

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

May 23, 2019

1. a. CALL TO ORDER

A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at 12:10 p.m. at the Educational Retirement Board, Suite A-319, 8500 Menaul Boulevard, N.E., 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. Rod Ventura, Deputy Director
Ms. Kay Chippeaux, Deputy CIO, Public Markets & Credit
Mr. Steve Neel, Deputy CIO, Alternative Assets
Mr. Aaron Armstrong, Portfolio Manager
Mr. G. Alan Myers, Public Securities & Credit Portfolio Manager
Ms. Debbie O'Dell, Investment Operations Manager
Ms. Heather Lujan, Financial Analyst Supervisor
Mr. Matthew Rosse, Financial Specialist

Others Present:

Mr. Allan Martin, NEPC
Ms. Hayley Tran, NEPC [on phone]
Mr. Brent Burnett, Hamilton Lane
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: April 18, 2019**

Mr. Magid moved approval of the April 18 minutes, as submitted. Ms. Cameron seconded the motion, which passed unanimously.

d. **Introduction of Guests**

Chairman Goff welcomed staff and consultants.

2. **ECOSYSTEM INVESTMENT PARTNERS FUND IV, L.P. – NATURAL RESOURCES**

[Presenters: Bob Jacksha and Hamilton Lane consultant Brent Burnett. Also present: EIP co-founder Nicholas Dilks.]

Mr. Jacksha noted that the ERB has invested in two previous funds with Ecosystem Investment Partners (“EIP”), and both funds have performed well.

Mr. Burnett stated that the ERB’s relationship with EIP dates back almost eight years, with their first institutional fund. Fred Danforth and Nicholas Dilks founded EIP. Mr. Danforth passed away in 2016, and Mr. Dilks has continued to build the firm over the last couple of years. EIP is currently raising \$350 million to continue its strategy of mitigation banking, a system by which developers of infrastructure, natural resources and housing projects offset their impact on the environment through the purchase of credits generated by offsetting remediation activities within the same ecosystem. These activities are primarily the result of the Clean Water Act and the Endangered Species Act, with prices for credits set through private negotiations between buyers and sellers. Mr. Burnett commented that relationships with these groups, and a history of execution in these projects, really matter for this type of strategy, and Hamilton Lane feels that Mr. Dilks and the team and the organization he has built bring that institutional credibility to this market.

Mr. Burnett said returns have been strong and consistent. He credited Mark Canavan, ERB’s Real Assets portfolio manager, for his vision in recognizing the value of this strategy early on and recommending an investment in the first fund.

Mr. Jacksha recalled that Mr. Canavan did a great deal of research on this investment initially, as the ERB is very wary of theses in projects that have to rely on government regulations, but the EPA has been in place for years and the Clean Water Act is well established. In addition, while there had been some concern more recently with the change in EPA administrators and various controversies surrounding that, the ERB has been monitoring this situation and does not feel there is a cause for concern.

Mr. Dilks stated that EIP very closely monitors what is happening at the regulatory level. He said the Clean Water Act has been around for 47 years, and it has never backslid, and this Administration has not made any attempt to overturn the Act or even roll back the requirement for mitigation. There are efforts to create clarity around jurisdictional boundaries, but EIP feels it is all within the norm of what has happened over multiple economic cycles. Anecdotally, EIP has actually seen some uptick in the last couple of years with the recent emphasis on infrastructure development.

Mr. Burnett said EIP has remediated over 160 miles of streams and 43,000 acres of wetlands in the course of their business. Not only has EIP brought in strong returns, there are tangential environmental benefits to what they do.

Mr. Magid moved that the Investment Committee approve a commitment of up to \$50 million to Ecosystem Investment Partners IV, L.P. 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. Ms. Cameron seconded the motion, which passed unanimously.

3. MANAGER SELECTION FOR EMERGING MARKETS EQUITY MANDATE

[Presenters: Alan Myers and NEPC advisor Allan Martin. On phone: Hayley Tran, NEPC research consultant.]

Mr. Martin presented background and stated that the ERB has a very large strategic weight in Emerging Markets; however, the firms managing the \$1.28 billion across four managers have not kept up with the index. ERB staff and NEPC, recognizing that the ERB could do better for this very important part of the portfolio, agreed to do a search but felt it would make more sense to do it using a closed list.

Mr. Myers stated that, in February, staff appeared before the Investment Committee and, because all four of the contracts would expire in June, requested approval to use the Request for Information process to select one or more managers for the Emerging Markets portfolio. Staff worked with NEPC to narrow down the managers on their top-ranked list of Emerging Markets equity managers. After careful analysis, staff selected Axiom International Investors, Allianz Global Investors, RBC Global Asset Management, Columbia Management Investment Advisers, and UBS Asset Management for further due diligence. Mr. Myers said he and Ms. Chippeaux conducted site visits last month with each manager, with NEPC consultant Mike Miranda attending either by phone or in person. After NEPC conducted a risk return analysis, staff decided to retain Neuberger Berman and hire RBC and UBS.

Mr. Myers stated that RBC and UBS would be presenting today. Neuberger Berman's last presentation was in the committee packet.

Ms. Tran provided a summary of the Neuberger organization, strategy and performance.

Prior to RBC's presentation, Ms. Goodwin disclosed that her older son has applied for a municipal bonds analyst job at RBC. Mr. Jacksha added that Ms. Goodwin played no role whatsoever in the Emerging Markets manager search.

RBC representatives Ashley Hyotte and Tom Heflin appeared before the committee and made a presentation.

[Representatives left the meeting.]

UBS representatives Gabriel Csendes, Bill DeSanto and Tracey Monroe appeared before the committee and made a presentation.

[Representatives left the meeting.]

Mr. Myers stated that staff and NEPC spent significant time whittling down the top managers in this space to a group of six they felt would produce good results. In the final

analysis, they feel the recommended combination of managers would provide the best opportunity for positive growth and excess returns.

Mr. Jacksha said Mr. Myers, Ms. Chippeaux, and Mr. Martin and the NEPC team did an excellent and thorough job in coming up with these recommendations.

Ms. Cameron moved that the Investment Committee approve investment of the emerging markets equity allocation to Neuberger Berman, UBS and RBC in either comingled trusts or separately managed accounts allocated equally to the three managers. This approval 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.

Ms. Chippeaux said that Mr. Myers put a great deal of time into this. He spent lot of time working on strategy, vetting the managers and meeting with NEPC, and would be spending a lot of time working on the upcoming transition. She thanked him for his efforts.

[Break.]

4. SV7 GROWTH FUND, L.P. – PRIVATE EQUITY

5. SV7 IMPACT FUND, L.P. – PRIVATE EQUITY

[Presenters: Steve Neel and Top Tier advisor Kevin Tatlow]

Mr. Neel presented staff's recommendation of a commitment of \$35 million to SV7 Growth Fund, L.P. and \$20 million to SV7 Impact Medicine Fund. SV Health Investors is raising these two funds, to be managed by separate teams within the SV Health organization. Historically, both strategies were under one platform, and the managers decided to disaggregate the strategies and raise two separate funds.

Mr. Neel said the ERB's relationship with SV goes back to 2016, when the ERB re-launched its venture platform and committed \$35 million to SV Sciences Fund VI. As of 9/30/18, net returns are at 33 percent with a 1.5x multiple.

In discussing the advantages of this relationship, Mr. Neel stated that SV has offered co-investment deal-flow to the ERB, which is very positive; in addition, the ERB has a seat on their limited partner advisory committee. SV's governance structure is also very transparent with regard to compensation and ownership.

Mr. Tatlow reviewed the two funds and strategies.

-- SV Growth Fund is a U.S.-managed, healthcare focused, growth equity fund that will primarily target investments in healthcare service, medical product, and digital health companies that are well aligned with a shift toward high quality lower cost of care, or that are exploiting the wired infrastructure to gain or sustain competitive advantages. The fund will make investments that will typically be preferred equity positions of \$15-\$25 million in a

portfolio of 10-12 companies. They have a very consistent track record across this strategy, and their sourcing is fully proprietary, which is a plus because of the amount of competition in this sector.

-- SV7 Impact Medicine Fund is a UK-managed biotech fund that will seek to generate attractive returns for investors through the discovery and development of high impact precision drugs that have the potential to either cure or have a significant impact on patients, their families, and society. The team will pursue VC investments across all stages of biotech drug discovery and development companies. The portfolio will consist of about 15 investments of \$15-\$25 million with an emphasis on seed/series A stage where SV can secure a significant equity position and control by investing at inception. They will tranche their investments and go in with milestones to control risk. Two-thirds of investments will be early stage, where they will partner with a research organization and build a company around that. The remaining one-third will be more mature drug projects that are much closer to market.

Mr. Magid moved that the Investment Committee approve a commitment of \$35 million to SV7 Growth Fund, L.P. for the Private Equity 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.

Ms. Cameron moved that the Investment Committee approve a commitment of \$20 million to SV7 Impact Fund, L.P. for the Private Equity 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.

6. OLEA SPECIAL OPPORTUNITY FUND I – DIVERSIFYING ASSETS AND OPPORTUNISTIC CREDIT

[Presenters: Steve Neel and NEPC advisor Allan Martin.]

Mr. Neel stated that, since preparation of the memo proposing a \$100 million increase to Orchard Global Asset Management's (OGAM) Olea Strategy in the Diversifying Assets and Opportunistic Credit portfolios, staff and NEPC identified this as a very compelling opportunity for the Private Equity portfolio as well, and are now recommending an additional \$50 million commitment to that portfolio for a total investment of \$150 million.

Mr. Neel reported that, as of April 30, Olea Special Opportunities Fund was showing net returns of 20+ percent.

Mr. Neel said the ERB has a long history with this manager in Opportunistic Credit, specifically with regulatory relief trades and trades with banks.

Mr. Martin stated that, because of the size of this overall investment, NEPC elected to re-underwrite the strategy. One of NEPC's best analysts went through an entire procedure and gave this product a "3" rating on a scale of 1 to 5, or "suitable for sophisticated clients who understand the risks." The analyst was specifically concerned about: 1) high amounts of embedded leverage; 2) new strategy; 3) key person risk and weak key person clause; and 4) senior portfolio manager not having economic interest in the firm.

Mr. Neel stated that staff has worked to address and mitigate each of the four issues raised by NEPC's analyst as follows: 1) Olea will provide monthly reports on their gross and net leverage. 2) ERB now has about eight months' worth of activity for this strategy, and returns are up significantly in the current fiscal year; in addition, they are very close to meeting their \$600 million fundraising goal. 3) ERB has incorporated no-fault provisions for this strategy -- a no-fault termination of the manager, a no-fault suspension of the commitment period, and a no-fault removal of the GP. 4) The team has committed about \$1.6 million, and CEO Paul Horvath has personally committed \$750,000. Staff feels that this creates strong economic incentives with regard to profit participation.

Mr. Martin described the Olea strategy, which will target several trade types across custom-dated single name CDS portfolios; CDS-related capital relief tranche transactions, and CDS-related capital relief annuity transactions. NEPC has found that the strategy is gaining traction with other institutional investors. Olea's initial performance has exceeded expectations of both OGAM and NEPC, and the opportunity set has continued to evolve as banks gain comfort with OGAM's approach to CDS risk transfer. NEPC believes that the breadth of the opportunity set will continue to evolve positively for this strategy, and it supports staff's recommendation.

Mr. Magid moved that the Investment Committee approve a commitment to OGAM's Olea Fund in the amount of \$50 million each for the Diversifying Assets, Private Equity and Opportunistic Credit portfolios. 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.

7. ILS 1609 FUND LTD. – DIVERSIFYING ASSETS

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

Mr. Neel presented staff's recommendation of a \$25 million commitment to the ILS 1609 Fund Ltd., in order to take advantage of current opportunities in US insurance, marine and offshore energy reinsurance and international property reinsurance. Staff has been monitoring this strategy for years because it brings in very respectable returns that are basically agnostic to the broader market.

Mr. Tatlow said this investment would improve the risk return profile of the current reinsurance portfolio by improving the modeled 50th percentile return from 7.6 percent to 10.1

percent, improving the “no loss” return by 2.3 percent, and only decreasing the modeled 95th percentile return by 0.7 percent.

Ms. Cameron moved that the Investment Committee approve a commitment of \$25 million to the ILS 1609 Fund Ltd. 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.

8. Q1 PROXY VOTING REPORT

Mr. Magid moved to accept this report. Ms. Cameron seconded the motion, which passed unanimously.

9. Q1 COMMISSION REPORTS

[Informational.]

10. OTHER REPORTS AND DISCUSSION

Staff scheduled a special telephone meeting on May 28 at 11:00 a.m. The meeting was scheduled to approve extending the Fidelity investment manager contract to the end of the calendar year, an item that was not on today’s agenda.

11. NEXT MEETING: THURSDAY, JUNE 27, 2019

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

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 3:30 p.m.

Accepted by:

A handwritten signature in blue ink, appearing to read "H. Russell Goff", is written over a solid black horizontal line.

H. Russell Goff, Chairman

