

STATE INVESTMENT COUNCIL
MEETING

FY13
SIGNED MINUTES

February 26, 2013

ACTION SUMMARY

STATE INVESTMENT COUNCIL

February 26, 2013

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Ongoing or pending litigation; investment matters and related legal issues	No action	
Limited Personnel matters: employee hiring/retention	No action	

MINUTES OF THE
NEW MEXICO STATE INVESTMENT COUNCIL

Santa Fe, New Mexico

February 26, 2013

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 on this date at 9:00 a.m.. in the Governor's Cabinet Room, State Capitol, Santa Fe, NM.

Members Present:

The Honorable Susana Martinez, Governor
Mr. Peter Frank, Public Member, Vice Chair
The Honorable Ray Powell, Commissioner of Public Lands
Ms. Linda Eitzen, Public Member
Mr. Harold Lavender, Public Member
Mr. Leonard Lee Rawson, Public Member
Mr. Scott Smart, Public Member
Mr. John Young, Public Member

Members Absent:

The Honorable James B. Lewis, State Treasurer
Dr. Thomas Clifford, Secretary, DFA
[1] vacancy

Attorney General Representative:

Ms. Tania Maestas

Staff and Committee Members Present:

Mr. Steven K. Moise, State Investment Officer
Mr. Vince Smith, Deputy State Investment Officer
Mr. Evan Land, General Counsel
Mr. Brent Shipp, Chief Financial Officer
Mr. Greg Kulka, Director of Private Equity
Mr. Charles Wollmann, Director of Communications
Ms. Kerri Segell, Executive Assistant
Ms. Judith S. Beatty, Recorder

Guests Present:

[See Sign-in Sheet.]

b. Approval of agenda

Upon motion by Ms. Eitzen, seconded by Mr. Lavender, the Agenda was unanimously approved by voice vote, as published.

c. Approval of minutes: January 22, 2013

Mr. Rawson moved approval of the January 22 minutes, as submitted. Mr. Young seconded the motion, which passed unanimously by voice vote.

2. INVESTMENT MATTERS: Investments requiring vote & related reporting (Vince Smith)

a. Vote: KPS Capital Partners Fund IV, L.P. (LP Capital)

Richard Pugmire, LP Capital Advisors, reviewed LP Capital's recommendation of commitment to KPS Special Situations Fund IV, L.P. in an amount up to \$75 million to Series B limited partner interests.

Mr. Pugmire stated that the NMSIC previously committed \$15 million to KPS' 2003 fund, KPS II; and as of September 30, it has generated more than \$30 million of net gain for New Mexico. It has been one of the best performing funds in the portfolio, and has been the best-performing fund since 2000 in the active portfolio.

Mr. Pugmire noted that Fund IV, which is targeting \$3 billion, is oversubscribed and has a high investor demand. He said the PEIAC's recommendation at its meeting yesterday was for up to \$75 million but no less than \$50 million, as the \$75 million could be pared back.

-- Fund IV will seek to invest in companies with substantial market share and strong product/distribution relevance, but which are poorly managed and have unsustainable cost structures.

-- The fund will target companies in the manufacturing and industrial sectors that may create products for a broad number of industries; however, the fund will not invest in high tech, telecommunications, entertainment and real estate and will also avoid investments in restaurants and retail.

-- Consistent with its predecessor funds, the fund expects to create new entities to buy underperforming or distressed assets or companies that are carve-outs from larger entities or operating in bankruptcy, in default of obligations to creditors or with a history of recurring operating losses.

-- The firm has established a reputation as being a “friendly” investor in distressed situations and, according to the firm, 25% of its deal flow comes from trade unions.

-- KPS is also focused on companies with headquarters in North America and Western Europe, although the companies may invest globally.

-- KPS has generated top quartile returns in their previous funds. They have done well in years when other traditional buyout funds have not done well (2005-2007). They have not had a realized loss in a number of years.

Mr. Pugmire stated that there are two choices of terms on management fee and carried interest. LP Capital did an analysis of the two choices and is recommending Series B.

Managing Partner David Shapiro appeared before the Council and made a presentation.

Responding to Vice Chair Frank, Mr. Shapiro said KPS plans to make two more investments in Fund III during 2013. He said Fund IV will not go active until Fund III is done and until Fund IV’s first investment is made.

Mr. Young noted that Fund IV is larger than Fund III, and asked if that presents any challenges.

Mr. Shapiro responded that, on average, the size of an ultimate investment (initial investment plus add-ons) is around \$200 million. KPS’s pace of investment is about two to three deals a year, or an average of \$500 million per year for a seven-year investment period.

Responding to Mr. Rawson, Mr. Shapiro said there have been no write-offs or write-downs in Fund III and the last write-off was in 2008.

Ms. Eitzen moved that, based on the recommendation of the Private Equity Investment Advisory Committee, LP Capital Advisors and NMSIC staff, the State Investment Council approve investment of up to \$75 million, but no less than \$50 million, of Series B interests with KPS Capital Partners Fund IV, L.P., not to exceed 20% of the total capital commitments to the fund, and subject to and contingent upon New Mexico state law, NMSIC policies, negotiation of final terms and conditions and completion of appropriate paperwork. Mr. Lavender seconded the motion.

Ms. Eitzen stated that the PEIAC heard a lengthy presentation from Mr. Shapiro and the committee was very satisfied with this investment and voted unanimously to recommend approval.

Vice Chair Frank commented on KPS's excellent track record; while this is a much larger fund than the previous one, which poses a bit of a risk given the size of the management team, he feels it is a good investment.

The motion passed unanimously by voice vote.

b. Vote: Real Return Investment Policy update (Townsend)

Present for this item were RV Kuhns consultants Marcia Beard and Guy Cooper; and Townsend Group consultant Jack Koch.

Mr. Smith stated that staff is recommending language changes within the Timber, Infrastructure and Farmland investment policies specifically to define "single investment" as any single standalone investment made or any single investment within a commingled investment vehicle.

Mr. Smith stated that the new policy for the energy portfolio, within the real return portfolio, was in the packet for review. He said the policy is modeled after the policies for timber and infrastructure.

Mr. Rawson expressed concern that the performance benchmark should be higher than 6.5% to 7%. Further, comparing it to a real return benchmark plus 3% inflation seems too low.

Mr. Rawson questioned why the real assets and real estate programs are being combined under Manager Concentration.

Mr. Koch responded that the opportunity-set of available options for infrastructure, timber, agriculture and energy is much smaller than it is for real estate. In order to properly diversify the portfolio, the scope of potential investments has to be expanded somewhat to avoid too much concentration in one manager.

Under Size of Investments, Mr. Rawson commented the language stating an investment cannot be more than 35% of the total energy portfolio seems like an aggressive number.

Mr. Rawson recommended that, under Council Investment Committee responsibilities, where it states the CIC will review the Energy Investment Policy during the first quarter of the year, that be changed to "annually" to allow for more flexibility.

Responding to comments by Mr. Rawson that the NMSIC should always have final approval, Mr. Lavender suggested changing the applicable language throughout the

document to say, “recommended by the Council Investment Committee and approved by the State Investment Council.”

Vice Chair Frank stated that he thought Mr. Rawson’s suggested language changes were appropriate for all four policies.

Mr. Lavender moved that, based on the recommendations of the Council Investment Committee, the Townsend Group and SIC staff, the State Investment Council update the real return investment policies for Timber, Infrastructure and Farmland, and the real return investment policy for its Energy portfolio, as reviewed and discussed by the Council today. Mr. Smart seconded the motion.

Mr. Smith said staff would bring the policies back to the Council at the next meeting as an informational item.

The motion passed unanimously by voice vote.

c. Vote: Real estate: Disposition of Dilweg SIC, LLC (Townsend)

Townsend Group consultant Jack Koch stated that the NMSIC’s joint venture partnership, Dilweg SIC, has received a new offer to buy the JV’s North Stage Storage property. Townsend has evaluated the offer, a third party independent appraisal, the background of the investment, and the current strategic and tactical focus and priorities of the NMSIC’s real estate portfolio.

Mr. Koch noted that this asset was brought before the NMSIC for approval toward the end of last year with a sales price very similar to that in the current offer. Unfortunately, that buyer was unable to secure funding to purchase the asset. At that time, the property was placed back on the market, and Dilweg SIC heard from a number of interested parties and ultimately elected to go forward with Square Foot Companies based on the price and buyer’s established reputation. He said Townsend has spoken with the buyer to confirm his intent to purchase, his capital source, and his intent to close.

Vice Chair Frank stated that, with the disposition of this property, this is an example of why the NMSIC should not be making direct investments.

Mr. Lavender moved that, based on the recommendation of the Council Investment Committee, the Townsend Group and SIC staff, the State Investment Council authorize its Joint Venture Partner Dilweg SIC, LLC to accept an offer for assets held by the partnership, under terms and conditions discussed and reviewed by the Council today. Ms. Eitzen seconded the motion, which passed unanimously by voice vote.

3. OTHER INVESTMENT MATTERS (Smith)

a. Investment performance report (Smith & RV Kuhns)

Mr. Smith reported 1-year returns (as of December 31) of 14.45% for the LGPF, 23 basis points ahead of the policy benchmark – approximately what the NMSIC pays in management fees to its publicly traded managers.

Mr. Smith commented that the restructuring of the portfolio has finally begun to pay off with extraordinary results.

Mr. Smith noted that these returns are in the 15th percentile in the TUCS universe of funds over \$1 billion; in other words, only six or seven funds in the U.S. exceeded the NMSIC's performance.

Mr. Smith also reported that the national private equity portfolio had a 1-year return of 14.65%, in the 21st percentile, and 12.5% for a 3-year return.

Mr. Smith reviewed the preliminary numbers for January, which was a very strong month for equities.

Mr. Smith noted that the international portfolio continues to underperform. He said he feels the NMSIC's inability to budget for active management in this portfolio is a contributing factor.

RV Kuhns consultant Marcia Beard presented a review of performance for the quarter ended December 31.

b. Investment Committee report

Mr. Lavender encouraged Council members to attend the monthly Council Investment Committee meetings either in person or by telephone.

Mr. Lavender stated that Townsend Group presented a real estate educational piece to the committee that was excellent and informative. He said the committee plans to have additional educational presentations in the future.

Vice Chair Frank noted that he was present and representing the NMSIC when management staff met with NMSBIC Chair Joe Badal and Executive Director Russ Cummins. He said the meeting was very useful, and he feels enthusiastic about the direction the NMSBIC has been taking since the Governor restructured its Board.

c. RFP update (Smith)

Mr. Smith reviewed the monthly RFP status report.

d. NM Private Equity Program reporting items (Informational)

[Report was in packet for review.]

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

-- NAV as of this morning was \$16.631 billion. Total distributions from the Land Grant and Severance Tax funds over the past 12 months were \$714 million.

Council matters

- March NMSIC & committee meetings:
 - a. Investment – Wednesday 3/13 at 10:00 a.m., SIC offices.
 - b. SIC – Tuesday 3/26 at 9:00 a.m., Cabinet Room
 - c. Audit – Tuesday 3/26 at 7:30 a.m., SIC offices
 - d. Governance – Friday 3/15 at 10:00 a.m., SIC offices
 - e. PEIAC – Wednesday 3/25 at 2:00 p.m., SIC offices

-- It is anticipated that the Legislative Council will appoint a new Council member following the legislative session.

-- The new monthly dashboard report is in the packet. Council members with suggestions for changes are asked to contact Kerri Segell.

Office Administration

-- Efforts to convince the Legislature that the NMSIC should have more budget and personnel flexibility have not been successful this year.

-- Two pending compensation requests, and requests to authorize hiring Real Return and Stable Value Directors, and Deputy General Counsel, have not been approved. NMSIC staff is asking the State Personnel Office to initiate the process by which the NMSIC can appear before the State Personnel Board to request authorization for the three additional exempt positions needed by the NMSIC.

External relations

-- Staff is generally pleased with progress being made in the legislature on NMSIC-initiated bills.

-- SIC has received considerable positive media coverage over the past month.

Mr. Moise thanked Governor Martinez and her legal staff for their assistance and support, as well as the litigation committee that led to the Vanderbilt legal settlement. He also thanked General Counsel Evan Land for the thought, leadership and long hours he devoted to this effort and Charlie Wollmann for his excellent work with the media.

Vice Chair Frank pointed out that the NMSIC is one of the few units in government with revenues and expenses and where results can be measured on a net profit basis. He said the NMSIC is arguably unable to properly execute its fiduciary responsibilities because of the various budget and personnel-related limitations under which it is being placed. Those often result in the NMSIC making decisions that are not necessarily optimal in maximizing returns.

Commissioner Powell commented in response that the State Land Office has been pointing out to legislators, with little result, that there is a return for each dollar spent by the Land Office that benefits future generations of New Mexicans.

5. FINANCE MATTERS: COMMITTEE & INFORMATIONAL REPORTS: DISCUSSION (Peter Frank)

a. Audit Committee report (Frank)

Vice Chair Frank reported on yesterday's meeting:

-- Jim Goodwin is working with Brent Shipp on setting scope and schedules with the outside auditors as part of their post audit, continuous audit work.

-- Discussed compliance. The lack of a compliance officer on staff raises serious concerns about risk facing an organization the size of the NMSIC.

Mr. Moise stated that, if the NMSIC has its requested budget approved and can get approval to hire a Deputy General Counsel, it will begin to do so as of July 1.

-- Discussed the budget process.

-- Discussed how contingency fees on Vanderbilt litigation will be handled.

-- Discussed tri-party repo program.

-- Is discussing how much work the committee should be doing in vetting, understanding and overseeing valuations that are performed by the managers.

b. CFO report (Brent Shipp)

Mr. Shipp reported that the FY 2013 budget is \$34.3 million, and the original SIC appropriation request for FY 2014 asked for \$56.9 million. The LFC recommendation of \$51.9 million was granted. The NMSIC is seeking a \$5 million increase by amendment, and a second amendment which would allow the NMSIC to make transfers from one budget category to the salary category.

6. GOVERNANCE MATTERS: COMMITTEE REPORTS; DISCUSSION AND VOTE (Scott Smart)

a. Governance Committee report (Smart)

Mr. Smart reported on the Governance Committee meeting, held about two weeks ago.

- Reviewed the draft dashboard.
- Mr. Moise discussed staffing issues.
- The committee plans to review the various committee charters to ascertain that they are current.
- Discussed an IPRA request received from Attorney General's Office.

b. Legislative update (Leonard Lee Rawson & Lavender)

Mr. Rawson reported on current legislation affecting the NMSIC.

7. CLOSING MATTERS (Governor Martinez)

a. Old or new business

Mr. Moise stated that the Senate Rules Committee has offered to confirm the appointments of Ms. Eitzen, Mr. Lavender, Mr. Rawson and Mr. Young tomorrow.

b. Next SIC meeting date: Tues., March 26, 9:00 a.m., Santa Fe, NM

8. PUBLIC COMMENT PERIOD (Governor Martinez)

None.

9. VOTE TO ENTER EXECUTIVE SESSION PURSUANT TO NMSA 1978:

- a. §10-15-1(H)(7) Ongoing or pending litigation: investment matters and related legal issues
- b. §10-15-1(H)(2): Limited Personnel Matters: employee hiring and retention

Mr. Frank moved that the NMSIC enter executive session, pursuant to NMSA 1978 Section 10-15-1(H)(7), to discuss ongoing or pending litigation: investment matters and related legal issues; and to discuss as allowed under Section 10-15-1(H)(2), Limited Personnel matters, employee hiring and retention. Mr. Lavender seconded the motion, which passed on the following roll call vote:

For: Governor Martinez; Mr. Frank; Ms. Eitzen; Mr. Lavender; Mr. Rawson; Mr. Smart; Mr. Young.

Against: None.

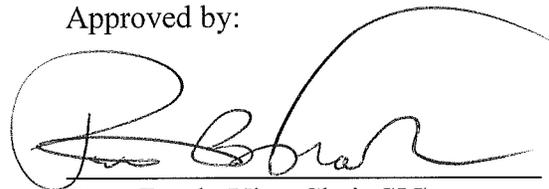
[Council was in executive session from 11:35 to 12:10 p.m.]

It was affirmed that the only matters discussed in Executive Session were those listed on the agenda.

10. ADJOURNMENT

Its business completed, the State Investment Council adjourned the meeting at approximately 12:10 p.m.

Approved by:

A handwritten signature in black ink, appearing to read "Peter Frank", written over a horizontal line.

Peter Frank, Vice-Chair SIC