



Minutes of the PRIM Administration and Audit Committee
Thursday, October 31, 2019

Committee members present:

- Robert Brousseau, Chair
- Treasurer Deborah Goldberg
- Patrick Brock
- Joseph Connolly
- James Hearty
- Dennis Naughton via telephone
- Michele Whitham, Esq.

Committee members not present:

- Karen Gershman, CPA
- Eileen Glovsky
- Theresa McGoldrick, Esq.

The PRIM Administration and Audit Committee meeting was called to order at 10:05 a. m.

The PRIM Board has adopted the provision of the Massachusetts Open Meeting Law that permits remote participation in meetings by a member if physical attendance would be unreasonably difficult, as was the case with Dennis Naughton, who accordingly participated in the meeting remotely by telephone, and all votes in the meeting were taken by roll-call.

I. Approval of the Minutes (Voting Item)

The PRIM Administration and Audit Committee approved by roll call vote the minutes of the August 1, 2019, Administration and Audit Committee meeting. James Hearty indicated he was not present for the August 1, 2019 meeting and therefore chose to abstain.

II. Executive Director / Chief Investment Officer Comments

Michael G. Trotsky, CFA, Executive Director and Chief Investment Officer, made comments to the Committee, including:

Market Performance Summary

Worldwide economies continue to slow, some are already in recession, and GDP growth in the U.S. is expected also to continue its decline. Third calendar quarter U.S. GDP growth was 1.9%, down from 2.0% in the second quarter of 2019, and was slightly higher than estimates, mainly due to a solid increase in federal government spending. Business investment declined 3% annualized, which followed a 1% decline in the second quarter. The 1.9% third quarter GDP growth is down from the more than 3% reported in the first quarter. Consensus estimates for the fourth calendar quarter and into 2020 continue to anticipate a continued slowdown. The current consensus is for quarterly GDP growth to bottom at approximately 1% in 2020 before rising again in 2021.

Recent economic data has been mixed. For example, the Institute for Supply Management (ISM) manufacturing index of 48.3 in October remains below the 50 threshold that separates expansion from contraction, and the Chicago Purchasing Manager Index dropped to 43.2, hitting a nearly four-year low. By contrast recent jobs reports were more positive. The Labor Department reported that 128,000 jobs were added in October, well above the expectation of 75,000. The unemployment rate fell 0.2% to 3.5% in September, a 50-year low, yet even with that positive surprise, job growth in 2019 remains below

previous levels and below the average monthly rate of more than 160,000. Consumption growth slowed to 2.6% from 4.6% in the second quarter, and with job growth slowing from previous levels, further moderation is expected. Perhaps a harbinger of things to come, U.S. retail sales fell in September for the first time in seven months.

Central banks around the world, including the U.S. Federal Reserve Bank (Fed), have shifted to an accommodative stance. As expected, the Fed lowered the federal funds rate a quarter of a percent at its October 2019 meeting to a range of 1.50% to 1.75%, the third cut this year, following similar cuts in July and September. Approximately 70% of the S&P 500 companies have reported quarterly earnings, and 76% of those have exceeded analysts' expectations, but corporate earnings have declined for the third consecutive quarter; on average, corporate earnings for the third quarter are 2.7% below last year's level. Meanwhile, despite the continued slowdown in global growth and a steady stream of mixed economic news, equity market returns strengthened in September and into October as investors continue to climb the proverbial "wall of worry". There is still plenty to worry about: slowing global growth, trade tensions, geopolitical tensions, political gridlock, political infighting globally, and military escalations in the middle east, to name just a few. Yet the S&P 500 index is making regular new all-time highs, while international equities are likewise rebounding. Bond yields are off their lows for the year (the 10-yr hit 1.47% in September), but these ultra-low levels (negative in some geographies) continue to indicate a lack of confidence in the global markets.

As discussed at the July PRIM Investment Committee meeting, we identified several reasons to remain cautious, and we recognized a divergence between economic sentiment and expectations versus actual economic performance. Markets eventually react to mismatches of data and expectations, so we will be watching closely in the coming months for confirming data to support the recently rising equity markets. Something to watch closely is the widely held belief that the consumer (the driving force of economic growth in the U.S.) is healthy, but there are already some worrisome signs: average hourly earnings are down, average weekly hours are down, retail sales were down in September, and monthly employment growth, while still positive, is slowing.

We think of the recent strength of equity markets in terms of three possibilities:

Scenario 1: The recent strength in equities is a counter-trend move. When trades become as one-sided as they were by late-summer, markets can try out the opposite scenario. In other words, perhaps the market weakness in the summer months was too extreme, and the recent bounce is merely a reversal.

Scenario 2: The recent strength in equities is an early indication of a stronger global economy. Changes in equity sector performance can be a first sign of regime change. If something really different is developing in the global economy, there will need to be evidence in orders and in spending. So far, global conditions are still deteriorating. This could change with confirming data.

Scenario 3: Shares that powered the U.S. market to rebounds from sell-offs in 2018 and 2019, and held it at high levels since, have more recently faltered. We highlighted recently at the PRIM Investment Committee meeting the historic, but temporary reversal into value stocks. If new leadership is not sustained, if the strength in the markets continues to be the result mainly of a narrow group of high performers, then equity markets are still vulnerable.

Bottom line: We will be watching closely for confirming data to support the recently rising equity markets and we continue to believe that the carefully constructed PRIT Fund asset allocation will enable strong performance in any of these potential scenarios.

Organizational Update

With the increase in PRIM's assets under management and our increasingly sophisticated investment strategies, and the increase in our number of clients, PRIM is continuing to add to its staff. PRIM currently has eight job openings for which we have received more than 2,500 applications.

We recently welcomed one new employee. Minching Kao, who joined the Real Estate and Timberland team this month as an Investment Analyst. Most recently, Minching was with Beacon Capital Partners in Boston as a Senior Acquisitions Analyst. Prior to Beacon, Minching held positions at the Boston real estate advisor GFI Partners, and at National Valuation Consultants in Denver, CO. Minching holds a bachelor's degree in Finance and English from Tung Hai University in Taiwan and an MBA and Master of Science in Real Estate and Construction Management from the University of Denver.

In the area for recognition for PRIM staff members, Qingmei Li, CPA, PRIM's Financial Reporting Manager, was awarded the Treasurer's 2019 Citation for Outstanding Performance. Those selected for this honor have made notable contributions to the office of the Treasurer, its agencies, and the citizens of MA. In early June, for the 14th consecutive year, PRIM was awarded the GFOA's (Government Finance Officer Association's) *Certificate of Achievement for Excellence in Financial Reporting*. This award recognizes the completeness and timeliness of PRIM's Comprehensive Annual Financial Report, the CAFR. Qingmei manages the production of the CAFR and an increasing number of audits that have dramatically increased in complexity in lock-step with PRIM's increasingly innovative investment program. Qingmei is the driving force behind PRIM's financial statements consistently having clean audit opinions.

Michael McGirr, CFA, has accepted an invitation from the Institutional Limited Partners Association (ILPA) to join its newly created Content Committee. This committee is responsible for creating and curating content that will be beneficial for the ILPA's membership, which includes more than 500 international institutional private equity investors from peer public pension funds, corporate pension funds, endowments and foundations.

And last, PRIM's Executive Director and Chief Investment Officer, Michael Trotsky, CFA, has been awarded the *Lifetime Achievement Award* from Institutional Investor. He will receive this honor at the annual Allocators' Choice Awards on December 3, 2019 in New York City.

PRIT Fund Performance Summary

Last quarter, we highlighted that the largest component of the relative underperformance for the trailing 12 months was due to the "*Actual v. Target Weight Divergence Effect*." This divergence is caused by the inability to precisely match the actual PRIT Fund assets to the target allocation of illiquid alternative investments. This was still the case in the September quarter. We were overweight poorly performing global equities as a result of being underweight the target private equity allocation, which performed strongly. This was the major source of the underperformance reported relative to the PRIT Fund's benchmark.

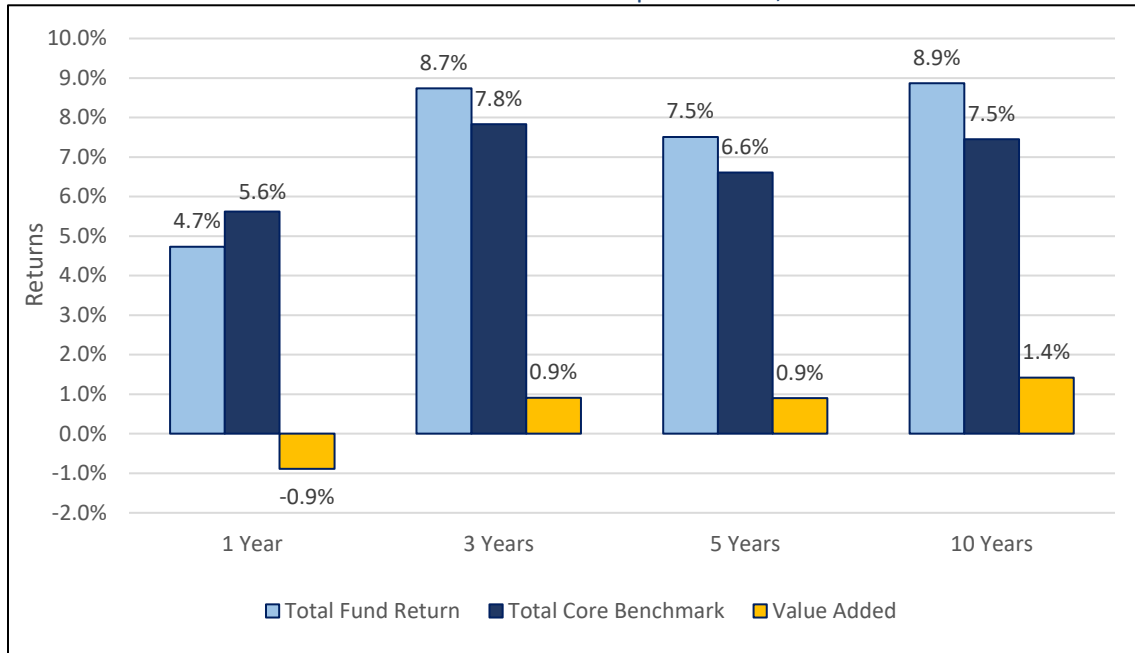
The PRIT Fund benchmark is based on its target asset allocation and not on the actual allocation. It is not always advisable, practical, or even possible to identify and invest in PRIM's high-performing, illiquid alternative investments such as private equity quickly enough to match the target allocation, particularly in volatile market environments. The current comparison to the target allocations penalized us during the last 12 months for not being able to invest quickly enough in PRIM's higher-performing, illiquid alternatives – Private Equity in particular. We will be addressing this divergence effect and may have a solution to propose for consideration at the next committee/Board meeting in February, but the real news here is good, namely that the PRIT Fund's target allocations are performing well, it just takes time to reach the targets.

The other much smaller contributor to underperformance for the 1-year period was due to weakness in a few specific strategies that we have discussed for several quarters, including Real Assets, the Put Spread Collar strategy (Equity Hedged program), Real Estate, and Private Debt. We understand the reasons for the underperformance, we believe that they are temporary in nature, and in all cases we have taken steps to address these underperforming areas, and in fact each of the underperforming areas had a much stronger September quarter, and the PRIT Fund’s longer term 3-, 5-, and 10-year performance remains strong.

- For the one-year as of September 30, 2019, the PRIT Fund was up 4.7% (4.3% net), underperforming the total core benchmark of 5.6% by 89 basis points (133 bps, net).
- This performance equates to an investment gain of \$3.5 billion (\$3.2B, net of fees).
- Net total outflows to pay benefits for the one-year ended September 30, 2019 were approximately \$960 million.

Mr. Trotsky made reference in his remarks to the following charts:

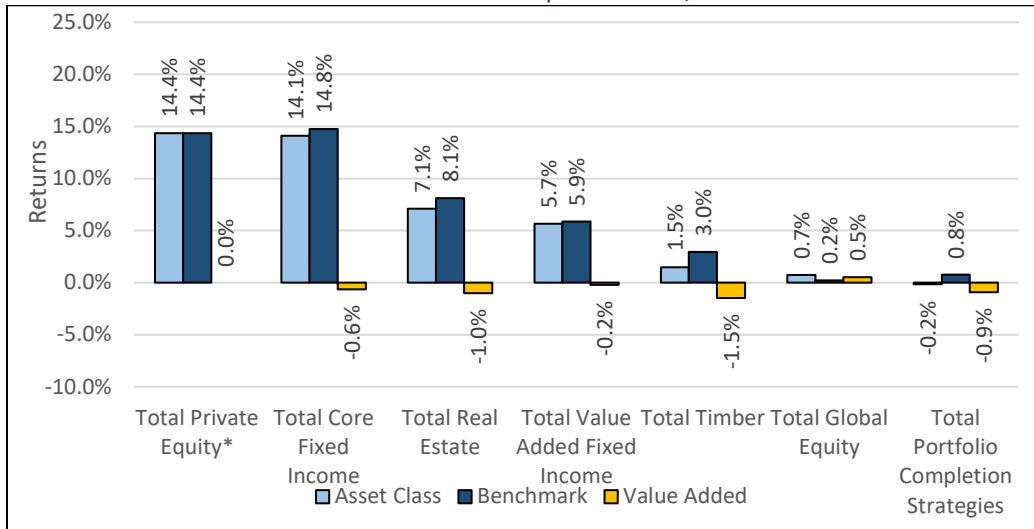
Total PRIT Fund Returns (Gross of Fees)
Annualized Returns as of September 30, 2019



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PRIT Asset Class Performance (Gross of Fees)

One Year Ended September 30, 2019



PRIT Fund Periodic Table of Returns (Gross of Fees)

Annualized Returns as of September 30, 2019

1 Year	3 Year	5 Year	10 Year
PRIVATE EQUITY 14.4%	PRIVATE EQUITY 20.6%	PRIVATE EQUITY 18.0%	PRIVATE EQUITY 18.5%
CORE FIXED INCOME 14.1%	GLOBAL EQUITY 9.8%	REAL ESTATE 9.7%	REAL ESTATE 10.5%
REAL ESTATE 7.1%	REAL ESTATE 7.4%	GLOBAL EQUITY 7.1%	GLOBAL EQUITY 9.0%
VALUE-ADDED FIXED INCOME 5.7%	VALUE-ADDED FIXED INCOME 6.0%	CORE FIXED INCOME 5.3%	VALUE-ADDED FIXED INCOME 7.4%
TIMBER 1.5%	TIMBER 5.7%	TIMBER 5.2%	CORE FIXED INCOME 5.3%
GLOBAL EQUITY 0.7%	PORTFOLIO COMPLETION STRATEGIES 4.7%	VALUE-ADDED FIXED INCOME 4.2%	PORTFOLIO COMPLETION STRATEGIES 4.6%
PORTFOLIO COMPLETION STRATEGIES (0.2%)	CORE FIXED INCOME 2.8%	PORTFOLIO COMPLETION STRATEGIES 3.1%	TIMBER 3.3%

III. Fiscal Year 2019 Audit Results (Voting Item)

Deborah Coulter, CPA, Chief Financial Officer, introduced KPMG Audit Partner David Gagnon and KPMG Audit Manager Marcus Chase, who attended the meeting to review their summary of the Fiscal Year 2019 PRIM and PRIT audits and the two Agreed-Upon Procedures (AUPs) that they perform each year. Ms. Coulter noted that the audits had once again resulted in clean opinions and the two AUPs concluded with no findings. Ms. Coulter thanked the Finance and Operations teams for their hard work, especially Qingmei Li, PRIM's Financial Reporting Manager, who coordinates the audits and prepares the financial statements. Ms. Coulter then described how the addition of new innovative investments to the portfolio had greatly increased the complexity of the financial reporting. Ms. Coulter also stated that PRIM staff and KPMG staff worked very well together and thanked Dave Gagnon for his years of service, noting that this was his last year on the engagement due to KPMG's internal partner rotation policy.

Mr. Gagnon began KPMG's presentation by discussing the growing complexities associated with the PRIT Fund and PRIM Board audits based on new investment strategies and the growing number of investment advisors. He also informed the Committee of the high level of involvement from both PRIM staff and KPMG, with audits being performed almost all year-round by KPMG, as approximately 30 PRIM-related audits and reports are issued by KPMG annually.

Mr. Gagnon then moved on to the prepared remarks from KPMG by discussing the responsibilities of those involved in the audit as it relates to management, the Administration and Audit Committee, and KPMG. He then discussed the areas of emphasis for both the PRIM Board and PRIT Fund audits.

Mr. Chase then reviewed the audit approach for the investments of the PRIT Fund, including the various procedures related to testing the marketable securities and the alternative investments.

Also presented were drafts of the procurement AUP report and the benchmarking AUP report, of which there were no material findings noted based on KPMG's performed procedures.

The Administration and Audit Committee voted (unanimously) by roll call vote to recommend to the PRIM Board that the Board accept 1) the Fiscal Year 2019 PRIM and PRIT audited financial statements, as well as 2) the Agreed-Upon Procedures reports on PRIM's Procurement Process for Investment Management and Other Professional Services, and 3) the Agreed-Upon Procedures reports on the PRIT Fund's Benchmark Calculation, all as contained in Appendix D to the Expanded Agenda.

In accordance with audit best practice, PRIM staff left the room at 10:57 a.m. so that Committee members could have an opportunity to speak with the auditors without staff present.

PRIM staff returned at 11:13 a.m.

IV. Draft Fiscal Year 2019 Comprehensive annual financial Report (CAFR) (Voting Item)

Anthony Falzone, Chief Operating Officer, explained that the Fiscal Year 2019 Comprehensive Annual Financial Report (CAFR) will be PRIM's 15th annual submission to the Government Finance Officers Association (GFOA) and is designed to provide information that goes above and beyond standard financial statements, meant to provide meaningful information concerning the PRIT Fund's financial condition and performance.

Mr. Falzone described the CAFR's four sections: Introductory, Investment, Financial and Statistical. He reminded the Committee that PRIM's report has received the Certificate of Achievement for Excellence in Financial Reporting for the past 14 straight years and is optimistic that this year's submission will earn the award as well. He thanked all the different teams at PRIM and reminded the Committee that this task is a total team effort, singling out Qingmei Li, PRIM's Financial Reporting Manager, for her significant contribution.

The Administration and Audit Committee voted (unanimously) by roll call vote to recommend to the PRIM Board that it approve the draft Fiscal Year 2019 PRIT Fund Comprehensive Annual Financial Report (CAFR) attached as Appendix E to the Expanded Agenda, and further to authorize the Executive Director to take all actions necessary to effectuate this vote.

V. Audit and Tax Services Request for Proposals (RFP) Recommendation (Voting Item)

Ms. Coulter presented the recommendations for audit and tax service providers. The Evaluation Committee consisted of PRIM Board member and Administration and Audit Committee Chair Robert Brousseau and PRIM staff members Deborah Coulter, CPA; Daniel Eckman, CPA; Anthony Falzone; Qingmei Li, CPA; Christina Marcarelli, CAIA; and George Tsipakis. By the deadline of August 26, 2019, PRIM received proposals for all three services from KPMG LLP, Deloitte & Touche LLP, and RSM US LLP. All of the responses were thoroughly reviewed, and all three firms were selected and invited to PRIM's office for interviews on October 3, 2019.

KPMG, the incumbent, was recommended for all audit services including: PRIM, PRIT, Real Estate, Timberland and Agriculture. Ms. Coulter explained some of the reasons for choosing KPMG were that KPMG is the leading government auditing firm, both nationally and locally. In addition, she stated that KPMG's team has grown with, and understands, the complexity of PRIT portfolio, and that retaining them would eliminate the transition risk and the learning curve that a new firm would have.

For tax compliance and advisory services, the incumbent firm, Deloitte, was recommended. Ms. Coulter explained the reason for selecting Deloitte was that Deloitte's tax team has extensive experience working with tax-exempt clients, such as PRIM, and that the team has added significant value over the years, helping PRIM staff structure complex transactions, specifically in the real estate sector.

The Administration and Audit Committee voted (unanimously) by roll call vote to recommend that the Board approve the selection of 1) the incumbent, KPMG, for PRIM and PRIT audit services and for Real Estate, Timber and Agriculture audit services, and 2) the incumbent, Deloitte, for tax related services, all as described in Appendix F of the Expanded Agenda.

VI. Proposed 2020 PRIM Board and Committee Meeting Schedule

Mr. Falzone reviewed the updated proposed 2020 PRIM Board and committee meeting calendar with the Administration and Audit Committee and mentioned many changes had been made to the calendar submitted in August due to a variety of conflicts with various Board and committee members.

The Administration and Audit Committee voted unanimously to make a recommendation to the PRIM Board that it adopt the proposed 2020 PRIM Board and Committee Meeting Schedule is attached as Appendix G to the Expanded Agenda, and further to authorize the Executive Director to take all actions necessary to effectuate this vote.

VII. Legal/Legislative Update

PRIM's General Counsel indicated that a new legislative proposal had been filed (S.2363) that would alter the composition of the PRIM Board in a manner similar to other proposed legislation discussed in previous meetings of this Committee.

VIII. Other Matters:

The Committee members briefly discussed the following topics:

- a. September 2019 PRIM budget
- b. Travel
- c. Client Service Update

The PRIM Administration and Audit Committee meeting adjourned at 11:26 a. m.

List of documents and exhibits used during the meeting:

- *Minutes of the PRIM Administration and Audit Committee Meeting of August 1, 2019*
- *PRIT Fund Performance Report*
- *BNY Mellon Gross of Fees Performance Report*
- *KPMG 2019 Audit Results Report*
- *Draft Fiscal Year 2019 Comprehensive Annual Financial Report*
- *Audit and Tax Services RFP Evaluation Committee Report*
- *Proposed 2020 PRIM Board and Committee Meeting Schedule*
- *Redlined Proposed 2020 PRIM Board and Committee Meeting Schedule*
- *September 2019 PRIM Operating Budget*
- *Travel Report*