Investment Committee recommend the board approve the changes to the Investment Policy Statement. Ms. Cameron seconded the motion, which passed unanimously.

4. PROXY REPORT

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

5. PRIVATE EQUITY QUARTERLY PERFORMANCE REPORT

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

Mr. Neel reported fourth quarter quarter results:

-- A positive fourth quarter return of 3.83 percent and a one-year return of 14.2 percent.

-- Since-inception return of 13.0 percent and a multiple on invested capital of 1.41x.

-- At quarter end, the portfolio had \$3.2 billion in net commitments to 78 private equity funds managed by 44 different managers.

-- Over the last year, over \$250 million has been received in cash distributions and the ERB paid in about \$300 million in capital calls.

Mr. Tatlow reviewed highlights from the portfolio, as well as charts reflecting ERB performance data compared with private equity vintage peer groups.

6. COMMISSION REPORT

[Informational.]

7. OTHER REPORTS AND DISCUSSION

Mr. Neel reported that the ERB Fund returned 8.3 percent net for the 2018 fiscal year. July returns are expected to be 1.25 – 1.50 percent.

8. NEXT MEETING: FRIDAY, SEPTEMBER 21, 2018

The meeting was set for 1:00 p.m.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 2:45 p.m.

Accepted by:



H. Russell Goff, Chairman