



**PENSION RESERVES
INVESTMENT
MANAGEMENT BOARD**

Minutes of the PRIM Real Estate and Timberland Committee Meeting
Wednesday August 2, 2017

Committee members present:

- Jill S. Hatton, CRE, Chair
- Treasurer Deborah Goldberg (via telephone)
- Sarah Kim, Esq., Treasurer Goldberg's designee
- Lydia Chesnick, Esq.
- Robert Gifford
- Anthony E. Hubbard, Esq. (via telephone)
- Jack Lutz, Ph.D.
- William F. McCall, Jr., CRE (via telephone)
- Garlan Morse, Jr., CRE (via telephone)
- Carly Rose (via telephone)

Committee members not present:

- Peter O'Connell

The PRIM Real Estate and Timberland Committee meeting was called to order at 9:34 a.m.

A quorum was not present at the meeting. The Committee members present agreed that PRIM staff should present reports and recommendations, but that no formal votes would be taken given the lack of quorum.

I. Executive Director/Chief Investment Officer Comments

Michael G. Trotsky, CFA, Executive Director and Chief Investment Officer, updated the Committee on numerous matters including, but not limited to:

Fiscal year 2017 was exceptionally strong for PRIM. The PRIT Fund ended the fiscal year at \$67 billion, a record high. The PRIT Fund was up 13.2% (gross of fees), outperforming its benchmark by 127 basis points. On a net-of-fees basis, the PRIT Fund was up 12.8%, outperforming its benchmark by 79 basis points. Six of the seven major asset classes outperformed their benchmarks. For the first time in several years, international equities outperformed domestic equities, though all equities were up strongly. As you know, we have maintained our relatively high exposure to international equities and this served us well in the fiscal year. We are especially pleased with our performance given that we have systematically de-risked our portfolio over the past several years.

Private Equity returned 21.3% for the year, Global Equities returned 20.9%, Value-added Fixed income returned 10.3%, and Hedge Funds were up 9.4% (net of fees). Real Estate and Timberland performed well, returning 6.8% and 8.3%, respectively, for the fiscal year.

PRIM completed its first ever direct real estate acquisition, acquiring 21 acres of prime office space land in Santa Clara, California. Executing the transaction directly will save PRIM more than \$11 million in

management fees over the expected life of the investment. Project SAVE is alive and well, deeply imbedded in our DNA, and we have now identified over \$160 million in value-enhancing strategies, well above our initial target of \$100 million. We also have launched Project SAVE Phase II – a careful deployment of direct investing – under Investment Committee member Mike Even’s insightful supervision.

At PRIM, we believe that any investment should be analyzed on three equally important parameters: return, risk and cost, and that it is incomplete to evaluate the success of any investment program on just one of those parameters. Too often in the investment world, we see investment programs evaluated solely on return, occasionally on cost, and very seldom, virtually never, on risk. We have noticed that few peer organizations can accurately measure and assess investment risk. We have allocated resources to measuring and controlling risk, and any new investment at PRIM takes risk into account. In fact, every investment we make at PRIM takes all three parameters into account: return, risk and cost.

Over the past few years we have re-engineered our hedge fund portfolio, re-engineered the fixed income portfolio, and added significant risk-reducing strategies such as long-duration Treasury securities, agriculture, the put-spread-collar options strategy, and alternative risk premia harvesting strategies. We have reached an important milestone in the Hedge Fund portfolio, often a misunderstood investment strategy. Now, more than 50% of our direct hedge fund portfolio is invested in separately managed accounts, providing improved transparency, more control and lower fees than the commingled fund format that had been the norm. Many in the nation are now following our lead, and we should all be proud that the Hedge Fund group is a recognized leader. And as a great illustration of our attention to risk, the Hedge Fund portfolio returned 9.4% net of fees, 3.1% above the benchmark, while exhibiting extremely low realized volatility of approximately 1.5%. 1.5% realized volatility combined with a return of 9.4%, was the highest risk adjusted return in the entire PRIM portfolio.

Those are a few important highlights of our investment program: Solid results, a careful focus on returns, risks and costs, and continued nation-leading innovation across the program. Organizationally as well, fiscal 2017 was another outstanding year. Once again, we are pleased to report that no senior-level employees departed, and consistent with the Board-approved hiring plans, we filled seven staff vacancies with top talent. We are now nearly fully-staffed with exceptional investment and finance professionals and all our job postings attract literally hundreds of talented and well-qualified applicants.

We developed a Board-approved, multi-year staff hiring plan in each functional area to ensure that we are appropriately resourced going forward. Our team continues to be recognized around the nation for the success and innovation of our investment program and for the transparency and completeness of our financial reporting. We have never been stronger, but retention of key employees remains our primary concern. The employment environment in the nation and in the region, is strong – there are opportunities for our employees outside of PRIM – and we have spent considerable time and effort on retention strategies for key PRIM employees. We all must be vigilant to ensure we provide a challenging and rewarding opportunity for all our employees, and a culture and work environment that our employees value.

To that end, in May we announced a series of personnel moves on the investment team. The changes provide stimulating new challenges for three strong professionals and will enhance PRIM’s role as a leading innovator and performance leader among public pension funds. This year we will look for similar opportunities for other deserving members on the investment staff and on the finance staff. To recap:

- Eric R. Nierenberg, Ph.D., Director of Hedge Funds and Low Volatility Strategies, was named PRIM’s Chief Strategy Officer. In this new role, Eric will look across the entire \$67 billion investment portfolio for innovative approaches to identify diversification strategies, enhance returns and reduce fees.

- Sarah N. Samuels, CFA, CAIA, will add responsibility for Hedge Funds to her current responsibilities overseeing Public Markets and investment research. Sarah was the first participant in PRIM's Professional Development Program.
- Michael Bailey, Senior Investment Officer – Director of Private Equity, will be the second person to take part in PRIM's Professional Development Program. As you may remember, the program rotates asset class heads through teams other than their own.

The organization has never been stronger or more innovative, not only in the investment arena but also in the finance, legal and operations area. Again, we were awarded the Government Finance Officers Association certificate for the completeness and transparency of our financial reporting, and as a result of our outstanding legal successes, our Deputy Executive Director and General Counsel, Chris Supple, has been reappointed to a second term as Chair of the Securities Litigation Committee of NAPPA, the National Association of Public Pension Attorneys. (Last term, Chris was co-Chair.)

There is no doubt our investment program is trend-setting and thoughtful, but without the finance and legal staff running in lock step with our investment program, none of PRIM's success would be possible. They are a group of consistent enablers, they enable, they make possible, they implement, account for, measure, control, and document our innovative and diverse investment program. That is no easy task, especially considering that with over 100 clients expertly supported by Paul Todisco and his Client Service staff, we already have one of the most complex accounting and reporting structures in the country. We have the great luxury of this group's professionalism and expertise and we don't take them for granted.

Economic news is encouraging and the global economy is slowly improving. The U.S. economy and the Eurozone have gathered momentum while slightly lower growth in China may be offset by faster growth in other emerging markets such as Brazil and Russia. Furthermore, central banks across the globe generally remain accommodative, while the United States Federal Reserve held rates steady recently, after three rate hikes since December.

Inflation remains subdued even as Gross Domestic Product growth in the U.S. rebounded to 2.6% in Q2 from 1.2% (revised) in Q1, and labor markets continue to improve -- the unemployment rate at 4.3% is the lowest in 16 years. Driving the improving GDP growth, real consumption was up 2.8% on strong consumer expenditures, business investments were up 5.2%, and equipment investment up 8%. June existing home sales fell 1.8% amid tight supply, while housing starts reached a 4-month high. Finally, S&P earnings for this earnings season have been strong, generally higher than expectations.

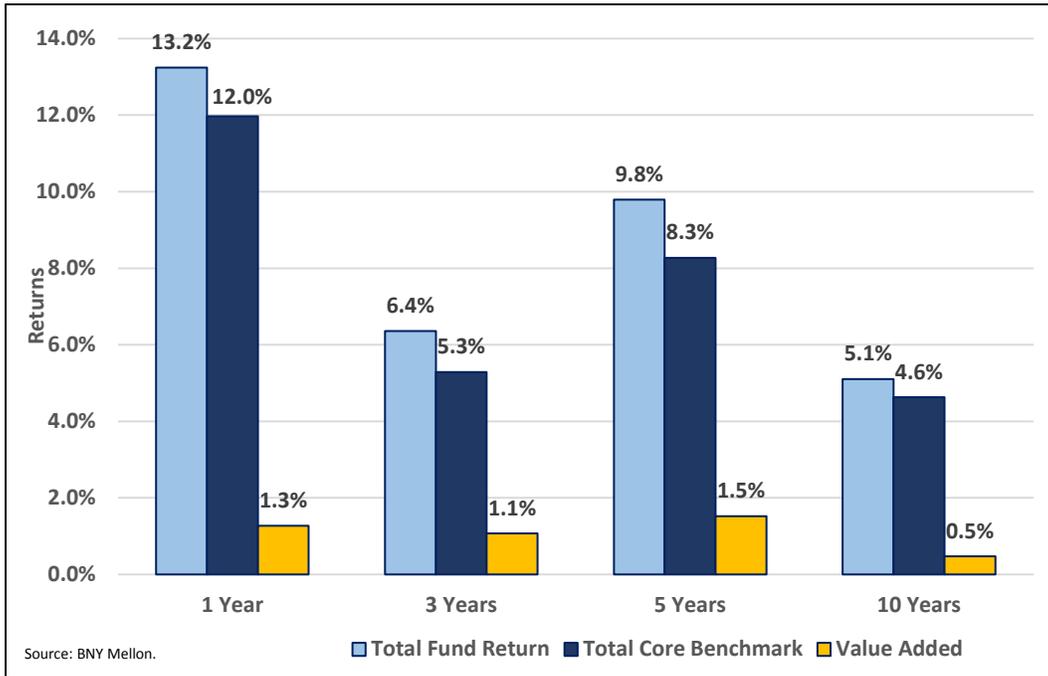
In this environment, the PRIT Fund has performed well:

For the one-year ended June 30, 2017, the PRIT Fund was up 13.2% gross, outperforming its benchmark of 12.0% by 127 basis points. On a net-of-fees basis, the PRIT Fund was up 12.8%, outperforming its benchmark by 79 basis points.

- This performance equates to an investment gain of \$7.7 billion, net of fees.
- This outperformance equates to \$480 million of value above the benchmark return, net of fees.
- Six of the seven major asset classes outperformed their respective benchmarks.
- Net total outflows to pay benefits for the one-year ended June 30, 2017, were approximately \$1.5 billion.

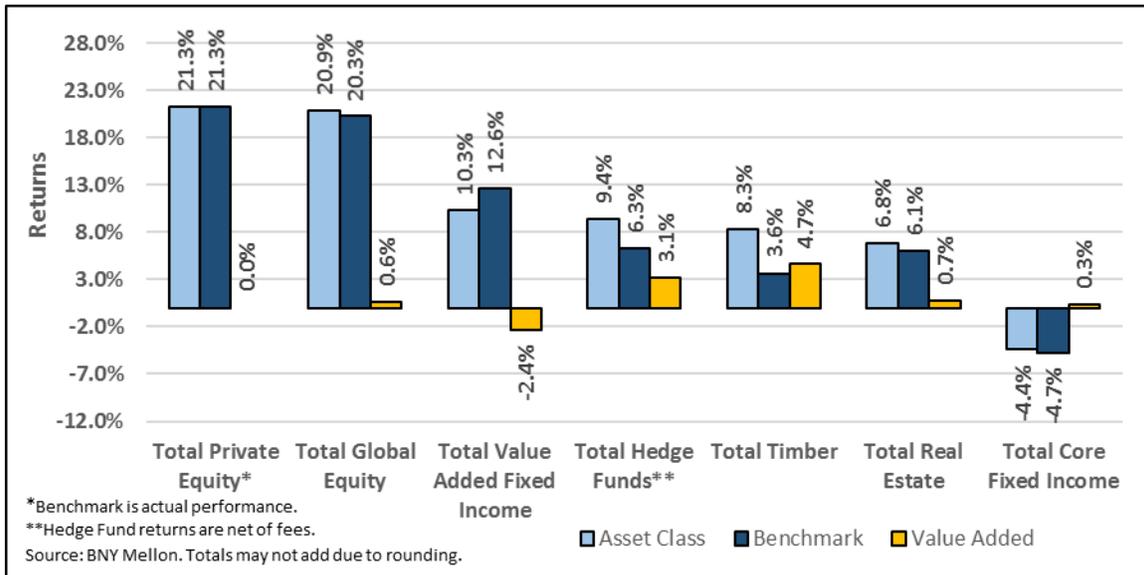
Total PRIT Fund Returns

Annualized Returns as of June 30, 2017 (Gross of Fees)



PRIT Asset Class Performance

Trailing 1-year Performance as of June 30, 2017 (Gross of Fees)



PRIT Core Fund Performance Summary

Trailing 1-Year Performance as of June 30, 2017 (Gross of Fees)

Trailing 1-Year Performance: June 30, 2017	Return	Benchmark Return	Over/(Under) Benchmark (bps)	\$Value (millions)	% of PRIT Fund
Total PRIT Fund	13.2%	12.0%	127	66,850	100%
Total Global Equity	20.9%	20.3%	60	30,498	45.7%
Domestic Equity	18.6%	18.7%	(8)	13,216	19.8%
International Developed	20.2%	20.4%	(16)	12,038	18.0%
Emerging Markets	28.2%	23.4%	479	5,243	7.9%
Private Equity	21.3%	21.3%	0	7,092	10.6%
Real Estate	6.8%	6.1%	70	6,048	9.1%
Total Timberland	8.3%	3.6%	467	2,483	3.7%
Hedge Funds	9.4%	6.3%	313	5,580	8.4%
Value Added Fixed Income	10.3%	12.6%	(235)	5,403	8.1%
Core Fixed Income	-4.4%	-4.7%	33	7,984	12.0%

PRIT Asset Class Performance

Annualized Returns as of June 30, 2017 (Gross of Fees)

1 Year	3 Year	5 Year	10 Year
PRIVATE EQUITY 21.3%	PRIVATE EQUITY 16.3%	PRIVATE EQUITY 17.9%	PRIVATE EQUITY 13.4%
GLOBAL EQUITY 20.9%	REAL ESTATE 10.3%	REAL ESTATE 11.4%	VALUE-ADDED FIXED INCOME 6.7%
VALUE-ADDED FIXED INCOME 10.3%	TIMBER 6.1%	GLOBAL EQUITY 11.3%	REAL ESTATE 6.5%
HEDGE FUNDS (NET OF FEES) 9.4%	GLOBAL EQUITY 5.4%	TIMBER 7.4%	TIMBER 6.1%
TIMBER 8.3%	CORE FIXED INCOME 4.7%	HEDGE FUNDS (NET OF FEES) 6.0%	CORE FIXED INCOME 5.3%
REAL ESTATE 6.8%	VALUE-ADDED FIXED INCOME 2.8%	VALUE-ADDED FIXED INCOME 5.1%	GLOBAL EQUITY 4.2%
CORE FIXED INCOME (4.4%)	HEDGE FUNDS (NET OF FEES) 2.4%	CORE FIXED INCOME 3.9%	HEDGE FUNDS (NET OF FEES) 2.8%

II. Performance Review and Market Update

Timothy V. Schlitzer, CRE, CFA, Senior Investment Officer - Director of Real Estate and Timberland, provided the Committee with an update on Real Estate and Timberland performance, noting that Real Estate comprises about 9.1% of the PRIT Fund – which is underweight due to the disposition of Real Estate

Assets during fiscal 2017 and faster growth in the value of the PRIT Fund overall. PRIM's Real Estate investments are about \$640 million below target and Timberland investments are about \$190 million below target, he said.

PRIM's Real Estate portfolio is 91% occupied and 35% of leases roll over during the next three years, Mr. Schlitzer said. The pipeline for potential acquisitions increased in the second quarter, he said.

Both of PRIM's Timberland managers outperformed the benchmark, Mr. Schlitzer said, and PRIM's decision to invest overweight in the Pacific Northwest has paid off.

Members of the Committee discussed the state of the market for retail properties.

Mr. Schlitzer said that for potential core real estate acquisitions, PRIM staff is focusing on a half-dozen U.S. primary markets.

III. Request for Proposals for Private Real Estate Investment Management Services

PRIM staff recommended the issuance of a Request for Proposals (RFP) for Private Real Estate Investment Management Services. Mr. Schlitzer told the Committee that PRIM is down to four managers for Private Core Real Estate Investments and prefers five and that an RFP, which would be PRIM's first for Private Real Estate Investment Management Services in seven years, would provide useful information about fees managers are charging.

Lacking a quorum, the Real Estate and Timberland Committee members present and via telephone consented to recommend to the PRIM Board that the PRIM Board approve the issuance a Request for Proposals for Private Real Estate Investment Management Services.

The PRIM Real Estate and Timberland Committee meeting adjourned at 10:49 a.m.

List of documents and exhibits used during the meeting:

- *Minutes of the PRIM Real Estate and Timberland Committee Meeting of February 1, 2017*
- *PRIT Fund Performance Report*
- *BNY Mellon Gross of Fees Performance Report*
- *Real Estate and Timberland Portfolio Report*