# ACTION SUMMARY
STATE INVESTMENT COUNCIL
April 25 2017

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1. OPENING MATTERS
   a. Roll call and introduction of guests: quorum present

A regular meeting of the New Mexico State Investment Council was called to order by Governor Martinez, Chair, on this date at 9:00 a.m. in the Governor’s Cabinet Room of the State Capitol Building, Santa Fe, New Mexico. A quorum was declared:

Members Present:
The Honorable Governor Susana Martinez
Ms. Linda Eitzen, Public Member
Mr. Harold Lavender, Public Member
Ms. Lynn Hoffman, Public Member
Mr. Scott Smart, Public Member
Mr. Leonard Lee Rawson, Public Member
Ms. Duffy Rodriguez, Secretary of Finance & Administration
The Honorable Tim Eichenberg, State Treasurer

Members Absent:
Mr. Peter Frank, Public Member
Mr. Tim Jennings, Public Member
The Honorable Aubrey Dunn, Commissioner of Public Lands

Staff and Committee Members Present:
Mr. Steven K. Moise, State Investment Officer
Mr. Vince Smith, Deputy State Investment Officer
Mr. Brent Shipp, Chief Financial Officer
Mr. Evan Land, Chief Counsel
Mr. Charles Wollmann, Director of Communications & Legislative Affairs
Ms. Kerri Segell, Executive Assistant, Recorder

Guests Present:
[See Sign-in Sheet.]
b. **Approval of agenda**

Ms. Eitzen moved approval of the agenda as presented. Mr. Lavender seconded the motion, which passed unanimously by voice vote.

c. **Approval of minutes: March 28, 2017**

Ms. Eitzen moved approval of the minutes of March 28, 2017, as submitted. Mr. Lavender seconded the motion, which passed by voice vote unanimously.

2. **INVESTMENT MATTERS: INVESTMENTS REQUIRING VOTE**

a. **Investment Committee Report (Linda Eitzen)**

Ms. Eitzen reported on and provided an overview of the meeting of April 13. Among the matters considered and reviewed by the Committee were the December 2016 TUCS report and a $100 million investment in Macquarie Infrastructure Partners IV, which was unanimously approved by the Committee for recommendation. Ms. Eitzen remarked on an investment that was removed from the Committee’s agenda due to difficulties negotiating the SIC’s transparency and disclosure policy with the venture firm. The Committee suggested staff review the policy to determine whether the changes are merited. A liquidity study, authored by Vince Smith, was presented to the Committee. The issue of liquidity was deemed important as part of the current asset allocation study and the establishment of new allocation weights. As part of the asset allocation study, the Committee also considered the re-characterization of hedge funds from an asset class to a strategy, and an increased real estate allocation.

b. **Vote: Real Return: Macquarie Infrastructure Partners IV, L.P. (Vince Smith, Paul Chapman, Townsend)**

Townsend and SIC staff recommended a $100 MM commitment to Macquarie Infrastructure Partners IV, L.P. (MIP IV), a core plus to value-add North American infrastructure strategy fund for the SIC’s real asset portfolio. Mr. Chapman began with an overview of the real asset portfolio, including target allocation, current commitments and pacing model. He highlighted the role of real assets within the broader SIC portfolio, commenting that they provide cash-flow, a hedge against inflation, and he gave emphasis to the large need for infrastructure development within the U.S.

Seth Marcus, on behalf of Townsend provided an introduction to Macquarie and its strategy. He provided the details on find size, target return, expected cash yield, and the fund’s anticipated primary investment sectors. Mr. Marcus reviewed the positive attributes offered by Macquarie, citing the firm’s experienced team, platform, track record, operational expertise, and favorable fund terms. A first close discount was available to the SIC which would provide additional fee savings, should the investment be approved today. Mr. Marcus discussed one of Townsend’s potential concerns with Macquarie was that while the firm had been involved globally as an infrastructure investor for over twenty years, the MIRA (Macquarie Infrastructure and Real Assets) team and platform was formed in 2010, through organizational restructuring. Although there was turnover and lateral moves, Townsend viewed the creation of the MIRA team as positive and stabilizing and will retain the same senior leadership as past infrastructure funds. Mr. Marcus reviewed the transactions that had failed to return capital in Fund I made before the financial crisis and discussed Macquarie’s track record over multiple economic cycles. Ultimately, Townsend felt that an infrastructure investment with Macquarie, with its long and experienced history was preferable to a newer manager limited track record in length and depth.

Guillermo Marroquin and Karl Kuchel, from Macquarie, presented Fund IV to the Council. Mr. Marroquin spoke about Macquarie infrastructure Partners, the firm’s track record, experienced team, proven sourcing capabilities, and value creation through active management. Mr. Kuchel led the Council through Macquarie’s strategy and the investment opportunities to be found in infrastructure in North America. He reviewed the firm’s regional strategies, the sectors that will be focused on, and potential opportunities. Mr. Kuchel described value creation strategy as EBITDA growth; an
average of 7% EBITDA growth has been realized in predecessor funds. He discussed the large existing market for private infrastructure ownership with additional opportunities expected in the near future. Mr. Kuchel believed that the attractive return profile, substantial depth of opportunities and relative strength of the North American market provided a compelling investment proposition. The targeted infrastructure sectors to be included in the portfolio, utilities, transportation, waste management and communications were reviewed.

Treasurer Eichenberg asked whether it was typical to be charged a fee on uninvested capital. Mr. Koch replied that yes this was typical in private fund investment vehicles. The Treasurer asked for clarification on the financial advisory services provided by Macquarie Capital, questioning whether the use of a Macquarie affiliate was disproportionate as compared to other financial advisors. Mr. Kuchel explained that in the pursuit of transactions, Macquarie often assessed the market for financial advisory services, which could be Macquarie Capital or any other number of third party advisors. All engagements and terms were justified and approved by an outside investor advisory committee. Macquarie has substantial experience in dealing with the conflicts as it has utilized the current business model for over seven years. The model ensures there are proper checks and balances and procedures to follow to ensure that all conflicts are dealt with properly. The advisory committee comprised of limited partners plays a key role in resolving conflicts and approving affiliated transactions. Treasurer Eichenberg also referred to a similar circumstance with leverage, and while it was not a preference to borrow from a Macquarie affiliate, sometimes there may be a situation where it was in the best interest of the fund to borrow from Macquarie subject to independent LPAC approval.

Ms. Hoffman asked Mr. Kuchel about the fund’s gross return target and whether Macquarie believed reaching the return goal would be more difficult in Fund IV than previous funds. Mr. Kuchel spoke to Macquarie’s investment discipline and risk profile, which has remained the same over all infrastructure fund vintages, their successful management of infrastructure assets throughout market cycles, and the expected moderation of returns due to the current phase of the market cycle for Fund IV.

Mr. Lavender inquired about preferred infrastructure sectors today, and Mr. Kuchel responded that in each sector Macquarie sought out investments that had a solid foundation and provided both growth and a hedge against inflation and higher interest rates.

Mr. Rawson expressed his concerns about both the fund’s expected rate of return and affiliate fees. Mr. Koch reviewed Macquarie’s transparency of affiliate fees, which were discussed and approved at LPAC meetings, going further in disclosure than most of Macquarie’s peers. Reiterating Mr. Kuchel, Mr. Koch discussed the market cycle and the anticipation of moderating returns. Townsend believed that investments in infrastructure remained prudent and beneficial opportunities were present in the market with acceptable returns. Townsend’s preference was for a tried and true manager that has operated through market cycles, and use the knowledge gained over history for future transactions. Except for MIP I, the other infrastructure funds were not yet in fully realized positions, and returns were expected to move higher as exits were made. Mr. Chapman added that he has attended Macquarie Asia LPAC meetings, and the discussions are extensive and rigorous in determining affiliate and/or third party transactions. Mr. Chapman also reasserted the investment recommendation by reason of Macquarie’s global reputation, platform, unique expertise, and capabilities in the infrastructure sector, and he spoke complimentary about the firm as an existing manager.

Based on the recommendations of the Council Investment Committee, SIC staff, real estate advisor Townsend, and the general fiduciary oversight of advisor RVK, Ms. Eitzen moved that the State Investment Council approve a commitment of up to $100 million to Macquarie Infrastructure Partners IV, L.P., subject to an contingent upon New Mexico legal requirements, New Mexico State Investment Council policies, negotiation of final terms and conditions, and completion of appropriate paperwork. Mr. Lavender seconded the motion which passed on a voice vote with Treasurer Eichenberg voting no.

3. INVESTMENT MATTERS: REPORTING, INVESTMENT PERFORMANCE & MARKET UPDATES

a. SIC Investment Performance Reporting (V. Smith & RVK)

State Investment Council Meeting: April 25, 2017
Mr. Smith briefed the Council on the March 31, 2017 performance report distributed today. He commented on asset allocation against the interim targets, all well within their respective policy bands. Fund composite performance for the 1-year was 11.52%, ahead of the policy benchmark. He remarked that the fixed income and real return portfolios were responsible for the outperformance over the past year.

Mr. Rawson, in light of continued strong returns, suggested it might be timely if the performance report was condensed and distributed to the legislators showing the value of the permanent funds and the substantial returns that benefit the state. Alternatively, the dashboard format could be adapted to present performance data in an effort to strengthen the message of the significant revenue provided by the funds on an annual basis. Mr. Smart advised that any communication include a longer-term vision, along with the recent short-term successes of the funds. Mr. Rawson agreed that showing intergenerational equity was important. Ms. Eitzen added that the increasing amount of distributions to the state over time should be shown, as well as the budgetary benefit to the state of the predictable inflow to the general fund.


Matthias Bauer presented RVK's 2017 capital markets assumptions report, reminding the Council that these assumptions bear a direct correlation to the asset allocation decisions to be made soon. He provided a broad overview of RVK's viewpoint of the current market environment, trends, and macroeconomic expectations. Mr. Bauer detailed the proposed asset allocation refinements developed by staff and consultants as 1) hedge fund re-categorization, 2) fixed income asset bifurcation, 3) increasing the real estate allocation, and 4) a review of the mix of U.S and international equities. Mr. Bauer provided a review of RVK's philosophy in the assumption-setting process and the incorporation of updated risk/return/correlation components into their expectations. There had been no significant changes to underlying assumptions from the previous year, only refinements to return assumptions, and Mr. Bauer went into detail by individual asset class looking at the fundamentals of each class and reviewing year-over-year changes in RVK's long-range assumptions for each asset class. Materials contained in the report - trendline diagrams, global equity and fixed income decomposition models, information on equity cycles, comparison of the price of real assets relative to financial assets, expectations of compound returns, among other macroeconomic information contained in the report, were reviewed and discussed.

c. **Asset Allocation Workshop: Liquidity Study**

Vince Smith presented his liquidity study beginning with an explanation of the four different types of portfolio liquidity – asset liquidity, "natural" liquidity, "normal" liquidity, and "crisis" liquidity. It was the latter that the study focused on. Mr. Smith went into detail in his analysis of crisis liquidity making use of a chart in the report that assigned liquidity scores to all asset types, in both a normal market and crisis market. He described the changes in an asset's liquidity score in a "crisis" market, and examined further the scores when preference liquidity was included in the equation. Mr. Smith stated that given the low asset liquidity in a crisis market of all assets except fixed income assets, crisis liquidity is confined to fixed income assets, core fixed income specifically. Further characteristics, purposes, and determining appropriate allocation size of fixed income investments were reviewed. Mr. Smith stated that the purpose of the liquidity study was to determine how much liquidity was needed in a crisis, and minimize the bond portfolio to that need. A drawdown model was created to determine the percentage of assets that need to be held in liquid fixed income investments for liquidity needs. Specific recommendations to the SIC's portfolio were proposed by Mr. Smith.

[Treasurer Eichenberg left the proceedings at 11:00 a.m.]

4. **STATE INVESTMENT OFFICER'S REPORT** (Steve Moise)

**Investment Matters:** Mr. Moise reported that the current intra-month NAV, as reported by JP Morgan, is $21.701B. Distributions to the State over the past twelve months from the LGPF and STPF totaled $840M. The price of WTI oil yesterday was $49.23. He remarked on the uptick in the State Land Office’s contributions to the LGPF, an increase thus far of $26.4 million year-over-year.

State Investment Council Meeting: April 25, 2017
A report on the SIC's portfolio exposure in New Mexico had been provided in the Council’s materials.

Council Matters: The May meeting dates had been included in the Council’s meeting materials. The Governance Committee, not listed on the report, will meet on Thursday, May 18 at 10 a.m.

Scott Smart will cover the requested endorsement of the accomplishments & goals memo, prepared annually by staff. Mr. Moise thanked the Council for their continuing support and requested that any comments, suggestions, or changes to the memo were welcome.

Operations: Recruitment work with SPO continued for the two vacant positions: public and private equity analysts. An excellent candidate had been identified for the private equity analyst position and hiring approval is being sought. A new accounting/compliance analyst, Chris Thompson, had been hired, and Mr. Moise remarked that he was pleased at the caliber of candidates that had been recently sourced.

Mr. Shipp will comment on the most recent internal audit report regarding investment management and incentive fees, as well as the FY18 budget.

External relations: Mr. Moise reported on upcoming outreach activities, commenting on his intention to travel throughout the state in an effort to better educate citizens about the permanent funds, the State Investment Council, and the important benefits of the funds. Speaking engagements were to begin the following week with UNM Anderson School's business breakfast. Other speaking dates had been scheduled and several invitations were pending.

5. FINANCE MATTERS: DISCUSSION

a. Audit Committee Report (Jim Goodwin)

Jim Goodwin reported that the Audit Committee had met on April 11. The primary purpose of the meeting was to review the SIC’s FY 2018 budget request. A draft of the budget had been previously provided to the Committee for review. Brent Shipp reviewed the budget and answered questions for the Committee. Mr. Goodwin reported that the Committee had unanimously approved the SIC’s FY 2018 budget subject to any minor modifications that might be needed between the Committee’s meeting and the budget submission date.

CLA's Agreed Upon Procedures Report (AUP) for the first and second quarters of FY17 had also been reviewed at the meeting, copies of which had been distributed to the Council. No exceptions were noted by CLA in the reports. The final REDW internal audit report regarding private investment management and incentive fees was also reviewed.

The Council discussed the results of the internal audit work regarding fees, and Mr. Goodwin and Mr. Shipp commented on the challenges encountered in fee calculation methodology and reporting of these private market fees.

Ms. Hoffman thanked Mr. Goodwin for his service and contributions to the Audit Committee.

b. CFO report (Brent Shipp)

The budget-to actual report for March, as well as the Investment Holdings Report had been included in the Council’s materials. Mr. Shipp did not anticipate any budgetary problems for the final few months of the fiscal year.

Mr. Shipp reviewed FY 18 budget matters. As reported, the Audit Committee had reviewed the budget in early April. Due to the early meeting date, numbers were not final at the time, but the updated final draft had been included in the Council’s supplementary materials for today. Mr. Shipp remarked that the dollar amounts in each category had not changed since the Audit Committee review, only small adjustments had been made within categories, and he offered to answer any questions the Council might have. Mr. Shipp remarked that the budget could be tight in the
personnel category in FY 18 as it was anticipated that positions which had been vacant for some time will be filled, and this may possibly require the transferring of budget dollars between categories.

6. **GOVERNANCE MATTERS: COMMITTEE REPORT: DISCUSSION & VOTE**

   a. **Vote: Accomplishments & Goals**

   Mr. Smart began by commenting that everyone had received the Accomplishments and Goals document prepared by staff and congratulated staff on their efforts. He remarked on investment accomplishments, the extensive portfolio changes that had been implemented, and the important investment goal for the upcoming year to implement the 2017 asset allocation study. Mr. Smart continued that accounting accomplishments were evident in the clean results of both the external and internal audits, and legal accomplishments were observable in litigation recoveries and the considerable contracting work that had been required in conjunction with portfolio/asset reconstruction. Communication efforts continued towards both education and transparency.

   Mr. Rawson commented on the differences in expectations and goals, using as an example under investment goals the language “conduct any necessary RFPs”. He considered this an expectation as part of ongoing responsibilities, and not necessarily a goal. Mr. Rawson suggested deleting items from the document that were more routine, rather than goals.

   Mr. Rawson discussed removal of the investment goal to “build a framework, for discussion, of a basic level of investment authority transfer to the CIC and the investment staff from the full Council”, observing that there may not be Council consensus on the matter. He acknowledged that it was appropriate for there to be ongoing discussions on staff/Committee/Council authority, but was not prepared to consent to directing staff to pursue the matter.

   Mr. Lavender disagreed, saying that the stated objective was to simply begin a discussion on what delegation might look like. Ms. Eitzen concurred with Mr. Lavender, believing that committee authority warranted discussion and that there may be added administrative procedures or processes that could be delegated to staff.

   Ms. Hoffman commented that the accomplishments and goals should be viewed in the context of the Council’s five year strategic plan. She agreed that some of the operational items could be removed, in order to focus on the important strategic matters that should be considered, even if controversial. Ms. Hoffman added that there were no expectation as to the outcomes of these issues, but they should be on the table for discussion and worked through in a collaborative manner in the best interests of the funds.

   Mr. Smart remarked that a challenge of removing some of the operational tasks, in the accounting area for example, would eliminate critical objectives of the department. The external audit, while it is expected to completed annually, is critical objective to the operation of the agency.

   Mr. Rawson suggested that staff revisit the document for modifications in order to emphasize the significant activities of staff. He also suggested that the delegation framework discussion be reworded and included under governance matters, since it involved broader aspects of committees and the organization, and was not just investment-related.

   Mr. Rawson stated he approved of the document in concept, but requested revisions and moved that the State Investment Council approve the SIC Accomplishments and Goals, as memorialized in the memo dated April 11, 2017 and reviewed and discussed by the Council at today’s meeting. Mr. Lavender seconded the motion, which passed unanimously by voice vote.

   The Council agreed that the Accomplishments and Goals document should be revised and distributed to the Council, and that it did not need to be brought back for further review.

State Investment Council Meeting: April 25, 2017
b. **Vote: 2017 Open Meetings Resolution**

Bruce Brown, SIC Deputy Counsel, familiarized the Council with its annual requirement, according to the Open Meetings Act, to approve a resolution stating how it will comply with the obligations of the Act. It was essentially unchanged from last year and remained very close to the model recommended by the Attorney General’s Office.

It was clarified that the requirement to publish in newspapers of general circulation was statutory, as part of the SIC’s enabling statute, not an open meetings requirement.

It was clarified that a closed session was the same as an executive session.

Based on the recommendations of SIC staff, Mr. Rawson moved that the State Investment Council approve the 2017 SIC Open Meetings Resolution, as reviewed and discussed by the Council at today’s meeting. Mr. Lavender seconded the motion, which passed unanimously by voice vote.

7. **CLOSING MATTERS**

a. **Old or new business:**

None.

b. **Next SIC meeting date:** Tuesday, May 23, 2017, 9:00 am, Santa Fe, NM.

8. **PUBLIC COMMENT PERIOD**

None.

9. **ADJOURNMENT**

As SIC business was completed, Mr. Smart moved to adjourn. The motion was seconded by Mr. Lavender and the meeting was adjourned at 11:55 a.m.

Approved:

Scott Smart, Vice-Chair