# ACTION SUMMARY

**EDUCATIONAL RETIREMENT BOARD**

**INVESTMENT COMMITTEE**

January 25, 2013

<table>
<thead>
<tr>
<th>Item</th>
<th>Action</th>
<th>Page #</th>
</tr>
</thead>
<tbody>
<tr>
<td>APPROVAL OF AGENDA</td>
<td>Approved</td>
<td>3</td>
</tr>
<tr>
<td>APPROVAL OF MINUTES December 13, 2012</td>
<td>Approved</td>
<td>3</td>
</tr>
<tr>
<td>ELEGANTREE FUND: Opportunistic Credit Approval</td>
<td>$50 million</td>
<td>3</td>
</tr>
<tr>
<td>CROW HOLDINGS REALTY PARTNERS VI: Real Estate Approval</td>
<td>$50 million</td>
<td>6</td>
</tr>
<tr>
<td>Q4 2012 PROXY VOTING REPORT</td>
<td>Approved</td>
<td>8</td>
</tr>
<tr>
<td>Q3 2013 REAL ESTATE AND NATURAL RESOURCES PERFORMANCE REPORT</td>
<td>Informational</td>
<td>8</td>
</tr>
<tr>
<td>Q3 2012 PRIVATE EQUITY PERF. REPORT</td>
<td>Informational</td>
<td>9</td>
</tr>
<tr>
<td>2013 PRIVATE EQUITY STRATEGIC PLAN</td>
<td>Informational</td>
<td>9</td>
</tr>
<tr>
<td>OTHER INVESTMENT REPORTS AND DISCUSSION</td>
<td>Informational</td>
<td>10</td>
</tr>
</tbody>
</table>
MINUTES OF THE
NEW MEXICO EDUCATIONAL RETIREMENT BOARD
INVESTMENT COMMITTEE
January 25, 2013

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 Room, 6201 Uptown Boulevard, N.E., Ste. 203, Albuquerque, New Mexico.

A quorum was present:

Members Present:
Mr. H. Russell Goff, Chair
Ms. Mary Lou Cameron
Ms. Jan Goodwin
Dr. Thomas McGuckin

Members Excused:
None.

Legal Counsel Present:
None.

Staff Present:
Mr. Bob Jacksha, CIO
Ms. Christine Ortega, Investment Financial Analyst
Mr. Steve Neel, Deputy CIO
Mr. Mark Canavan, Real Estate Portfolio Manager
Ms. Kay Chippeaux, Portfolio Manager
Mr. Jude Perez, Portfolio Manager

Others Present:
Mr. Allan Martin, NEPC
Mr. Kevin Tatlow, NEPC
Mr. Steve Gruber, RAPM
Ms. Judith Beatty, Recorder
APPROVAL OF AGENDA

Dr. McGuckin moved approval of the agenda, as presented. Ms. Goodwin seconded the motion, which passed unanimously by voice vote.

APPROVAL OF MINUTES: December 13, 2012

Dr. McGuckin moved approval of the December 13 minutes, as submitted. Ms. Goodwin seconded the motion, which passed unanimously by voice vote.

INTRODUCTION OF GUESTS

Guests were introduced.

ELEGANTREE FUND – OPPORTUNISTIC CREDIT APPROVAL

Mr. Jacksha stated that the ERB has been working toward filling out the opportunistic credit allocation. EleganTree is an existing manager, and NEPC and staff are recommending that the ERB commit an additional $50 million, increasing the commitment from $150 million to $200 million.

Ms. Chippeaux presented an overview of the manager and types of the investments in the fund:

-- Following the credit crisis, banking institutions had large and unprecedented write-downs in their balance sheets, reducing the capital in the banks. At the same time, regulators enacted reforms to bank capital requirements to strengthen their ability to withstand financial stress.

-- Regulatory capital relief trades, such as those provided by EleganTree, provide near term relief and boost the banks’ tier one capital ratios by lowering their risk-weighted assets. The fund and the bank select assets from the bank’s balance sheet and pool them together. These assets are generally core assets of the bank that the bank does not want to sell. EleganTree takes a slice of the credit risk and then receives a high coupon payment for their piece of the pool and for taking the credit risk. The bank maintains these assets on their balance sheet, and has a vested interest in continuing to monitor and service the assets.

-- The fund manager, Orchard Global Asset Management, is located in London, Singapore and Toronto. They have 23 professionals, including the 6 principals that
manage the fund. Orchard and its predecessor companies have been in existence for over 9 years; they specialize in bank capital trades, opportunistic sovereign and provincial trades, non-US asset based lending, and structured finance trades. AUM is at $2 billion.

NEPC consultant Allan Martin stated that one of the few opportunities to continue to earn reasonably attractive returns is in this distressed credit space. Right now, the ERB’s target is 20%, and it is slightly lower than that in actual investments; however, these investments have been so successful for the ERB that a number of these strategies will start returning money.

Mr. Martin said returns since inception (a year ago) are at 13%, well in line with expectations.

Responding to Ms. Goodwin, Mr. Jacksha said EleganTree has called $75 million of the $150 million the ERB has committed, and they will be calling all or most of the remainder this year to make new investments – they have told staff they see a robust pipeline of potential investments. He added that these are generally not distressed assets – these are core assets that the bank wants to keep.

Responding to Chairman Goff, Mr. Jacksha said these investments will primarily be in European and Asian banks.

Ms. Chippeaux asked Mr. Martin to discuss this opportunity going forward.

Mr. Martin responded that European banks are seriously undercapitalized, and while relaxing Basel III may lower the near-term appetite, the demand is still there. He added that there are not many opportunities for European banks to repair their balance sheets, and this is one method of choice. Furthermore, there are not a lot of suppliers of funds into this market.

CEO Paul Horvath and senior portfolio manager John Young, of Orchard Global Asset Management, appeared before the Committee and made a presentation.

Responding to Dr. McGuckin, Mr. Young said Basel III has recently issued additional guidelines, most of which may soften up some of their very harsh capital provisions while also helping solve the liquidity problem, but this has also created a greater need for capital.

Responding to Mr. Martin, Mr. Young said they are seeing increased competition, but they are also seeing new entrants and expect that to continue. He said what they hope for – and their pipeline bears this out – is that in the foreseeable future they will be able to maintain returns in the mid teens at least during the draw-down period. He said there are two drivers: 1) there is still a very large need for capital; and 2) EleganTree is focused on one area while its competitors are focused on several.
Mr. Martin added that, relative to the size of EleganTree, the banks don’t want to deal with multiple suppliers of this kind of credit. Mr. Young agreed.

Ms. Chippeaux referred to EleganTree’s rating exposure pie in their presentation and asked how much collateral is secured versus unsecured, generally speaking.

Mr. Young responded that 9% of the portfolio is single B exposure, and most of that is secured. As a general rule, the higher the rating, the less likely there will be security.

Ms. Chippeaux asked if it was fair to say that 25% of the pie might be secured, and Mr. Horvath responded yes.

Understanding that the underlying collateral can be global, Ms. Chippeaux observed that most of the investments are with European banks.

Mr. Young responded that many of their investments with European banks have had U.S. collateral. In this fund, they have executed a transaction with a North American bank as well as a European-regulated bank that has all of its operations in Asia. He commented that EleganTree has found that their counterparties “are a little bit more global than expected.”

Ms. Chippeaux asked how they view tail risk in Europe, and Mr. Young responded that there are many challenges ahead in Europe, but in terms of liquidity issues there seems to be a bit less systemic risk.

[Mr. Horvath and Mr. Young left the proceedings.]

Mr. Jacksha noted that this is an experienced team that is probably the leader in this area. He said they have delivered what they said they would deliver, they have been good partners to work with, and they have been very forthcoming with information.

Mr. Martin added that the ERB would be getting a very high-income coupon and would be getting its money back in a very short period of time.

Mr. Jacksha said no placement agent was used in this transaction or in the previous one with EleganTree.

Dr. McGuckin moved that the Investment Committee approve a commitment of $50 million to EleganTree. 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. Goodwin seconded the motion, which passed unanimously by voice vote.
CROW HOLDINGS REALTY PARTNERS VI – REAL ESTATE APPROVAL

Mr. Canavan, appearing with Steve Gruber of RAPM, presented staff’s recommendation of a $50 million investment in Crow Holdings Realty Partners VI.

-- Crow seeks to raise $750 million to invest in value-add real estate. The fund can invest across virtually all segments of the commercial and industrial real estate sectors, and this flexibility allows fund management to take advantage of opportunities as they arise and to allocate capital to sectors with the best risk/return profile.

-- Fund management anticipates weighting Fund VI more toward multifamily, convenience and gas stores, and industrial properties, with less emphasis on office and retail segments and lowest priority to hotels and land.

-- Value-add strategies may include increasing net operating income through rollover of leases, lease-up of current vacancies, rebalancing tenant mix, and rebranding and/or repositioning the property to attract more profitable clientele.

-- Value creation may also come from renovation of facilities, installation of new management to obtain greater operational efficiencies, the addition of capacity in supply-constrained markets, and the acquisition of properties below replacement cost.

-- The Crow family name is one of the most readily recognizable and highly respected names in the real estate industry. The family history of investing in real estate began in 1948 with Trammell Crow. CHRP VI is the firm’s sixth private equity real estate fund, and Crow Family Holdings is investing $75 million alongside their Fund VI investors.

Mr. Gruber discussed the firm’s value-add strategy. He said they use conservative leverage (generally below 65%) and have a real income orientation with respect to the assets they buy.

Mr. Gruber said a benefit of Crow is that they do not allocate capital to a partner who then develops the property; rather, they do the development activity themselves, which limits the amount of fees paid by investors.

Mr. Gruber said Crow generally invests in smaller properties; a typical fund will have 50 investments, with each investment on average making up 2% of the portfolio with a 10% limit. This highly diversified strategy is one of the ways they mitigate risk.

Harlan Crow, Chairman of Crow Holdings Capital Partners, appeared before the Committee with managing directors Bob McClain and Dan Feeney and made a presentation.
-- CHCP formally began the fund business in 1998 and has raised $3 billion of equity since then, of which the Crow family has committed $600 million. In that timeframe, they have developed $11 billion of real estate.

-- Funds II and III are 100% realized, with IRRs of 25% and 40% respectively. Fund I is 91% realized and has been extended, with two deals that have achieved a 1.8x multiple. Fund IV has a 4% projected gross IRR and Fund V has a projected gross IRR of 17%.

Mr. Feeney and Mr. McClain reviewed a breakdown of the Fund V portfolio, comprising 48 transactions and a projected gross yield of 9% in 2013, and a projected breakdown of Fund VI.

Crow representatives left the proceedings.

Ms. Cameron noted that RAPM’s report mentioned the following concerns (pages 20 and 23):

-- RAPM found that Crow’s underwriting models in a number of deals were rudimentary and overly reliant on simplified assumptions. There was no sensitivity modeling or downside scenarios on the key assumptions used in the underwriting. Crow conceded that these analyses have been poorly documented and they intend to alter their investment committee packages to ensure that all supplemental sensitivity analyses are incorporated into the materials.

Mr. Gruber said the problem was that issues that were very intuitive to the investment team were not making it into the investment committee memos - they had completed the analyses, but they were buried elsewhere in the organization.

-- More recent Crow funds are largely based on projections that may not materialize, although RAPM believes their track record is compelling.

Mr. Gruber responded that Fund IV is largely unrealized, and while the business plans and models for the assets appear reasonable to RAPM, there is no guarantee that they will reach projections. He said their track record is very consistent over a very long period of time – 230 transactions, $3 billion of equity, and 130 realizations.

Ms. Goodwin asked how the vintage years of the Crow funds compare to their peers, and Mr. Gruber responded that they are second quartile, or above average. Mr. Canavan said that, when compared to value-add and opportunistic funds, as detailed in his report, Crow’s performance is pushed down because opportunistic has higher targeted return levels.

Mr. Jacksha said this is a very experienced and cohesive team, and this is a good fit for the ERB real estate portfolio.
Ms. Cameron moved that the Investment Committee approve a commitment of $50 million to Crow Holdings Realty Partners VI, L.P. subject to and contingent upon New Mexico state law, Educational Retirement Board policies, and negotiation of final terms and conditions and completion of appropriate paperwork. Dr. McGuckin seconded the motion, which passed unanimously by voice vote.

[Break.]

**Q4 2012 PROXY VOTING REPORT**

Mr. Jacksha reported on exceptions where ISS recommended voting against management.

Ms. Cameron voted to approve the Proxy Voting Report. Dr. McGuckin seconded the motion, which passed unanimously by voice vote.

**Q3 2012 REAL ESTATE AND NATURAL RESOURCES PERFORMANCE REPORT**

Mr. Gruber presented this report, with the following highlights as of 9-30-12:

-- ERB total portfolio value was $9.7 billion. Long-term target allocations to real estate and natural resources are 5% ($500 million) and 3.5% ($341 million) respectively. NAV of the real estate portfolio was $566 million and NAV for natural resources portfolio was $28 million.

-- ERB had $132 million of committed but uncalled allocations to private real estate managers and $76 million of committed but uncalled allocations to natural resources managers. [Not included: RAM Realty Partners III, Brookfield Brazil Timber Fund II; Sares Regis Group; Haldeman Agricultural Separate Account; and Lone Star Real Estate Fund VIII.]

-- Public REITS returned .70% for the quarter and 9.25% since inception, beating the index.

-- Private Real Estate returned 3.66% for the quarter (beating the index) but lagging since inception.

-- Natural Resources returned .56% for the quarter and .34% since inception, under the index.
Q3 2012 PRIVATE EQUITY PERFORMANCE REPORT

Mr. Neel and Mr. Tatlow presented this 3rd quarter report.

-- ERB earned a nominal IRR of 4.23% for the quarter and a one-year IRR of 18.50%. Annualized IRR of the private equity portfolio since inception was 9.47% at quarter end.

-- As of Q2 2012, the ERB had a return of an 8.7% net IRR since inception with $47 million in distributions, which was the first quarter when there was more in distributions than capital called. Distributions continued to be very strong for Q3 and are expected to be very favorable for Q4 as well.

-- Most of the funds in the portfolio are still actively investing.

-- At quarter end, the ERB had commitments totaling $1.4 billion to 35 private equity funds. Of the 35, 1 is in the fundraising stage, 27 in the investing stage, and 7 in harvesting stage.

2013 PRIVATE EQUITY STRATEGIC PLAN

Mr. Tatlow presented this report.

-- Included in the $250 million recommended allocation to this year’s vintage funds is: $20 million in venture capital (to be included with the $30 million already approved in 2012); $100 million to buyout and growth; $50 million to mezzanine; $30 million to distressed; and $50 million to co-investment.

-- In addition, several allocations in the 2012 plan are currently in process and will be made in early 2013: $40 million to distressed; $30 million to venture; $50 million to mezzanine.

-- ERB should maintain an active commitment pace in each vintage year going forward as the plan approaches its target allocation.

-- Short-term objective: utilize strategies with a short time horizon to liquidity to mitigate the J-curve; utilize secondary strategies, mezzanine strategies and drug royalties.

-- Long-term objective: utilize strategies with a longer time horizon to liquidity and potential to generate returns in excess of public equity returns; invest in venture, growth equity and buyout whose principal source of returns is capital appreciation.
-- Opportunistic objective: distressed strategies are cyclical and will be utilized on an opportunistic basis.

-- Combining 2013 and 2014 in the proposed commitment schedule, the ERB would be actively participating across all strategies with the exception of the energy sector, where there may be a commitment in 2015.

Ms. Goodwin and Committee members commended Steve Neel for his hard work and dedication to the private equity program since its inception, and for the excellent results.

OTHER INVESTMENT REPORTS AND DISCUSSION

Mr. Jacksha reported preliminary returns for the portfolio as of 12/31/12:

-- 1-year returns, 13.6%; 3-year returns, 9.2%; and 5-year returns, 3.6%.

Mr. Jacksha also stated that the fund NAV of $9.9 billion is a new high for the ERB.

Mr. Martin commented that, based on the 5-year number of 3.6%; the ERB will likely be in the top quartile in the public funds universe.

Mr. Martin reviewed a portion of an NEPC report discussing NEPC’s 2013 capital market observations and general actions for clients, plus information on bond returns forecasting.

Chairman Goff reported that he and Mr. Jacksha attended the NEPC conference in Phoenix last week, where there was extensive discussion on governance. He asked Mr. Jacksha to discuss the models for Wisconsin, Arizona State Retirement, and Wyoming.

Mr. Jacksha said Wisconsin has a staff internal investment committee chaired by CIO David Villa. Other staff members are on the committee.

Mr. Jacksha said Arizona State hired a consultant to look at their governance structure, and he will share that report with the Board.

Mr. Martin commented that Arizona, a $28 billion fund, has a 9-member board. Historically they have had a subset of the board serve as an investment committee, and they have had a public and private markets committee making the decisions, upon which board members sit. He said they hired a consultant, Cortex, to look at best practices, with the fundamental question being: If the decision-making is vested with a lay board (teachers, educators, appointees of the governor), is the best use of their time debating which managers to hire and fire, when 95% of the fund return is going to be determined by the strategic asset allocation.
Mr. Martin said Arizona has decided to have staff determine manager hiring and firing subject to their fiduciary consultant working for the board to make sure proper procedures are followed. The board will receive documentation every quarter detailing who was hired and who was fired and what procedures were followed, and will be in control where their policies are executed; however, their main focus will be on long-term strategy and each quarter the board will review an asset class in detail. He added that the board’s decision to move manager selection to staff was out of concern among some board members that there could potentially be political pressure exerted on investment decisions.

**NEXT MEETING: THURSDAY, FEBRUARY 14, 2013 – SANTA FE**

**ADJOURN**

Its business completed, the Investment Committee adjourned the meeting at 3:45 p.m.

Accepted by:

[Signature]

H. Russell Goff, Chair