

MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE

February 11, 2009

CALL TO ORDER

A meeting of the New Mexico Educational Retirement Board Investment Committee was called to order on this date at approximately 2:00 p.m. in the Educational Retirement Board Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

A quorum was present, as follows:

Members Present:

Mr. Bruce Malott, Chair
Ms. Jan Goodwin
Mr. James B. Lewis [teleconference]

Members Excused:

Mr. Gary B. Bland

Other ERB Members Present:

Mr. H. Russell Goff
Dr. Beulah Woodfin

Legal Counsel Present:

Mr. Chris Schatzman

Staff Present:

Ms. LeAnne Larrañaga-Ruffy, Investment Officer
Mr. Steve Neel, Portfolio Manager

Others Present:

Mr. Holland Gary, Aldus Equity
Mr. Kenneth Miller, Aldus Equity
Mr. Brian Schneider, NEPC [teleconference]

APPROVAL OF AGENDA

Mr. Lewis moved approval of the Agenda, as published. Ms. Goodwin seconded the motion, which passed by voice vote.

APPROVAL OF MINUTES: January 8, 2009 & December 10, 2008

Mr. Lewis moved approval of the January 8 and December 10 minutes, as submitted. Ms. Goodwin seconded the motion, which passed by voice vote.

PRIVATE EQUITY UPDATE & ALDUS EQUITY PARTNERSHIP TURNOVER

Mr. Neel reported that NMERB staff was notified on January 29 that Marcellus Taylor, one of Aldus Equity's partners, had left the firm to launch a new private equity firm. He said NMERB staff drafted a questionnaire and conducted a phone interview with Saul Meyer, Holland Gary and Aldus's external counsel Brian Wick, who responded fully and satisfactorily. He said there no issues of concern going forward.

Mr. Neel also reported that staff is in contract negotiations with VSS, Sevin Rosen and Lee Equity.

PRIVATE EQUITY: APPROVE PRIVATE EQUITY INVESTMENTS

1. NGP Energy Technology Partners II

Mr. Gary reviewed Aldus's recommendation of a \$30 million commitment in NGP Energy Technology Partners II, LP, a \$300 million late stage venture fund focused exclusively in the energy space and based in Washington, D.C. Mr. Gary said the ETP team is led by Phil Deutch and Chris Sorrells, whose relationship dates back to 1997.

Mr. Gary stated that Natural Gas Partners has been in the energy space actively since 1988, and the Energy Technology Partners Group was created and founded by Mr. Deutch and his team in 2005. He said NGP Energy Technology Partners is affiliated with NGP Energy Capital Management, a family of funds focused across the entire energy sector and based in Irving, Texas.

Mr. Gary stated that Fund II will invest in 15 to 25 energy technology companies operating in four distinct and diversified energy technology subsectors—oil & gas technologies, power generation technologies, alternative

energy, and energy efficiency. He said the core of this strategy is the firm's disciplined focus on late stage energy technology companies with meaningful commercial revenue. He stated that this means companies with customers who are already paying for the service and technology being provided. He commented that this is a particularly good strategy in the venture space given existing market conditions.

Mr. Gary spoke to the expertise of the team in terms of their ability to go out into the energy space, understand what is going on in the market and the regulatory space, understand the various technologies, and then identify potential opportunities. He said this \$300 million fund has access to a much larger entity—the NGP platform manages about \$9 billion in total—so the exclusively dedicated Energy Technology Partners team will be able to leverage a lot of those resources and expertise in energy that date back into the late 1980s as they source deals and continue to add value to those transactions.

Looking at the track record, Mr. Gary said Fund I (2006 vintage) has had one write-down to date, and it is not uncommon for a venture fund to not have significant realizations yet. He noted a 10.4% net IRR as of September 2008, putting them comfortably in the top quartile. He said the benchmarks are still lagging a bit.

Mr. Gary said Aldus looked at the December numbers and found that the gross IRR numbers did decrease from about 20% to about 11%. He pointed out, though, that this is very early in the life of the Fund, an additional investment was made, and the Fund is still within the J-curve. He stated that the underlying value of the Fund has not dramatically changed. He also stated that Aldus is still waiting for the benchmarks to come out, and while he would assume those would also come down, this is an early VC fund with strong positive returns that could easily keep them within the top quartile two or three years out.

Managing Partner Phil Deutch presented slides that detailed estimated Fund I performance as of 12/31/08.

Mr. Deutch said NGP-ETP is in the final quarter or two of fundraising with a hard cap of \$400 million, and has raised about \$300 million to date.

Mr. Deutch stated that NGP-ETP feels its success in raising money in this environment is because the drivers of energy technology remain—people still care about limiting exposure to imported oil, reducing either the price of energy or the cost of getting new energy, keeping the electric grid reliable and safe, and climate change. He said all of these things remain as true now long-term as when NGP started the fund six months ago.

Mr. Deutch pointed out that, additionally, there are very powerful stimuli coming out of Washington, D.C., and there is no doubt that there will be an element of the stimulus that applies to renewable technologies. He said the companies in the portfolio are already seeing the benefit of the tax changes and spending, and it is very powerful particularly in the solar and wind areas. He noted that 35% of all electric generation added in the U.S. last year came from wind power, so there is a change in the nation's energy puzzle that is to the benefit of these new technologies.

Mr. Deutch stated that NGP-ETP feels that the risk of being early stage does not pay off in energy technology, and this has been evidenced time and time again. He said they leverage off of the NGP franchise so there is virtually no company in which they do not have great insight as a result of this relationship. He commented that they see this as a "thoughtful approach to investing."

Mr. Deutch stated that the Fund I portfolio had a 1.6x valuation on June 30, and by September it was at 1.3x, and at December 31 it was at 1.2x. He pointed to the resiliency of the portfolio because of its late stage companies, however, and discussed individual examples.

Mr. Deutch commented that NGP-ETP's strategy of staying late and being conservative has really helped them weather the economic downturn. He said they do not have a lot of debt on any of their companies, and all of the companies—if the stimulus plan hits and trickles through—will see huge markups.

Addressing the Fund II pipeline, Mr. Deutch said they are looking at four companies with \$100 million in revenue, all of them cash flow positive in 2009, and they are unable to get working capital. He said some have term loans with Bank of America; and even though they are current on the loans, the bank wants to de-lever and get out of the loan. Mr. Deutch remarked that this is a great place for NGP-ETP to be.

Ms. Goodwin asked Mr. Deutch how NGP-ETP views the apparent downward trend in natural gas and oil, and where is the crossover and where does this begin to negatively affect their portfolio companies.

Mr. Deutch responded that if people were to believe that long-term oil was going to be \$30 a barrel, for example, it would dampen upside returns in this space. He commented that there is a certain stimulus effect with high oil, but they avoid investments that have a direct play on commodities, so it may not hurt them directly. He commented that, while it is always nice to have higher oil and gas prices in alternative energy, they would never make a bet on something that would require \$80 oil or \$100 oil. He said NGP buys oil and gas assets, but they always hedge it out so they are not "naked in the commodity."

Ms. Goodwin moved that the Investment Committee approve a commitment of \$30 million plus any notional interest to NGP Energy Technology Partners II, LP. The commitment shall not exceed 20% of the committed capital of the fund, and is subject to New Mexico state law, Educational Retirement Board policies and negotiation of final terms and conditions and completion of appropriate paperwork.

Mr. Lewis seconded the motion, which passed by voice vote.

ABSOLUTE RETURN STRATEGIES—AUSTIN CAPITAL MANAGEMENT—REDEMPTION ISSUE

[Joining the meeting by teleconference was NEPC representative Brian Schneider.]

Summarizing staff's report, Mr. Neel stated that Austin Capital Management had exposure to Bernard Madoff through a Tremont feeder fund. He said staff and NEPC both recommend full redemption from Austin Capital.

Responding to questioning from Mr. Malott, Mr. Neel said Austin was at one time one of the ERB's best-performing fund of funds—leading into the Madoff situation, they were around -14% for the year, and to date they are -24% through the end of December (including the 7.5% piece of the portfolio that was essentially outsourced).

Mr. Neel reported that he, ERB general counsel Chris Schatzman and NEPC fund of funds expert Brian Schneider attended a full day due diligence visit at Austin.

Mr. Neel said staff looked at three issues.

Mr. Neel said the first issue was whether Austin followed their own policies and procedures; in other words, did they follow what they said in writing they were going to do. He said staff concluded that that was not necessarily the case.

Mr. Neel said the second issue was regarding the use of the feeder fund. He said Austin gained access to Madoff through Tremont, which was the feeder fund, and staff felt that Austin basically outsourced a piece of their due diligence to Tremont, which is a 7.5% piece of their portfolio and in staff's opinion was not prudent.

Mr. Neel said the third issue was the viability of the organization. He stated that Austin has received significant redemptions. He said staff did a back-of-the-

envelope analysis of Austin's assets under management and the associated fee income, and the fee income under their current proposal. He noted that, at a peak, they had about \$2.8 billion in assets and their management fee was 150 basis points. He said one of their proposals was a 75 basis point management fee. He noted that the fee revenue goes from between \$32 million and \$40 million down to \$8 million, so there is a real question regarding the viability of the organization.

Mr. Neel said the other piece is that Austin is owned by Victory Capital, a subset of Key Bank. He stated that staff met with Key and Victory executives, and they represented that there is support, and the question is what is the support and for how long are they really willing to subsidize the organization. He commented that obviously they purchased the organization and don't want it to go away, but the question is whether they are willing to subsidize the organization at \$2-\$3 million a year for four or five years while they regain assets.

On the matter of Austin's proposal to reduce their management fee, Mr. Neel said one recommendation is to go from 150 basis points to 75 basis points, or to go from 150 basis points to 50 basis points with a performance hurdle. He said both of these are significantly off market if one compares them to what Gottex is offering.

Mr. Neel said the other piece is the high water mark. He said Austin proposes an option that includes a high water mark that was reset in January 2008, and includes losses incurred due to Madoff and one month LIBOR. Under this option, he said they will have to generate about 10-12% before they actually start earning any performance, which makes the economic picture look that much worse.

Mr. Malott asked where the ERB's investment stands at this point and Mr. Neel responded that it was down 22-24% in 2008 and at this point was probably underwater.

Mr. Goff asked what chances there are of getting the money back.

Mr. Schatzman responded that there are some litigation issues that he would discuss in executive session at the Board meeting later this week. He commented that there are some strategies that can be pursued, but realistically, the amount was very small and sometime in the future.

Ms. Goodwin moved that the Investment Committee recommend that the NMERB redeem all of its shares in Austin Capital Management.

Mr. Lewis seconded the motion, which passed by voice vote.

Mr. Malott pointed out that there were a number of reasons why the ERB chose the fund of funds strategy, but the predominant one was all about risk management – the ERB would pay an extra level of fees to ensure that. He said he realized the investment world had changed in the two intervening years, but wondered what staff's thinking was on paying the extra fee for fund of funds as opposed to directly investing in hedge funds or not investing in anything related to hedge funds.

Mr. Neel responded that this was a topic of discussion at the Investment Committee several months ago, when Mr. Jacksha discussed the idea of starting off with a core fund of funds structure, and then spending the next 18 to 24 months gaining resources and knowledge of the industry, and then operating like a core satellite that is augmented with direct investments in individual hedge funds. He said he and Mr. Jacksha have discussed this idea at length.

Mr. Neel said the question goes to oversight and monitoring of this fund. He said NEPC does this for some entities.

Mr. Malott expressed concern about getting the resources to do due diligence at the levels of sophistication required.

**ABSOLUTE RETURN STRATEGIES—GOTTEX MARKET NEUTRAL
PLUS,
EMERGENCE FROM SUSPENSION**

[Joining the meeting by teleconference was NEPC representative Brian Schneider.]

Mr. Neel reported that Gottex suspended redemptions in November, and they are in the process of coming out of that moratorium.

Mr. Neel said the ERB has the choice of going into the continuing share class or the redemption share class, and staff and NEPC recommend the former.

Mr. Neel referred to a table in NEPC's memorandum describing Gottex's restructuring proposal. He said Gottex is proposing a management fee of 65 basis points (after negotiations), and there is a high water mark that covers all losses from the prior year.

Mr. Schneider recommended that the ERB remain in the continuing class, sign the appropriate documentation, consent to the revised terms and stay with Gottex. He said a shareholder vote will be held tomorrow.

Mr. Schneider stated that there is no lockup involved and liquidity will be there on a quarterly basis going forward. He said they will limit early withdrawals, and investors will not be able to pay a penalty to withdraw money early.

Mr. Schneider said Gottex has agreed to include a performance fee claw back where performance fees may be retrieved from Gottex for future poor performance.

Mr. Schneider said NEPC feels that Gottex has worked out these terms in a thoughtful manner, and NEPC recommends that the ERB remain an investor with Gottex.

Mr. Neel pointed out that this fund of funds has leverage at the fund of funds level, which is very important. He asked the Committee to consider, should it decide to stay with Gottex, whether it wants to retain the leverage share class or relinquish the leverage. He said staff recommends retaining the leverage going forward.

Mr. Malott said the question is whether the ERB wants leverage if things start moving the other way in the markets.

Dr. Woodfin asked if there are fixed borrowing costs, or are they going down because LIBOR has gone down.

Mr. Neel agreed that this was a good point, since it makes the leverage more attractive.

Mr. Malott said he personally thought the ERB should stay with the leverage.

Ms. Goodwin stated that she was still not comfortable with their due diligence procedures and asked Mr. Neel when staff last visited with them.

Mr. Neel responded that staff could arrange a trip to Gottex in Boston. He said staff has not visited with Gottex for about six months.

Mr. Neel suggested that, because of the time constraint, the Committee may want to give its approval of staff's/NEPC's recommendations today subject to the due diligence visit; and if the findings from the visit are found to be unacceptable, the ERB could redeem at that point.

Mr. Malott recommended that the approval be subject to a 90-120 day window for the due diligence visit.

Ms. Goodwin moved that the Investment Committee elect that NMERB's shares in Gottex Market Neutral Plus be committed to the continuation

leveraged share class subject to New Mexico State law, Educational Retirement Board policies and negotiation of final terms and conditions and completion of appropriate paperwork; and subject to a satisfactory due diligence on site visit by NMERB staff and NEPC staff, to take place within 90-120 days.

Mr. Lewis seconded the motion, which passed by voice vote.

Mr. Malott recommended that members of the Board opt to accompany staff on due diligence visits in the future.

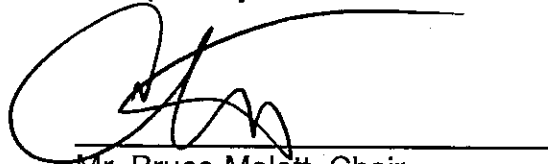
APPROVE PROXY VOTING REPORT Q-4 2008

Ms. Goodwin moved for approval. Mr. Lewis seconded the motion, which passed by voice vote.

ADJOURN

Its business completed, the Investment Committee adjourned the meeting at approximately 3:40 p.m.

Accepted by:



Mr. Bruce Malott, Chair