



State Investment Commission
Monthly Meeting Minutes
Wednesday, December 18, 2013
9:00 a.m.
Room 205, State House

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:07 a.m., Wednesday, December 18, 2013 in Room 205, State House.

I. Roll Call of Members

The following members were present: Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Paula McNamara, Mr. Thomas Mullaney, Ms. Marcia Reback, Mr. Andrew Riley, Mr. Frank Karpinski, and General Treasurer Gina Raimondo. Also in attendance: Mr. Darren Lopes and Ms. Christine Pishko (by phone) of TIAA-CREF, administrator of the defined contribution plan; Mr. John Burns, Mr. Austin Carmichael, Ms. Christy Fields and Mr. Alan Emkin of Pension Consulting Alliance (PCA), general and real estate consultant; Mr. David Schwartz, Mr. Marc Swerdlow and Ms. Michelle Wells of Waterton Associates; Mr. Thomas Lynch of Cliffwater, alternative investment consultant to the Commission; Mr. James Freeland, Ms. Courtney McCarthy and Mr. Thomas Roberts of Summit Partners; Ms. Sally Dowling of Adler Pollock & Sheehan P.C., legal counsel; Ms. Anne-Marie Fink, chief investment officer and members of the Treasurer's staff. Treasurer Raimondo called the meeting to order at 9:07 a.m.

II. Approval of Minutes

On a motion by Ms. Reback and seconded by Mr. Giudici, it was unanimously **VOTED: to approve the draft of the minutes of the November 20, 2013 meeting of the State Investment Commission.**

III. Socially Aware Addition Recommendation

Ms. Fink reminded the board of a previous discussion about looking into adding a socially aware fund option to the Defined Contribution lineup. PCA was asked to analyze the socially aware funds available.

Mr. Burns reviewed the recommendation by PCA to select TIAA-CREF Social Choice Equity Fund. He said the fund is well diversified and has 862 holdings. He reviewed some of the criteria used to screen companies in the fund.

Mr. Burns reviewed the performance of the fund. Since July 1999, the fund trailed the Russell 3000 by 0.10%. In a peer group comparison with other equity funds in general, the fund looks very competitive. In comparison with a socially responsible index, the fund outperformed the KLD 400 Social Index. PCA put together a peer group comparison of other socially responsible funds. This fund is in the top half in performance.

Mr. Burns reviewed fees of the fund. He said the fees are very competitive versus other large institutional equity funds and even more competitive versus any similar, screened funds. The expense ratio in the fund is 0.19%.

The board discussed the fund further.

On a motion by Ms. Reback and seconded by Mr. Riley, it was unanimously

VOTED: to approve the addition of the TIAA-CREF Social Choice Equity Fund as an option to participants of the Defined Contribution Plan.

IV. Real Estate Recommendation—Waterton Residential Property Venture XII

Ms. Fink introduced Waterton Residential, a firm specializing in multi-family real estate. She explained Waterton is a more specialized manager than the generalist funds the board has seen recently. She noted the benefit of adding a more niche firm specialized in a specific area. As a vertically integrated specialist in multi-family, Waterton is well situated. Historically, Waterton has used an outsourced marketing firm when raising new funds. Because of Treasury's strict placement agent policy, this placement agent was not at all involved in sourcing or vetting the fund.

Ms. Fields presented the recommendation. She said the investment is consistent with the strategic plan for the portfolio. This allocation would assist with reinvesting the proceeds received from the secondary sale executed in the past year and help reach the target allocation in real estate.

Mr. Carmichael explained Waterton has experts in the multi-family space and they have managed to find unique opportunities throughout various market cycles. PCA believes there is still an opportunity in the multi-family sector and that fundamentals are strong for the long term.

Mr. Carmichael said PCA likes this firm, especially in the apartment space, because it is a vertically integrated operator who is hands-on with the assets on a day to day basis through all the different steps. PCA believes there is good alignment of interests between Waterton as the general partner and the limited partners.

Mr. Schwartz briefly reviewed the firm. He and co-founder Pete Vilim have been doing apartment acquisitions for almost 28 years. Waterton specializes in renovation and repositioning of apartments. Since inception, Waterton has bought about \$5 billion dollars in multi-family assets.

Mr. Schwartz reviewed the current fund. It has about 20,000 units and is geographically diverse with properties coast to coast. The fund has good return history with an IRR on realized investment of over 20%.

Mr. Schwartz added that the firm is vertically integrated. Waterton does the property management, construction management and construction supervision in-house.

Mr. Swerdlow talked about the Waterton organization. He said on-the-ground research is the key to their investment strategy. With regional management offices, they have management teams in the field to help in identifying opportunities and acquiring properties.

Mr. Swerdlow added that Waterton is focused on top 30 designated market areas (DMAs) where there is economic growth and they can bring the value-add approach to buying existing real estate, improving it and driving rental growth.

Mr. Schwartz talked about the opportunities and risks in the market. He said there are currently historically low vacancies and the propensity to rent is high. Waterton believes supply additions will be at the long-time average rate in 2014 and 2015. They hope to see economic and employment growth as job growth is directly correlated to apartment demand. As far as risks, they are most

concerned about supply. Most concentrations of upcoming supply are in urban areas so fund XII will be most likely be more concentrated in suburban areas. He added that an increasing interest rate environment may create unique opportunities from misvaluations. They also foresee maturing mortgages in the investment period for Venture XII that could create opportunity.

Mr. Schwartz went over the terms of the fund. Waterton is looking to raise \$500 million with a first closing in January. The expected IRR to investors is 13%. Waterton will cap leverage at 65% of project cost. Fees are 1.25% on committed capital during the investment period and 1.5% on invested capital thereafter.

The board asked questions and Waterton Associates left the room.

Treasurer Raimondo expressed concern regarding PCA's recommended size of investment (up to \$50 million) and the potential to be 30% of the fund's first close.

Ms. Fink said although PCA's recommendation is up to \$50 million, she would recommend an investment of \$35 million. Being that Waterton is more of a niche manager and more value-add, she wouldn't make the size of investment as in core manager.

On a motion made by Mr. Riley and seconded by Mr. Costello, it was unanimously

Voted: to approve up to \$35 million of investment but not to exceed 10% of the total Waterton Residential Property Fund XII and only if the fund exceeds a minimum committed value of \$200 million.

V. Private Equity Recommendation—Summit Credit Fund II

Mr. Lynch introduced Summit Partners. He said the state was invested in Summit Credit Fund I. The fund is part of the overall portfolio strategy to increase private debt exposure in the private equity portfolio. He mentioned Cliffwater has negotiated a preferential fee for its clients.

Mr. Roberts gave a brief introduction to the fund. Summit Credit lends to companies with \$10 million to \$50 million in earnings. With interest rates in the mid-teens, these loans are riskier than bank loans. However, the loans are well above the companies' equity components in repayment priority with the goal being to have the loans in the top half of the companies' capital.

Mr. Roberts reviewed Fund I. Summit Partners is raising Fund II to pursue the exact same strategy. Fund I was able to accomplish its goals with interest rates of 14% on average.

Mr. Roberts added that the general partner has committed \$50 million to Fund II and will be co-investing in it as well. He said the vast majority of interest is current pay; the fund remits any cash interest to investors as it's received. The fund will essentially be producing 0.80% to 1% in payments per month.

Mr. Fay asked how compression in the high yield market affected terms on new debt.

Mr. Roberts said that their rates are influenced, but not dominated, by the high yield or bank markets. The companies Summit lends to are too small to access the high yield market; they average about \$40 million of earnings.

Mr. Roberts added that their strategy is to have a group of analysts whose job is to be in touch with companies in industries they follow, striking up a relationship with the companies before they need capital.

The board asked further questions and Summit Partners left the room.

Treasurer Raimondo asked what the negotiated fee would be.

Mr. Lynch said Cliffwater negotiated a management fee of 0.75% for their clients compared to 1.5% and 1.35% after the investment period once certain aggregate commitments have been raised.

The board discussed the recommendation.

On a motion by Mr. Riley and seconded by Mr. Costello, it was unanimously

VOTED: to approve into Summit Credit Fund II up to \$25 million of investment.

VI. Update on Secondary Sale of Interests in Wellspring

A motion was then made by Mr. Mullaney and seconded by Mr. Riley to convene into executive session pursuant to Rhode Island General Law §42-46-5 (a) (7) as the discussion may relate to the investment of public funds, the premature disclosure of which may adversely affect the public interest. A roll call vote was taken to enter executive session and the following members were present and voted Yea: Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Paula McNamara, Mr. Thomas Mullaney, Ms. Marcia Reback, Mr. Andrew Riley, and General Treasurer Gina Raimondo.

It was then unanimously

VOTED: To convene into executive session pursuant to Rhode Island General Law §42-46-5 (a) (7) as the discussion may relate to the investment of public funds, the premature disclosure of which may adversely affect the public interest.

A motion was then made by Mr. Costello and seconded by Ms. Reback to seal the minutes of the executive session of December 18, 2013, pursuant to Rhode Island General Laws §42-46-5 (a) (7) as the discussion may relate to the investment of public funds, the premature disclosure of which may adversely affect the public interest. A roll call vote was taken, and the following members were present and voted Yea: Mr. J. Michael Costello, Mr. Thomas Fay, Mr. Robert Giudici, Ms. Paula McNamara, Mr. Thomas Mullaney, Ms. Marcia Reback, Mr. Andrew Riley, and General Treasurer Gina Raimondo.

It was then unanimously

VOTED: To seal the minutes of the executive session of December 18, 2013, pursuant to Rhode Island General Law §42-46-5 (a) (7) as the discussion may relate to the investment of public funds, the premature disclosure of which may adversely affect the public interest.

On a motion made by Mr. Giudici and seconded by Mr. Riley, to exit executive session pursuant to Rhode Island General Law §42-46-5 (a) (7). A roll call vote was taken and it was unanimously

VOTED: To exit executive session and return to open session.

It was reported to the public that two votes were taken during the executive session.

In the first vote during executive session, it was unanimously voted to authorize Cliffwater to negotiate and execute the sale of the State's limited partnership interests in Wellspring Capital Partners IV on terms satisfactory to Treasury staff and pending legal review.

The second vote taken during executive session was an unanimous roll call vote to seal the minutes pursuant to Rhode Island General Law §42-46-5 (a) (7).

VII. PCA Market Risk Metrics Briefing

Mr. Emkin made an abbreviated presentation of the market risk measures PCA looks at and compares against historical averages. He said he could do a more thorough presentation in the extended meeting scheduled for January.

VIII. Legal Counsel Report

There was no legal counsel report.

IX. CIO Report

Ms. Fink said November was the first month the total fund value finished above \$8 billion since the financial crisis. She praised the efforts of the SIC for this testament to their work. She cautioned the \$8 billion level may not hold as markets have been going down in December with equities down 2.5% and bond markets down 0.4%. The hedge funds protected the portfolio, only down 0.8% as of the prior Friday. She explained that as ups and downs are to be expected, the diversification of the portfolio is important.

Ms. Fink said in November the portfolio was up 1.2% compared to just under 1% for the policy benchmark and 0.7% for the 60/40 plan. Fiscal-year-to-date the portfolio is up 8.7%. She cautioned this increase is more than expected in any given year and has been accomplished in five months. The performance is ahead of the benchmark which is up 8.3% and the 60/40 plan up 8.6%.

Ms. Fink said that despite the strong returns, the portfolio continues to have less risk. The portfolio is at 7.4% volatility compared to 8.1% for the benchmark and 8.5% for the 60/40 plan. Not only is the plan getting better returns, it also has less volatility. Those two are not disconnected over the long-term. Pursuing a strategy of less volatility over time, the compounding works and the portfolio gets better returns.

X. Treasurer Report

Treasurer Raimondo commended the efforts of the board and thanked them for their continued work.

There being no other business to come before the Board, on a motion by Ms. Reback and seconded by Mr. Fay the meeting adjourned at 11:40 a.m.

Respectfully submitted,

Gina M. Raimondo
General Treasurer