

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

July 18, 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 1:00 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
Ms. Kay Chippeaux, Deputy CIO, Public Markets & Credit
Mr. Mark Canavan, Real Estate & Real Assets Portfolio Manager
Mr. Steve Neel, Deputy CIO, Alternative Assets
Mr. Nathan Sax, Core Bonds Portfolio Manager

Others Present:

Mr. Asif Hussain, CBRE Caledon [on phone]
Mr. Brent Burnett, Hamilton Lane
Ms. Charmaine Clair for 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 27, 2019

Mr. Magid moved approval of the June 27 minutes, as submitted. Ms. Cameron seconded the motion, which passed unanimously.

d. Introduction of Guests

Chairman Goff welcomed staff and consultants.

2. CORE BONDS POLICY APPROVAL

[Presenters: Kay Chippeaux and Nathan Sax]

Mr. Sax reviewed the redlined changes in the policy, with the following highlights:

-- Section C, Derivatives: "Derivatives may ~~will not~~ be used to leverage the Fund."

Mr. Jacksha stated that, as discussed at last month's meeting, staff is looking at allowing some leverage in the portfolio to adjust the allocations where there isn't the liquidity to do that, or when the ERB doesn't want to sell things to do it. He said the primary reason for wanting the ability to do leverage is in a situation where there is a big drawdown and the ERB wants to invest to take advantage of the market going back up. While it's highly unlikely leverage would be used in Fixed Income, there could be an occasion where the ERB might want to hold some defensive assets, which is usually long Treasuries.

-- Change the Index versus non-Index securities in the Bond portfolio from 70/30 to 60/40, in effect increasing that allowance.

Mr. Sax said he is largely responsible for this, because in the securitized portion of the portfolio he buys a lot of securities that are not in the Index. The ERB used to buy mainly pass-through securities, but now it is buying more asset-backed securities and different types of commercial mortgage-backed securities.

Mr. Jacksha added that this would let the Fixed Income portfolio manager(s) invest where they see more value without being tied to bonds that are solely in the Index.

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

3. STONEPEAK DEBT FUND – INFRASTRUCTURE

[Presenters: Mark Canavan with Caledon consultant Asif Hussain on phone.]

Mr. Canavan reviewed staff's recommendation for an additional \$25 million commitment to Stonepeak Infrastructure Credit Separate Account (Credit SMA), bringing the total commitment to the Credit SMA to \$50 million, building on the ERB's initial \$25 million commitment in April 2017.

Mr. Canavan said the ERB's history with founders Michael Dorrell and Trent Vichie goes back more than a decade, when Messrs. Dorrell and Vichie were the original investment team in the Blackstone Infrastructure Partners Fund and were in discussions with the ERB. After Blackstone ultimately decided not to move forward with that, Messrs. Dorrell and Vichie created their own platform, and the ERB became their second institutional investor in SIF I, which closed in 2013 with capital commitments of \$1.65 billion, including \$40 million from the ERB.

Mr. Canavan said Stonepeak's credit investment team for Credit SMA will be overseen by Messrs. Dorrell and Vichie, and Ryan Roberge will lead the day-to-day running of the business.

Mr. Hussain commented that it has been a good strategy to initially deploy \$25 million to see how the team does, followed by this top-up of \$25 million. He said Caledon likes this from a portfolio perspective because it is hard to find anything like this in the market, where most of the opportunities are in senior debt, senior private debt, public credit or credit opportunity.

Mr. Canavan noted returns on SIF I at a gross IRR of 20.3 percent, half of which was coupons (interest) and the other half capital gain. The ERB is currently the sole investor. Geographic focus is North America in power generation, utilities, midstream energy, transportation, communication infrastructure, shipping and aircraft.

Mr. Canavan said the ERB would probably have recommended a higher follow-up commitment but it is up against capital constraints right now in the pacing plan.

Mr. Canavan stated that Mr. Hussain has indicated that the employees of Caledon Capital Management would be interested in being allowed to invest alongside the ERB in this particular vehicle. He said he personally saw no problem with this, but saw it as a statement of trust, confidence and faith in what the ERB is doing.

Mr. Jacksha said he would agree with that. While someone might see this as a potential conflict of interest, he didn't see it that way; if people believe in this enough to invest their own money, that is a vote of confidence.

Mr. Canavan said Stonepeak can create a structure so that the Caledon employees can go in as one bloc as another LP.

Mr. Jacksha wondered if this is a case where fixed income managers and buyers aren't buying into this right now, but that it is gradually gaining more acceptance in that marketplace. Mr. Canavan commented that there are generalist bond players who don't really have the operational sophistication needed to understand some of these infrastructure assets, and so are more likely to overlook them. Also, some of them are in such small pieces that large investors aren't interested in them. He added that certain banks have left this space and it is now being captured by bond originators or private equity funds originating deal flow, and they often do not have the industry expertise needed for these kinds of transactions.

Ryan Roberge joined the proceedings to respond to a question from Mr. Magid, who had asked for a description of what a typical investment would look like in the fund portfolio. Mr. Roberge discussed an investment made in the last two weeks and why Stonepeak saw no capital risk impairment in its downside analysis.

Mr. Jacksha commented that this is a great example of what Mr. Canavan and staff have done in terms of working with the ERB's existing relationships and developing new and interesting investment vehicles. He said he liked the risk-return profile when compared to core infrastructure, which is lower in the capital structure.

Ms. Cameron moved that the Investment Committee approve a commitment of \$25 million to the Stonepeak Infrastructure Credit Separate Account 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. Mr. Magid seconded the motion, which passed unanimously.

4. FIVE POINT III, L.P. – NATURAL RESOURCES AND PRIVATE EQUITY

[Presenters: Mark Canavan and Hamilton Lane consultant Brent Burnett.]

Mr. Canavan discussed staff's recommendation of an \$80 million commitment in Five Point Energy Fund III, with \$50 million for the Natural Resources portfolio and \$30 million for the Private Equity portfolio. He said the ERB underwrote a co-investment four or five years ago in Twin Eagle, with David Capobianco, who was a co-founder and co-head of the private equity group at Vulcan Capital. Mr. Capobianco led the take-private transaction of Plains Resources and several other successful energy investments. He formed Five Point Capital Partners to pursue energy and energy infrastructure investments with his own capital and that of a range of institutional partners and family offices.

Mr. Burnett said this is one of Hamilton Lane's highest conviction and longest standing relationships in the energy space. He said Five Point's strategy is to target midstream infrastructure development acquisitions, which they do on a small to midsize scale in the very targeted areas of the Permian and Arkoma basins and, to a lesser degree, the Scoop/Stack and Eagle Ford basins. They have been very successful at getting into transactions early on and creating proprietary investment opportunities, and have been very prescient in the way that they have thought about how infrastructure needs to develop in these basins. They have gotten into these positions early and have built them out ahead of many of their competitors and even some of the large midstream MLPs that have decades of experience in this space.

Mr. Burnett said their ability to succeed in this strategy is driven by the strength of their team. David Capobianco and Matt Morrow are the two founders of the firm, and both have very deep investment and operating roles in the midstream space. Since the ERB invested in Fund I, they have significantly built out their team and the group they have added are very senior operating individuals from some of the large midstream companies.

Mr. Burnett said this is one of the highest performing relationships Hamilton Lane has in the energy portfolio. Because they just started in 2014, there haven't been many realizations out of the portfolio. With the one realization they had earlier this year, however, where they sold 20 percent of one company that spanned both Fund I and Fund II, that sale returned 40 percent of the total fund capital. The ERB had significant co-investment positions in that, so that brought in a three to four times return in that single investment. He added that, behind that investment, there are several midstream opportunities that are performing exceptionally well.

Mr. Magid moved the Investment Committee approve a \$50 million commitment in Five Point Energy Fund III, LP. for the Natural Resources portfolio and a \$30 million commitment 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 of the fund, should they become available from time to time. Ms. Cameron seconded the motion, which passed unanimously.

5. Q4 REAL ESTATE AND NATURAL RESOURCES

[Presenters: Mark Canavan and Hamilton Lane consultant Brent Burnett.]

Mr. Canavan summarized the Q1 report:

- Total capital committed: \$2.09 billion
- Market value: \$1.3 billion
- Total value multiple: 1.38x
- Total portfolio net IRR: 11.58%, up 12 basis points from Q1 2018 of 11.46%.

Mr. Burnett said this is a very diversified portfolio, and that will hold up very well in the event of any economic downturn.

6. OTHER REPORTS AND DISCUSSION

None.

7. NEXT MEETING: THURSDAY, AUGUST 22, 2019

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

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at 2:05 p.m.

Accepted by:



H. Russell Goff, Chairman