



**PENSION RESERVES
INVESTMENT
MANAGEMENT BOARD**

Minutes of the PRIM Real Estate and Timberland Committee Meeting
Wednesday, May 2, 2018

Committee members present:

- Garlan Morse, Jr., CRE, Acting Chair
- Treasurer Deborah Goldberg
- Lydia Chesnick, Esq.
- Anthony E. Hubbard, Esq.
- Jack Lutz, Ph.D.
- William F. McCall, Jr., CRE
- Peter O'Connell
- Carly Rose

Committee members not present:

- Jill S. Hatton, CRE
- Robert Gifford

The PRIM Real Estate and Timberland Committee meeting was called to order at 9:36 a.m. PRIM Real Estate and Timberland Committee member Garlan Morse, Jr. indicated that Chair Jill S. Hatton had asked him to Chair the meeting in her absence.

I. Approval of the Minutes (Voting Item)

The PRIM Real Estate and Timberland Committee unanimously approved the minutes of its January 31, 2018, meeting.

Treasurer Deborah Goldberg arrived at 9:38 a.m. after the vote for minutes approval.

II. Executive Director/Chief Investment Officer Comments

Michael G. Trotsky's, CFA, Executive Director and Chief Investment Officer, comments to the Committee included:

Organizational Update

Earlier this month PRIM engaged an outside consultant to conduct an in-depth study on diversity and inclusion, which will outline and help us plan any needed actions. Anthony J. Falzone, Chief Operating Officer, Deb Coulter, CPA, Chief Financial Officer, and Christina Marcarelli, Investment Officer are working closely with outside consultants from IBIS Consulting Group to conduct this organizational assessment. Anonymous surveys were completed in mid-April, and in mid-May IBIS will conduct in-person interviews. PRIM chose IBIS because of their 30 years of experience combined with their unparalleled knowledge of emerging best practices. The more we can embrace differences within PRIM—diversities of thinking style, experience, race, gender, sexual orientation, faith, ability and more—the better we can serve the diverse citizens of Massachusetts, both now and in the future. PRIM staff will report back to the Committee at future meetings.

Mr. Trotsky and Ms. Marcarelli will be traveling to NYC in May to participate in the CFA Institute's Diversity and Inclusion roundtable event. After Mr. Trotsky's term ended as a Governor of the CFA Institute last September, he was asked to join an advisory committee of CEOs, CIOs, and other investment industry executives from across the nation to develop a best practice guide for companies in the investment industry to use to increase diversity in the investment industry. The investment industry lags most others

in terms of diversity, but industry leaders are banding together and are very serious about addressing the issue. Mr. Trotsky noted that he would be able to share some of the results of this work this fall. Mr. Trotsky mentioned that working on this project with the CFA Institute and other CEOs across the country has been a very rewarding activity for him.

Mr. Trotsky stated that increasing the diversity of PRIM staff is a priority and demonstrated PRIM's recent successes. He added that of the 6 new hires over the last 12 months, 5 are diverse in either race, gender or both. He added that the intern pool at PRIM is equally as diverse. Of the 5 interns hired last year, all were diverse in either race, gender or both. PRIM is planning to add another 5 interns this year and they are all diverse in either race, gender or both, with all 5 intern candidates in this year's class being women.

Mr. Trotsky reminded the Committee that PRIM's experience shows that turnover and recruitment efforts disproportionately affect diverse candidates because all private sector employers in the investment industry are targeting diverse candidates and the pool from which to choose is not large. It is hyper-competitive for diverse employees in this industry.

Mr. Trotsky concluded his organizational update by providing an update on the ongoing searches for three open positions at PRIM, Director of Human Resources, Director of Information Technology, and Private Equity Investment Analyst. Mr. Trotsky informed the Committee that The Director of Human Resources and the Director of Information Technology searches are nearly complete, with the Private Equity Investment Analyst not very far behind.

PRIM received approximately 585 applications for these three positions and Mr. Trotsky told the Committee there is no greater compliment that PRIM can receive—to receive so many highly qualified applicants.

Market Summary

Mr. Trotsky stated that while the final quarter of 2017 was strong, and it capped an outstanding year in the financial markets, the first calendar quarter ended March was more volatile, and markets were down. Domestic stocks were down, developed international equities were down, and bonds were down as yields and interest rates continued to rise modestly. A 60/40 mix of stocks and bonds, a common benchmark for diversified portfolios, was down more than 1% in the quarter. The lone bright spot was in Emerging Markets equities, which were up 1.3% in the quarter. The commitment to EM equities served PRIM well; it was the only equity sleeve that wasn't cut last year in PRIM's asset allocation decisions.

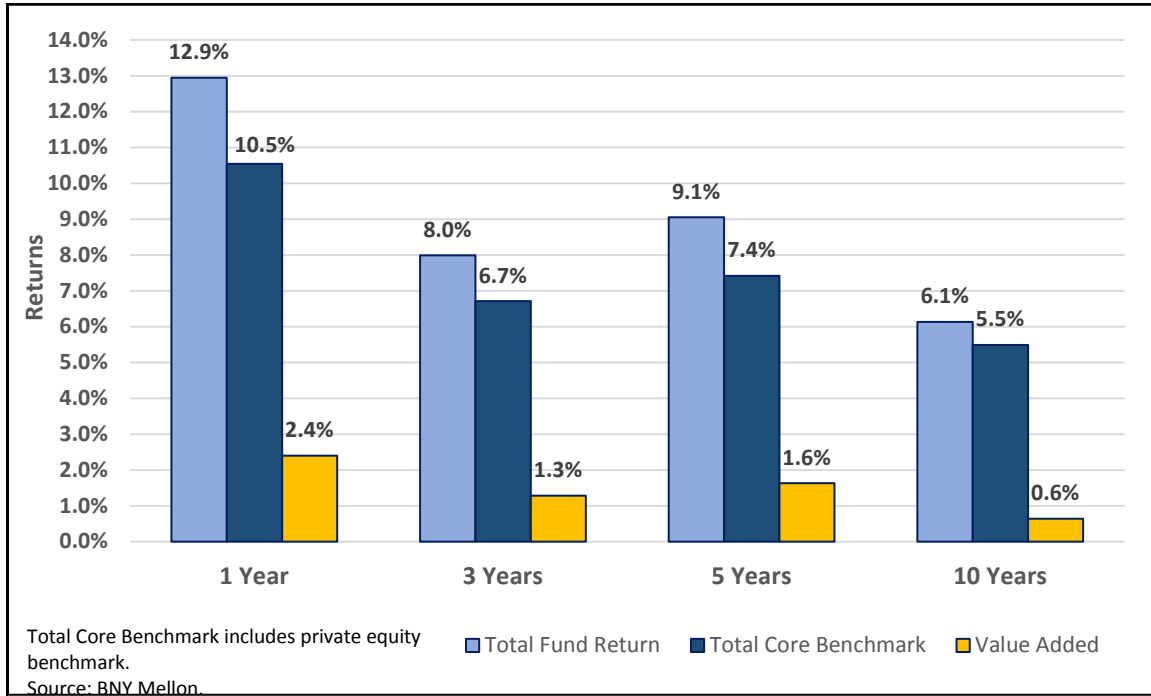
PRIT Fund Performance Summary

The PRIT Fund performed very well in the first quarter of 2018. For the quarter, the PRIT Fund was up 0.6% gross, or 0.5% net, outpacing the benchmark by 23 basis points. Mr. Trotsky mentioned earlier that a 60/40 split of stocks and bonds was down 1.3% in the quarter and staff have reason to believe that PRIM's performance will be very strong competitively.

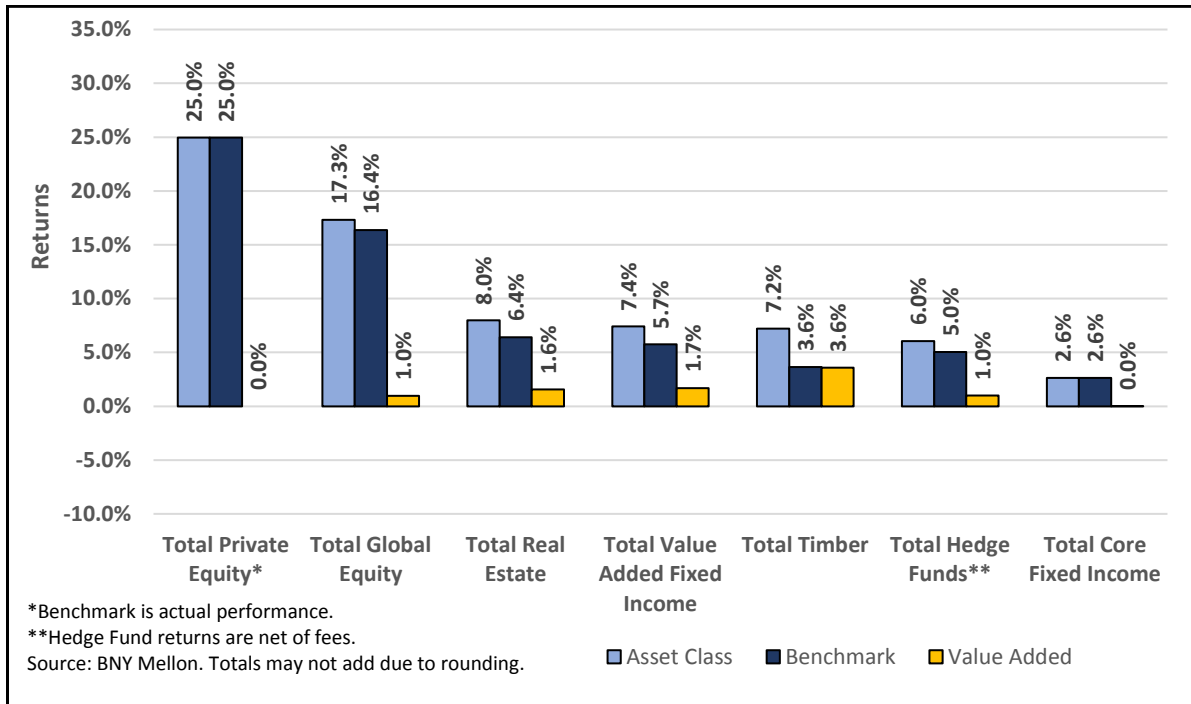
Mr. Trotsky reminded the Committee that this outperformance was achieved with a significantly lower risk profile than PRIM's peers, who on average have a 50% allocation to global equities, versus PRIM's 40% allocation. PRIM is thankful for that very strong performance in an up market, but what is even more telling is that in the last 12-month downturn, which occurred when global equities were down more than 5% in our fiscal year 2016, PRIM was up 2.3%, while most other funds were either flat or down. PRIM knows of no other fund in the country PRIM's size or larger that performed better in the down market of fiscal year 2016. PRIM also significantly outperformed the endowments and foundations in those same years. This shows that PRIM's carefully constructed and de-risked portfolio is working exactly as intended, providing us with substantial outperformance in both challenging markets (down markets) like FY16, and Q1 of this year, and in rewarding markets (up markets) like CY17.

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

Total PRIT Fund Returns (Gross of Fees)
Annualized Returns as of March 31, 2018



PRIT Asset Class Performance (Gross of Fees)
One Year Ended March 31, 2018



PRIT Core Fund Performance Summary
Gross of Fees Performance
Trailing 1-Year Performance as of March 31, 2018 (Gross of Fees)

Trailing 1-Year Performance: March 31, 2018	Return	Benchmark Return	Over/(Under) Benchmark (bps)	\$Value (millions)	% of PRIT Fund
Total PRIT Fund	12.9%	10.5%	240	71,628	100%
Total Global Equity	17.3%	16.4%	96	30,984	43.3%
<i>Domestic Equity</i>	<i>14.3%</i>	<i>13.8%</i>	<i>49</i>	<i>13,390</i>	<i>18.7%</i>
<i>International Developed</i>	<i>16.8%</i>	<i>15.8%</i>	<i>100</i>	<i>12,396</i>	<i>17.3%</i>
<i>Emerging Markets</i>	<i>26.5%</i>	<i>24.9%</i>	<i>169</i>	<i>5,198</i>	<i>7.3%</i>
Private Equity	25.0%	25.0%	0	7,536	10.5%
Real Estate	8.0%	6.4%	155	6,121	8.5%
Total Timberland	7.2%	3.6%	357	2,548	3.6%
Hedge Funds	6.0%	5.0%	100	5,944	8.3%
Value Added Fixed Income	7.4%	5.7%	168	5,855	8.2%
Core Fixed Income	2.6%	2.6%	2	9,122	12.7%

PRIT Asset Class Performance (Gross of Fees)
Annualized Returns as of March 31, 2018

1 Year	3 Year	5 Year	10 Year
PRIVATE EQUITY 25.0%	PRIVATE EQUITY 19.1%	PRIVATE EQUITY 19.6%	PRIVATE EQUITY 13.1%
GLOBAL EQUITY 17.3%	GLOBAL EQUITY 9.3%	REAL ESTATE 10.5%	VALUE-ADDED FIXED INCOME 7.0%
REAL ESTATE 8.0%	REAL ESTATE 8.8%	GLOBAL EQUITY 9.9%	REAL ESTATE 6.5%
VALUE-ADDED FIXED INCOME 7.4%	VALUE-ADDED FIXED INCOME 5.7%	TIMBER 6.8%	GLOBAL EQUITY 6.5%
TIMBER 7.2%	TIMBER 5.0%	HEDGE FUNDS (NET OF FEES) 4.8%	TIMBER 4.4%
HEDGE FUNDS (NET OF FEES) 6.0%	HEDGE FUNDS (NET OF FEES) 2.5%	VALUE-ADDED FIXED INCOME 4.4%	CORE FIXED INCOME 4.1%
CORE FIXED INCOME 2.6%	CORE FIXED INCOME 0.7%	CORE FIXED INCOME 3.4%	HEDGE FUNDS (NET OF FEES) 3.4%

III. Performance Review and Market Update

Timothy Schlitzer, CRE, CFA, Senior Investment Officer - Director of Real Estate and Timberland, updated the Committee on performance.

Before he began his presentation, Mr. Schlitzer provided an update on the private real estate investment management services request for proposal (RFP). He noted that the RFP was progressing and that he expects to provide more information to the Committee at the next meeting cycle.

Real Estate and Timberland Performance

Mr. Schlitzer informed the Committee that total real estate returned 8% over the past year, 155 basis points above PRIM's benchmark (private asset classes typically present on a one-year timeline which captures the full year of appraisals). The private portfolio returned 9.1%, 217 basis points above benchmark. The REIT portfolio returned 4.9% for the last year, outperforming PRIM's global REIT benchmark by 7 basis points. The broader Global REIT index had negative returns in Q1, down 3.4%. The US was down 7.2% while Europe was down slightly at 0.8%. Asia was up 0.8% (all regional performance is in USD). The operating environment was generally sound but fundamentals are slowing. The team is comfortable with PRIM's portfolio positioning.

Mr. Schlitzer said that total timberland returned 7.2% over the last 12 months, 360 basis points above PRIM's benchmark (private asset classes are typically presented on one-year timeline which captures the full year of appraisals). For the one year ended March 31, 2018, the NCREIF timberland index returned 3.8%. The Pacific Northwest outperformed the South at 8.1% vs. 2.6%.

Real Estate Strategic Mix

Mr. Schlitzer noted that at calendar year end, total real estate assets were valued at \$6.1 billion, or 8.5% of the PRIT Fund. This equates to a dollar underweight to the mid-point of PRIM's range of \$1.04 billion. The underweight is primarily due to the increase in the denominator during 2017. The PRIT Fund increased by almost 18% versus the asset class return of 9%.

Mr. Schlitzer said timberland is valued at \$2.5 billion or 3.6% of the PRIT Fund, a dollar underweight to the asset class mid-point of approximately \$315 million, and that the same denominator effect had impacted the timberland portfolio.

Mr. Schlitzer mentioned that both real estate and timberland had slightly higher returns than the fund in the first quarter but were not enough to offset the prior denominator effect. He stated that this dynamic could be supportive of values as many investors face similar challenges and may be less willing to sell assets in this environment. He also stated that multiple sources were reporting significant amounts of "dry powder" available for acquisitions. Finally, he mentioned that the average target allocation to real estate is 10.3%, while invested allocations are now at approximately 9.1%.

Mr. Schlitzer told the Committee that PRIM continues to be slightly overweight the combined benchmark to REITs at approximately 25% vs. the 20% target. U.S. REITs have sold off in the first quarter and are currently the poorest performing asset class in the equities market, down approximately 8%. He stated that REITs are trading at a 10% discount to net asset value (NAV). Non U.S. REITs are adding some stability to performance recently which has been the objective of a global portfolio. Europe was up slightly (0.5%) in Q1 and Japanese companies were up 7% for that period, reflecting a flight to quality.

Mr. Schlitzer mentioned that PRIM's managers did not complete any acquisitions during the first quarter, but notified the Committee of a non-U.S. timberland pipeline investment opportunity. He mentioned that his team has reviewed 47 investment opportunities including all property types and geographies.

IV. Project SAVE II – Real Estate Internal Management Update and Recommendation (Voting Item)

Mr. Schlitzer summarized the items in Appendix E. He clarified that staff would focus on attractive fee structures but that he expected that certain direct investments would contain asset management fees. Staff will take a holistic approach to fee structures. Mr. Schlitzer also informed the Committee that he planned to engage CoStar for market data and advisory services.

Mr. Morse suggested that the real estate team perform their own outreach to the best developers given PRIM's profile as a large capital partner.

The Real Estate and Timberland Committee voted (unanimously) to recommend that the PRIM Board accept the strategy recommendation for PRIM's real estate internal management as described in Appendix E.

V. Investment Approval Process (Voting Item)

Mr. Schlitzer reviewed Appendix F and provided an overview of a newly created process for the review of internally managed real estate investments. Similar to the fund closing schedule in private equity, property sale processes often do not coincide with PRIM's Committee/Board quarterly meeting cycle. In a competitive sale process, PRIM will often have to adapt to the seller's timeline in order to be selected as the buyer. He explained that the proposed process is similar to that used for interim investments in the private equity portfolio.

The Committee had a brief discussion regarding the definition of "non-binding" and came to the conclusion that typical letters of intent created no legal or economic obligation for PRIM.

The Real Estate and Timberland Committee voted (unanimously) to recommend to the PRIM Board to adopt the process described in Appendix F of the Expanded Agenda for the review and approval of internally managed real estate investments that conflict with the Committee and Board meeting schedule and that the Executive Director be authorized to approve investments after they are approved by PRIM staff and an outside real estate investment advisor and after an interim meeting recommendation has been mailed to all Real Estate Committee and Board Members for discussion prior to making an investment.

VI. Real Estate Appraisal - Issuance of Request for Proposal (Voting Item)

Mr. Schlitzer summarized the recommendation as described in the Expanded agenda.

The Real Estate and Timberland Committee voted unanimously to recommend to the PRIM Board to approve the issuance of a Request for Proposals for Real Estate Appraisal Services, as described in Section VI of the Expanded Agenda.

The PRIM Real Estate and Timberland Committee meeting adjourned at 11:33 a.m.

List of documents and exhibits used during the meeting:

- *Minutes of the PRIM Real Estate and Timberland Committee Meeting of January 31, 2018*
- *PRIT Fund Performance Report*
- *BNY Mellon Gross of Fees Performance Report*
- *Real Estate and Timberland Performance Charts*
- *Project SAVE II Presentation*
- *Investment Approval Process*