MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES – CALLED MEETING

Thursday, July 19, 2016
9:15 a.m.
1400 West Third Street
Little Rock, AR 72201

ATTENDEES

Board Members Present
Jeff Stubblefield, Chair*
Danny Knight, Vice Chair*
Anita Bell*
Lloyd Black
Kathy Clayton*
Kelly Davis*
Susannah Marshall, designee for Candace Franks*
Jim Harris, designee for Dennis Milligan*
Bobby Lester*
Robin Nichols*
Deborah Thompson
Janet Watson*

Board Member Absent
Dr. Richard Abernathy
Johnny Key
Hon. Andrea Lea

ATRS Staff Present
George Hopkins, Executive Director*
Gail Bolden, Deputy Director
Shane Benbrook, Internal Audit/Risk Management
Curtis Carter, Chief Financial Officer
Rod Graves, Assoc. Dir of Operations
Wayne Greathouse, Assoc. Dir. of Investments
Manju, Dir. Data Processing
Tammy Porter, Executive Assistant
Clint Rhoden, Director of Operations
Leslie Ward, Manager, Private Equity

Consultants Present
PJ Kelly, AHIC (Aon Hewitt)*
Chae Hong, AHIC (Aon Hewitt*
Michael Bacine, Franklin Park*
Sean Barron, Simmons

**** via teleconference***

I. **Call to Order/Roll Call.** Mr. Jeff Stubblefield, Chair, called the Board of Trustee meeting to order at 9:15 a.m. Voice roll call was taken by the Board Recorder. Dr. Abernathy, Ms. Lea, and Mr. Key were absent.

II. **Adoption of Agenda.**

Ms. Bell *moved* for *adoption* of the Agenda. Ms. Nichols s*econded* the *motion,* and the Board *unanimously approved the motion.*

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

IV. Investment Committee Report. Ms. Nichols, Chair, gave a report on the Investment Committee meeting.

A. **Recommendation from the Fund of Opportunities Search to Commit up to $100 Million Dollars in the Arkansas Opportunity Fund, LP, an Opportunistic/Alternatives Fund Managed by Stephens, Inc. and Neuberger Berman Alternative Advisers, LLC, a Diversified Fund Focused on Investment Opportunities Across Various Asset Classes Expected to Compliment the Current ATRS Portfolio with Imminent Need.** Due to the growth of the ATRS trust fund, the ability of ATRS to take advantage of the often enhanced returns from smaller more specialized opportunities can be diminished due to the size of the deal in comparison to the size of the ATRS trust fund. Often opportunities come from Arkansas based firms and other opportunity pipelines that due to the small size of the potential investment makes the potential investment difficult since ATRS is now regularly making investments with a lower range of $20 million dollars to $25 million dollars.

The identification of a single manager to evaluate all these potential opportunities is not realistic. The process has evolved over time to use more than one manager while focusing on the potential strengths of managers. Through this continuing process a number of Arkansas based firms have been identified that provide expertise in specialized areas. Such managers maintain focus on specific asset types to achieve quality returns through focused, highly specialized approaches. As a result of the due diligence process to select possible managers for the Fund of Opportunities, some potential candidates for other specialized investments have been identified.

The Board began the specialized individual manager approach for the Fund of Opportunities by approving two funds managed by the Circumference Group (CG) at the April 6, 2015, meeting. The CG Core Value Fund, LP and the CG Concentrated Positions Fund, LP are both CG managed funds that seek to utilize the firm's operational experience in the fields of information technology, telecommunications, and business services to generate quality returns. Both funds have performed well and significantly outperformed their benchmark.

The continuing due diligence process has identified another potential specialized fund for Investment Committee and Board consideration, the Arkansas Opportunity Fund, LP, managed by Stephens, Inc. (Stephens), and Neuberger Berman Alternatives Advisers, LLC (Neuberger). Stephens, founded in 1933 and headquartered in Little Rock, has over 50 years of investment experience across multiple asset classes, and due to their location and expertise conduct due diligence on investment opportunities of various sizes in Arkansas, surrounding areas, and nationwide. Neuberger, founded in 1939, has extensive global experience providing customized portfolios for institutional investors designed to complement and enhance the investor's portfolio. Both Stephens and Neuberger have successfully sourced investment opportunities in different asset classes for investors and this partnership will combine the two firms' areas of expertise into a fund with investment opportunities of various sizes originating in Arkansas and other areas that is customizable to ATRS's investment objectives.

If approved, the Arkansas Opportunity Fund would position Stephens and Neuberger to apply a best ideas approach across multiple asset classes with various investment sizes designed to complement and enhance the existing ATRS portfolio. The fund would seek investment opportunities in the range of $6 to $12 million dollars. This size of investment is below the typical range for ATRS investments on a standalone basis. The fund would provide ATRS a vehicle to participate in these smaller investment opportunities that may offer enhanced returns and continue to increase the diversification of the ATRS portfolio in asset classes that are not as correlated to the stock markets.

The combined effort of Stephens and Neuberger would bring deal sourcing and due diligence with each firm adding their specific skill sets, geographical diversification, process oversight, and experience to generate a diversified fund. The fund would seek investments in various asset classes including private equity, private debt, real assets, and other alternative strategies both in Arkansas and globally. Both Simmons and ATRS staff recommend an investment in the Arkansas Opportunity Fund, LP, with a commitment of up to $100 million dollars. As with other funds of this type, the commitment will be drawn over several years as investment opportunities are identified. Other investments of this type allow for distributions from the investment to be reinvested or recalled by the investment, for clarity the proposed Resolution for the Arkansas Opportunity Fund allows recallable distributions for this investment. Since ATRS may need to close on this investment to take advantage of opportunities currently being reviewed by the fund before the next scheduled ALC meeting, Imminent Need is requested. Staff concurs with the recommendation.

Ms. Nichols *moved* to *adopt* Resolution 2016-26, to Commit up to $100 Million Dollars in the Arkansas Opportunity Fund, LP, an Opportunistic/Alternatives Fund Managed by Stephens, Inc. and Neuberger Berman Alternative Advisers, LLC, a Diversified Fund Focused on Investment Opportunities Across Various Asset Classes Expected to Compliment the Current ATRS Portfolio with Imminent Need. A voice roll call vote was taken by the Board Recorder, and the Board *unanimously adopted the Resolution.*

B. Recommendation to Commit up to $25 Million Dollars in CBRE Strategic Partners U.S. Value 8, LP, a Value Added Real Estate Fund Focused on Institutional Quality Multifamily, Office, and Retail Properties in the U.S. with Imminent Need. Chae Hong, of AON Hewitt Consulting presented the recommendation for CBRE Strategic Partners, U.S. Value 8, LP. Based in Los Angeles, California, the CBRE value added platform was formed in 2000 to focus on commercial real estate investments. ATRS invested in CBRE Strategic Partners U.S. Opportunity Fund 5, LP (CBRE 5), in 2008. Similar to other funds in this timeframe, early investments were impacted by the financial and economic downturn associated with mortgage and real estate during 2008. Despite the slow start, CBRE 5 is anticipated to generate a net 7.1% IRR with a 2019 final distribution date. The previous seven value added CBRE funds averaged a net 9.7% IRR.

This fund will seek to buy, reposition, and re-lease high quality real estate in U.S. markets for sale into the core real estate marketplace. The fund will focus on real estate in markets that are well positioned to capture tenant demand coming from population and employment growth. Once properties are identified, the fund will seek to add value to the property by improving lease rates and terms. The improved lease rates and terms should increase the property's value allowing the fund to sell the property at a premium to investors interested in core or income producing properties.

The successful team is led by Vance Maddocks who joined CBRE in 1984. Mr. Maddocks is the founder of Strategic Partners U.S., the firm’s enhanced return platform. Under the direction of Mr. Maddocks, Strategic Partners U.S. has raised $7.7 billion of capital from 81 limited partners in ten funds and three co-investment vehicles and closed 202 transactions totaling $18.1 billion. Aon Hewitt Investment Consulting and ATRS staff recommend an investment of up to $25 million dollars in CBRE Strategic Partners U.S. Value 8, LP. First close participants receive a 25 basis point reduction in management fees and the first close is expected to be before the next scheduled ALC meeting. To provide ATRS the ability to participate in the first close and take advantage of the associated management fee discount, Imminent Need is requested. Staff concurs with the recommendation.

Ms. Nichols *moved* to *adopt* Resolution 2016-27 to Commit up to $25 Million Dollars in CBRE Strategic Partners U.S. Value 8, LP, a Value Added Real Estate Fund Focused on Institutional Quality Multifamily, Office, and Retail Properties in the U.S. with Imminent Need. A voice roll call vote was taken by the Board Recorder, and the Board *unanimously adopted the Resolution.*

C. Recommendation to Commit up to $30 Million Dollars in Arlington Capital Partners IV, L.P., a Private Equity Buyout Fund Specializing in Small to Lower Mid-Market Companies in the U.S. with Imminent Need. Michael Bacine of Franklin Park presented the recommendation in Arlington Capital Partners IV., L.P. Based in Chevy Chase, Maryland, Arlington was founded in 1999 and has raised three prior funds. The firm is led by Jeffrey Freed, Matthew Altman, Michael Lustbader and Peter Manos (principals) who have an average of 21 years of experience each in the private equity industry and over 15 years with Arlington. The fund is being raised to make "buy and build" investments in four government-related areas: (1) defense and aerospace (2) government services (3) healthcare and (4) business services and software. Arlington employs a top-down approach to identify market segments with tailwinds and to develop investment themes. The team focuses on core areas and themes in which it can add value and benefit from experience through repeat deals. The firm has generated attractive returns with a net multiple of 1.7x and 22.3% IRR on its previous 21 core deals.

For this fourth fund, Arlington is planning a second and final close by the end of July. Since there is no scheduled ALC meeting this month, Imminent Need is requested in order for ATRS to participate in the final closing. Both Franklin Park and ATRS staff recommend an investment of up to $30 million dollars in Arlington Capital Partners IV, L.P. with

Imminent Need, subject to final due diligence. The remaining diligence items are routine and should present no issues as to the investment. Staff concurs with the recommendation.

> **Ms. Nichols *moved* to *adopt* Resolution 2016-28 to Commit up to $30 Million Dollars in Arlington Capital Partners IV, L.P., a Private Equity Buyout Fund Specializing in Small to Lower Mid-Market Companies in the U.S. with Imminent Need. A voice roll call vote was taken by the Board Recorder, and the Board *unanimously adopted the Resolution.***

D. Recommendation to Commit up to $25 Million Dollars in Highland, LLC. A Wood Pellet Manufacturing Facility Located in the Pine Bluff Industrial Complex Adjacent to White Hall, Arkansas, with Imminent Need.

<u>Overview on Biomass and Wood Pellets as a Renewable Energy Source.</u> Biomass is a term for organic matter such as plant material and trees that are used for fuel. A newer and material use is for fuel, especially in power generation facilities for the generation of electricity. Wood pellets are the most common type of biomass pellet fuel and are generally made from compacted wood. The raw material used in the pellet making process may be sawdust, wood chips, and full trees. The use of this renewable material is increasing globally as more countries strive to reduce carbon emissions and become more environmentally friendly by replacing coal with wood pellets as a means of producing heat and electricity. For example, the United Kingdom plans to use renewable resources such as wood pellets to produce 15% of their energy demand by 2020. Electricity generation using biomass (including wood pellets) in the United Kingdom increased 47% from 2013 to 2014 primarily driven by the ongoing conversion of power plants from coal to biomass.

The Drax Group is an innovative energy company that owns the United Kingdom's largest power plant and typically provides 8% or more of the United Kingdom's electricity. Drax has plans to convert three of its six power generating units to burn biomass instead of coal. The first of these units was successfully converted in 2013, the second in 2014, and plans to convert the third are underway. Conversion of the first unit resulted in 1.8 million tons of wood pellets used for fuel supply that year. The conversion of the second unit increased wood pellet demand 150% to 4.5 million tons of fuel. The U.S. is the largest supplier of wood pellets to the United Kingdom, and in 2014, imports of

U.S. wood pellets only met 58% of Drax's need. The current wood pellet supply will continue to face pressure as demand for wood pellets increases both for Drax and globally.

Highland, LLC, the operating entity of the Highland Pellet Plant, located in the Pine Bluff Industrial Complex adjacent to White Hall at the Sheridan exit on I-530, has a ten-year agreement to supply Drax with over 600,000 tons of wood pellets per year. The agreement between Highland and Drax provides a ten-year rate that may increase annually based on the consumer price index (a means of measuring inflation) or local wood prices. This means the Highland contract with Drax provides for a base price that can increase based on any rising costs of the plant's manufacturing. The ability to increase the price of the wood pellets sold to Drax will help maintain the profitability of the plant through varying economic conditions.

ATRS staff has worked over the past several months to analyze a potential investment in Highland. Simmons First National Bank (Simmons) was also hired to perform due diligence on Highland. The recommendation of Simmons and ATRS staff is a commitment of up to $25 million dollars for 31% equity in Highland, LLC, the parent company of the wood pellet manufacturing plant located in the Pine Bluff Industrial Complex adjacent to White Hall, Arkansas.

Supply of Wood Fiber. One of the biggest risks faced by wood pellet producers is the ability to secure a sufficient long term supply of sustainable wood fiber intake needed for processing wood pellets. Highland has mitigated this risk by securing a ten year agreement with Plum Creek (now merged with Weyerhaeuser). Plum Creek will provide 100% of the wood fiber intake needed by Highland with targets and guarantees of quality and pricing. The contract is structured for Highland to pay a fixed price on a portion of the wood fiber and has incentives in place to encourage Plum Creek to source the rest of the needed wood fiber at a favorable cost to Highland.

For a daily view of the supply needs of Highland, the plant will look to receive 175 loads of tree length pulp wood per day. In addition to the Plum Creek supply guarantee, ATRS has ample supply of timber in the area. ATRS timber holdings in Jefferson, Grant, Dallas, Cleveland, and Calhoun counties may benefit from the increased demand for pulp wood in the area to fulfill the needs of Highland.

Quality Location. Due diligence conducted by Simmons has shown that Pine Bluff, Arkansas, has the needed supply of energy, transportation, and infrastructure to meet and exceed the requirements of this project.

Union Pacific has a quality rail line near the facility and Highland has secured a long term agreement with Union Pacific to run unit trains twice a week using the mainline rail. Union Pacific is currently operating a rail service for Drax to their facility in Port Allen, Louisiana, and is familiar with the product and customers. Should shipping by rail be unexpectedly disrupted for a prolonged period, Highland is able to truck and barge the wood pellets to the Drax facility so a rail disruption should not have a major effect on Highland's ability to ship the wood pellets to Drax. The point of sale from Highland to Drax is Delivered at Place (DAP) meaning Drax takes possession of and pays for the wood pellets at their facility in Port Allen. Once the wood pellets reach the Drax facility in Louisiana, Drax is responsible for shipping the wood pellets overseas to their power plant. This should eliminate any foreign currency exchange risk for Highland as their product will be sold in the U.S. with payment in U.S. dollars. DAP in Port Allen also saves Highland any large scale storage or sea vessel loading costs.

Capacity and Capabilities of this Plant. Highland has taken an innovative "modular" approach in the construction of the plant. The modular approach used by Highland means the plant will have four separate lines used to produce the wood pellets. The plant is designed so three lines will produce the supply needed to exceed the requirements of the Drax contract and the fourth line is available for use if one of the other lines needs to be shut down for maintenance or repair. The ability to operate the lines independently of each other should help reduce any needed downtime for maintenance or repair. The equipment needed for the production of the wood pellets is built by Astec, Inc. Astec is renowned for excellent customer service and nationwide parts and service teams. Astec is based in Chattanooga, Tennessee, and has a long history in asphalt and paving equipment. Highland has agreements in place with Astec to guarantee the quality and volume of the wood pellets produced at the facility. Astec has the financial resources and strength to fully back those guarantees.

Construction Time. Construction is almost complete and wood pellet production is expected to begin in November 2016.

Investment Return Projections. After the financing structure, revenue streams, and cost of operation are figured, the projected return is expected to be between 14.7% to 15.6%. All calculations include full operation of the potential Sun Paper Pulp Facility's supply needs.

Conclusion. The long term contracts secured by Highland have minimized several of the risks associated with this type of project. Highland's executed contracts with Plum Creek, Drax, and Astec mitigate several risks associated with this industry by securing supply, product demand, pricing, shipping, and manufacturing equipment guarantees. Plant construction is almost complete and all environmental permits are in place. With the plant close to production and the expected rate of return to be between 14.7% and 15.6%, ATRS staff and Simmons recommend a commitment of up to $25 million dollars for 31% equity ownership in Highland, LLC. Other investments of this type allow for distributions from the investment to be reinvested or recalled by the investment, for clarity the proposed Resolution for Highland allows recallable distributions for this investment. Since the only close for this investment opportunity is expected to take place before the next scheduled meeting of the ALC, Imminent Need is also requested.

Ms. Nichols *moved* to *adopt* Resolution 2016-29, to Commit up to $25 Million Dollars in Highland, LLC. A Wood Pellet Manufacturing Facility Located in the Pine Bluff Industrial Complex Adjacent to White Hall, Arkansas, with Imminent Need. A voice roll call vote was taken by the Board Recorder, and the Board *unanimously adopted the Resolution.*

VI. Other Business. None.

VII. Adjourn.

Mr. Stubblefield *moved* to *adjourn* the Board of Trustees Meeting. Mr. Knight *seconded* the *motion*, and the Committee *unanimously approved the motion.*

Meeting adjourned at 9:48 a.m.

George Hopkins,
Executive Director

Mr. Jeff Stubblefield, Chair
Board of Trustees

Tammy Porter,
Recorder

Date Approved