MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
INVESTMENT COMMITTEE MEETING

Monday, June 1, 2015
9:00 a.m.
1400 West Third Street
Little Rock, AR 72201

ATTENDEES

Investment Committee Members Present
Robin Nichols, Chair
Danny Knight, Vice Chair
Dr. Richard Abernathy
Kathy Clayton
Kelly Davis
Candace Franks
Jim Harris, designee for Dennis Milligan
Janet Watson

Board Members Present
Lloyd Black
Hazel Coleman
Andrea Lea
Bobby Lester
Jeff Stubblefield
Deborah Thompson

Guests Present
Donna Morey, ARTA
Beverly Leming
Desi Berry, BOSC, Inc.

Reporters Present
Mike Wickline, Arkansas Democrat Gazette

ATRS Staff Present
George Hopkins, Executive Director
Shane Benbrook, Internal Audit/Risk Mgmt.
Donna Bumgardner, Investment Manager
Mitzi Ferguson, Chief Financial Officer
Vicky Fowler, Director, Human Resources
Laura Gilson, General Counsel
Rod Graves, Manager, Investment Dept.
Wayne Greathouse, Assoc. Dir. Investments
Clementine Infante, Staff Attorney
Mike Lauro, Information Systems Manager
Manju, Dir, Data Processing
Jerry Meyer, Manager, Real Assets
Tammy Porter, Administrative Assistant
Michael Ray, Dir. Member Services
Clint Rhoden, Assoc. Director of Operations
Joseph Sithong, Data Processing
Leslie Ward, Manager, Private Equity
Brenda West, Internal Audit/Risk Mgmt.

Consultants Present
Michael Bacine, Franklin Park
P.J. Kelly, AHIC (Aon Hewitt)
Katie Comstock, AHIC (Aon Hewitt)
Chae Hong, AHIC (Aon Hewitt)

I. **Call to Order/Roll Call.** Robin Nichols, Chair, called the Investment Committee meeting to order at 9:02 a.m. Roll call was taken. All members were present.

II. **Adoption of Agenda.**

Ms. Davis *moved* for *adoption* of the Agenda. Mr. Knight s*econded* the *motion,* and the Committee *unanimously approved the motion.*

III. **Executive Summary.** The Executive Summary was provided for reference with no questions or expansions on the written summary.

IV. **Approval of April 6, 2015, Investment Committee Minutes.**

Dr. Abernathy *moved* to *approve* the April 6, 2015, Investment Committee minutes. Ms. Davis *seconded* the *motion*, and the Committee *unanimously approved the motion.*

V. **Investment Update and Arkansas Related Update.** Mr. Hopkins gave an update on Arkansas real estate and investments.

A. List of Recent Fund Maturities and Closings.

1. Recent Property Sale:

a. **Woodland Heights. (Real Assets, Property Located in Little Rock, Arkansas, Sold for Appraised Value of $16.8 Million Dollars)**. Mr. Hopkins reported that the Board authorized sale of Woodland Heights closed on April 30, 2015, for the appraised value of $16.8 million dollars.

2. Fund Closings.

a. Lone Star Real Estate Fund IV, L.P. (Real Assets, Real Estate Fund Specializing in Distressed and Opportunistic Commercial Debt and Equity Investments, the Board Authorized Commitment of up to $30 Million Dollars with Imminent Need on April 6, 2015. $24.2 Million Dollars of the $30 Million Dollars Recommended Allocation was Obtained on April 20, 2015). Mr. Hopkins reported that due to the high demand for this fund the General Partner was unable to accept the entire ATRS commitment. ATRS was able to invest $24,260,817 million dollars of the authorized $30 million dollar commitment on April 20, 2015.

b. EnCap Energy Capital Fund X, L.P. (Private Equity, Energy Fund that Seeks to Make Control Investments in Oil and Natural Gas Exploration and Production Companies, the Board Authorized Commitment of up to

$30 Million Dollars with Imminent Need on April 6, 2015, Accepted All of the $30 Million Dollars Recommended Allocation Obtained on April 7, 2015). Mr. Hopkins reported that the ATRS full commitment of $30 million dollars was accepted and closed on April 7, 2015.

B. **American Center Update. (97% Occupied, Chillers and Cooling Tower in One (1) Building Replaced, Remains a Core Asset).** Mr. Hopkins reported that the American Center is approximately 97% occupied. ATRS, along with Cooper Realty Investors (Cooper) of Bella Vista, Arkansas, owns American Center Towers through the American Center Partnership in Nashville, Tennessee. ATRS owns 80%, Cooper owns 20% through an Arkansas general partnership that purchased the buildings in December of 2000 for $71 million dollars. American Center Towers is a 410,662 square foot class A office asset located adjacent to the northwest corner of the Vanderbilt Campus in the upscale West End sub market.

The buildings' tenants are typically financial services, engineering, medical and legal professionals. Amenities include a parking deck, work-out facilities, and restaurants. The towers are also Silver Leadership in Entergy & Environmental Design (LEEDs) certified, which is increasingly important as more and more corporations and professionals stipulate environmentally friendly office space. Recent energy saving upgrades to one of the towers includes a new water cooler tower and two new water chillers. Though the upgrades were nearly $1million dollars, they are expected to save 25% on that tower's electrical energy cost. For the past twelve months the towers average $447,000 each per year in electrical expense.

Cooper initially managed the property for a five year period and in 2010 through an RFP was re-awarded the management assignment for a five year term. The property appraised for $99.4 million dollars in February of 2014. The property was refinanced in 2006 for a 15 year term at 7.04% and cannot be paid in advance without a large prohibitive prepayment penalty. The projected IRR is approximately 8.8% at loan maturity assuming current value as sale amount. ATRS staff views this property as a core type investment due to the historical lack of volatility in returns.

C. Victory Building Update. (97% Occupied, Boiler Replaced, Incentive Program, Remains a Core Asset). Mr. Hopkins reported that the Victory building is currently at an approximate 97% occupancy level. Additional leases are in the negotiation phase and, if successfully concluded, the building will be in excess of a 99% occupancy level. In October 2014, ATRS replaced the Victory buildings' 85% efficient hot water boiler with a 96% efficient hot water boiler at a cost of approximately $44,000 dollars. With the boiler rebate of $3,998.00 and future utility savings, the cost of the new boiler will have less than a four year payback. ATRS staff views this property as a core type investment due to the historical lack of volatility in returns.

VI. General Investment Consultant Update – Aon Hewitt Investment Consulting.

A. Preliminary Performance Report for the Quarter Ended March 31, 2015. P.J. Kelly and Katie Comstock of Aon Hewitt Investment Consulting (AHIC) presented the preliminary performance report for the quarter ended March 31, 2015. The total market value of the ATRS fund was $15.01 billion dollars. The total fund had a return of 8.6% since inception, underperforming its benchmark of 8.7%. U.S. Equity had a return of 3.4% for the quarter.

B. Preliminary Performance Report for the Month Ended April 30, 2015. P.J. Kelly and Katie Comstock of Aon Hewitt Investment Consulting presented the portfolio update for the month ending April 30, 2015. The total market value of the ATRS fund was $15.07 billion dollars with a fiscal year-to-date return of 5.2%. Total market value of U.S. equity was $4.02 billion dollars.

C. Global Equity Presentation and Recommendation to Combine the Domestic and Global Equity Portfolios into One Global or Total Equity Asset Class. P.J. Kelly and Katie Comstock of Aon Hewitt Investment Consulting (AHIC) presented the information concerning the asset allocation mix of domestic and global equities. The current target ranges as stated in the ATRS Investment Policy Statement (IPS) are 20% for domestic equity and 30% for global equity. The IPS also states the total equity exposure of the ATRS portfolio is designed to be viewed in aggregate since the global allocation includes both domestic and international equities producing some overlap in the domestic investment opportunity set.

AHIC research has shown the most efficient way to access public equities is through a global mandate that will offer a wider opportunity set and greater flexibility for skilled managers. The combination of equity asset classes into one global allocation will provide more consistency with the IPS view of public equities as one asset class. The move from separate classes will also help to reduce certain portfolio biases or benchmark misspecifications, such as domestic small-cap, by aligning the overall global equity portfolio with a blended benchmark weighted to accommodate the underlying fund manager's strategies.

Both AHIC and ATRS staff recommend updating the IPS to combine the current allocation targets of domestic (20%) and global equity (30%) into one global equity allocation (50%). If approved, the combination into one global or total equity allocation would also allow for other ATRS managers to possibly modify their mandates to a global orientation, should the manager have the skillset and desire to make the change, over time.

Dr. Abernathy *moved* to *recommend* to the Board to Amend the Investment Policy Statement to Combine Domestic and Global Equity Portfolios into One Global or Total Equity Asset Class. Ms. Davis *seconded* the *motion* and the Committee *unanimously approved* the *motion.*

D. Recommendation to Modify the Deployment of Approximately $550 Million Dollars of the Approximately $650 Million Dollars Currently Invested in Allianz Structured Alpha Fund Investments to the AllianzGI Structured Alpha Global Equity 500 Fund. P.J. Kelly of Aon Hewitt Investment Consulting (AHIC)presented the recommendation of moving a portion of the existing Allianz Structured Alpha U.S. Equity 250 and the entire Allianz Structured Alpha U.S. Equity 500 fund into a separate Allianz fund with a global focus. As of March 31, 2015, ATRS had approximately $510 million dollars invested in the Allianz Structured Alpha U.S. Equity 250 product and approximately $130 million dollars invested in the Allianz Structured Alpha U.S. Equity 500 fund. If approved, the new global fund would help to further diversify the ATRS portfolio by increasing the strategy's global opportunities while maintaining some U.S. exposure. The "250" and "500" represent 250 and 500 basis points of tracking around the target index which, in the current funds, is the S&P 500 Index. This investment was initially made by ATRS in early 2008 as an options overlay separate account using the former Oppenheimer U.S. equity portfolio as its collateral source. The strategy migrated over time to its current form which is an LLC structure. Performance of the strategy since inception has been strong and the volatility of the return has declined due in large part to enhancements made to the process. Given this, AHIC and ATRS staff recommended transferring $100 million dollars of the 250 fund to the 500 fund which has higher tracking error (500 basis points) to the S&P 500 Index but also greater potential for value added. The Investment Committee and Board approved this transfer at the October 7, 2013, regular meeting and the fund was established in November 2013.

The strategy uses put and call options on a variety of indices to create "profit zones". If the value of the index falls within those zones at expiration, the strategy profits from the structure of the options strategy. The manager adjusts these zones as market conditions change and limits the downside of the strategy by buying out of the money put options. The strategy is a net seller of options which creates premium income. This is similar to selling insurance – you pay a premium for the rights provided by the option or you collect premium to provide that right.

The recommendation, if approved, will be a separate fund whereby some of the U.S. 250 and U.S. 500 fund investments can be transferred in-kind to minimize transition costs to shift approximately $420 million dollars from the U.S. 250 fund and approximately $130 million dollars from the U.S. 500 fund for a total of up to $550 million dollars to the AllianzGI Structured Alpha Global 500 fund. The global fund is however a separate and distinct fund so a new set of legal documents will need to be reviewed and executed by ATRS. The performance of each fund will be shown separately for comparative purposes. The terms including a performance fee only structure of 30% of profits above the high water mark and the strategy of the funds are the same with the exception of the tracking error risk levels (250 and 500) and the base index for which "profit zones" are created. In the case of the AllianzGI Structured Alpha Global Equity 500 fund, the base index will be the MSCI All Country World Index Investible Market Index (ACWI IMI). This index captures large, mid, and small-cap representation from 23 developed markets and 23 emerging markets countries. This comprehensive index covers approximately 99% of the global investment opportunity set. The investment in the new fund will have a fresh high water mark which is beneficial given the current investment is well above the high water marks set for the U.S. 250 and U.S. 500 funds.

Mr. Hopkins confirmed that staff concurs with the recommendation.

Mr. Knight *moved* to *recommend* to the Board to Modify the Deployment of Approximately $550 Million Dollars of the Approximately $650 Million Dollars Currently Invested in Allianz Structured Alpha Fund Investments to the AllianzGI Structured Alpha Global Equity 500 Fund. Ms. Clayton *seconded* the *motion* and the Committee *unanimously approved* the *motion.*

VII. **Real Assets Investment Consultant Update – Aon Hewitt Investment Consulting.**

A. Performance Report for the Quarter Ended December 31, 2014. Chae Hong of Aon Hewitt Investment Consulting presented the performance report for the quarter ended December 31, 2014. Through the fourth quarter, NCREIF's NPI and NFI-ODCE both returned at 3.0%, an increase of 40 bps. Trailing 12-month returns currently remain above the sector's long run average. The NCREIF Timberland Index returned 6.0% for the quarter and 10.5% for the trailing one year, an increase of 450 bps. The NCREIF Farmland Index gained 6.6% for the fourth quarter of 2014 with a 12.6% return for the trailing one year, an increase of 510 bps. The Real Assets portfolio stands at 11.7% for ATRS' total assets, a decrease of 10 bps from the third quarter of 2014.

B. Recommendation to Commit up to $30 Million Dollars In Long Wharf Real Estate Partners Fund V, L.P., a Value Added Real Estate Fund Focused on Acquiring a Diversified Portfolio of Assets at Significant Discounts to Values. Long Wharf Real Estate Partners V is a closed-end, value added fund focused on domestic real estate investing. The strategy will be to pursue a diversified portfolio of properties with a focus on acquiring assets at significant discounts to peak values with positive fundamental trends that offer the opportunity to increase returns through the execution of a value added strategy. The fund will target a 12-15% net IRR.

Based in Boston, Long Wharf was originally an arm of the investment giant Fidelity before it spun out as an employee owned entity. Long Wharf's previous 4 funds have averaged a 9.4% net IRR with the most recent fund, Long Wharf IV, currently producing a net IRR of 23%. If approved, this will be ATRS's second investment in the Long Wharf series of funds. The first ATRS Long Wharf investment in Fund III has a projected IRR of 9% at maturity by the manager despite its two year pre-financial crisis inception date.

Since the firm is majority Hispanic owned it is a certified MWBE (Minority and Women-Owned Business Enterprise) Manager. Both ATRS staff and Aon Hewitt Investment Consulting recommend an investment of up to $30 million dollars in Long Wharf Real Estate Partners Fund V, L.P.

> **Mr. Knight *moved* to *recommend* to the Board to Commit up to $30 Million Dollars In Long Wharf Real Estate Partners Fund V, L.P., a Value Added Real Estate Fund Focused on Acquiring a Diversified Portfolio of**

Assets at Significant Discounts to Values. Ms. Davis *seconded* the *motion* and the Committee *unanimously approved* the *motion*.

C. **Recommendation to Commit up to $25 Million Dollars in Torchlight Debt Opportunity Fund V, L.P., an Opportunistic Real Estate Fund Focused on High Yield Debt Investments in Both the Public and Private Markets.** Torchlight Debt Opportunity Fund V is a closed-ended opportunity fund focused on high yield real estate debt investments in both the public and private markets. Fund V will have the ability to opportunistically invest across the entire spectrum of real estate debt strategies including first-lien commercial mortgages, commercial mortgage-backed securities (CMBS), mezzanine loans, and commercial real estate backed collateralized debt obligations (CDO's). Additionally, the fund will have the ability to originate or acquire loans in the private market. The fund has a target net IRR of 13-15%.

ATRS has invested in three previous Torchlight funds. If approved, this will be ATRS's fourth investment in the Torchlight series of funds, guidance from the manager on these three prior funds is currently a 9.5% average net IRR once the funds have reached maturity.

Founded by Dan Heflin in 1995 as a joint venture with Jones Lang Wooten Realty Advisors (now ClarionPartners), Torchlight Investors is an independent, SEC-registered investment advisor. Torchlight provides investment management services to institutional clients seeking exposure to commercial real estate debt markets. The firm has acquired and managed over $20.0 billion in commercial real estate investments since its inception and currently has $4.0 billion under management across the spectrum of U.S. commercial real estate debt strategies.

Both ATRS staff and Aon Hewitt Investment Consulting recommend an investment of up to $25 million dollars in Torchlight Debt Opportunity Fund V, L.P.

Mr. Knight *moved* to *recommend* to the Board to Commit up to $25 Million Dollars in Torchlight Debt Opportunity Fund V, L.P., an Opportunistic Real Estate Fund Focused on High Yield Debt Investments in Both the Public and Private Markets. Ms. Watson *seconded* the *motion* and the Committee *unanimously approved* the *motion*.

D. **Recommendation to Commit up to $25 Million Dollars in Westbrook Real Estate Fund X, L.P., a Value Added Real Estate Value Added Fund Focused on Distressed Debt.** Westbrook Real Estate Fund X is a closed-end, value added fund that will employ an investment strategy focused on distressed debt, gateway cities, low leverage, minimal development activity, and complex transactions. Westbrook's vertical integration and use of affiliated operators is a unique aspect of the fund. On a relative basis, Westbrook intends to pursue a more conservative strategy within the opportunistic style category. The fund will target a 15% net IRR.

The Westbrook Group has evolved over the past fourteen years to ultimately become a vertically integrated global opportunistic real estate investment management firm. Initially structured as a domestically based boutique, the original Westbrook Group was formed by Paul Kazilionis in 1994. Mr. Kazilionis was well versed in opportunistic investing as he developed and launched the Morgan Stanley Real Estate Fund series in the early 1990's.

ATRS has invested in 4 previous Westbrook funds and has experienced a 12.3% net IRR while the entire nine fund series has produced an average 18.4% net IRR. Westbrook has maintained an extremely loyal client base and some of its clients have been with the firm since the launch of the fund series in 1994. Westbrook's past funds have experienced re-up rates (from existing clients) of 85% - 95%.

Both ATRS staff and Aon Hewitt Investment Consulting recommend an investment of up to $25 million dollars in Westbrook Real Estate Fund X, L.P.

Ms. Clayton *moved* to *recommend* to the Board to Commit up to $25 Million Dollars in Westbrook Real Estate Fund X, L.P., a Value Added Real Estate Value Added Fund Focused on Distressed Debt. Mr. Knight *seconded* the *motion* and the Committee *unanimously approved* the *motion.*

E. **Recommendation to Terminate the ATRS Investment of Approximately $54 Million Dollars in JP Morgan Special Situations Property Fund.** JP Morgan Special Situations Property Fund (JPMSSPF) is an open-ended opportunistic real estate fund. ATRS invested in JPM SSPF in 2006 immediately before the financial crisis. Although the fund has recovered the initial downturn and provided a good return the last three years, performance of the fund has not produced a return proportional to the risk often associated with opportunistic strategies. Given that open-ended opportunistic funds are not a high conviction strategy for Aon Hewitt Investment Consulting (AHIC), ATRS staff and AHIC are recommending termination of JPMSSPF. The ATRS investment in the fund has a current value of approximately $54 million dollars and going forward, AHIC and ATRS staff believe a redeployment of these assets will be beneficial to the real assets allocation as a whole.

Ms. Davis *moved* to *recommend* to the Board to Terminate the ATRS Investment of Approximately $54 Million Dollars in JP Morgan Special Situations Property Fund. Dr. Abernathy *seconded* the *motion* and the Committee *unanimously approved* the *motion.*

VIII. Private Equity Consultant Report.

A. Private Equity Consultant Report for the Quarter Ended December 31, 2014. Michael Bacine of Franklin Park presented the private equity report for the quarter ended December 31, 2014. ATRS Legacy Portfolio had a net IRR of 9.2%. CSFB Portfolio had a net IRR of 8.4%. The total fund had a net IRR of 9.9% for the quarter ended December 31, 2014.

B. Recommendation to Commit up to $25 Million Dollars in Castlelake IV, L.P., a Private Equity Fund that Invests in Debt and Distressed Assets. Castlelake was formerly known as TPG Capital, and ATRS is invested in two of the general partner's previous funds, Castlelake II and III. Both funds are performing very well with net IRR calculations of 19.4% and 11.5% respectively as of December 31, 2014. Based in Minneapolis, this fund was founded as an affiliate of TPG Capital by Rory O'Neill who previously led Cargill's global credit and special situations business. Mr. O'Neill's key partners are Evan Carruthers and Jonathan Fragodt. The fund is targeting commitments of $1.75 billion and will pursue an opportunistic distressed investment strategy primarily in the U.S. and Europe. Distressed strategies are expected to generate slightly lower returns than equity oriented corporate finance strategies such as "buyout" or "turnaround" types. At the same time though, distressed strategies are relatively less risky than other types.

Although some of the fund may be invested in secured corporate debt, the majority of the fund will be focused on acquiring distressed assets primarily in the aviation space, mortgage and consumer loan portfolios and various financial assets. When distressed corporate debt prices are stable with low default rates, the fund will target distressed asset investments. If default rates climb rapidly and corporate debt prices are volatile, the fund will shift towards corporate debt investments.

Both Franklin Park and ATRS staff recommend an investment of up to $25 million dollars in Castlelake IV, L.P.

Ms. Davis *moved* to *recommend* to the Board to Commit up to $25 Million Dollars in Castlelake IV, L.P., a Private Equity Fund that Invests in Debt and Distressed Assets. Mr. Knight *seconded* the *motion* and the Committee *unanimously approved* the *motion.*

IX. **Other Business.** None

X. **Adjourn.**

Ms. Franks *moved* to *adjourn* the Investment Committee Meeting. Ms. Clayton seconded the *motion*, and the Committee *unanimously approved the motion.*

Meeting adjourned at 10:27 a.m.

George Hopkins,
Executive Director

Ms. Robin Nichols, Chair
Investment Committee

Tammy Porter,
Recorder

Date Approved