



Minutes of the PRIM Administration and Audit Committee  
Thursday, August 3, 2017

Committee members present:

- Robert L. Brousseau, Chair
- Treasurer Deborah B. Goldberg
- Ted C. Alexiades, CPFO
- Patrick E. Brock
- Joseph A. Connolly
- Eileen Glovsky
- Karen E. Gershman, CPA
- James Hearty
- Dennis J. Naughton
- Michele A. Whitham, Esq.

Committee members not present:

- Theresa T. McGoldrick, Esq.

The PRIM Administration and Audit Committee meeting was called to order at 10:03 a.m.

**I. Approval of the Minutes**

The Administration and Audit Committee approved, with one abstention, the minutes of the May 4, 2017, meeting.

**II. Executive Director/Chief Investment Officer Report**

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

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%. This 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 areas. 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.

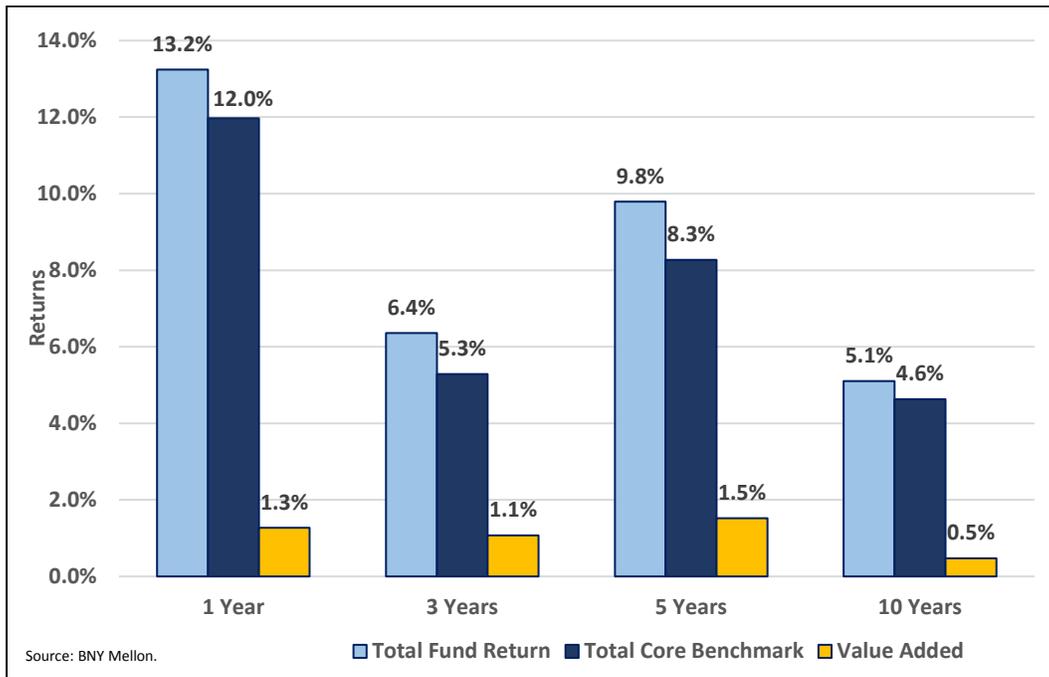
Inflation remains subdued even as Gross Domestic Product growth in the U.S. rebounded to 2.6% in Q2 from 1.2% (revised) in Q1, and labor markets continue to improve -- the unemployment rate at 4.3% is the lowest in 16 years. Driving the improving GDP growth, real consumption was up 2.8% on strong consumer 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:

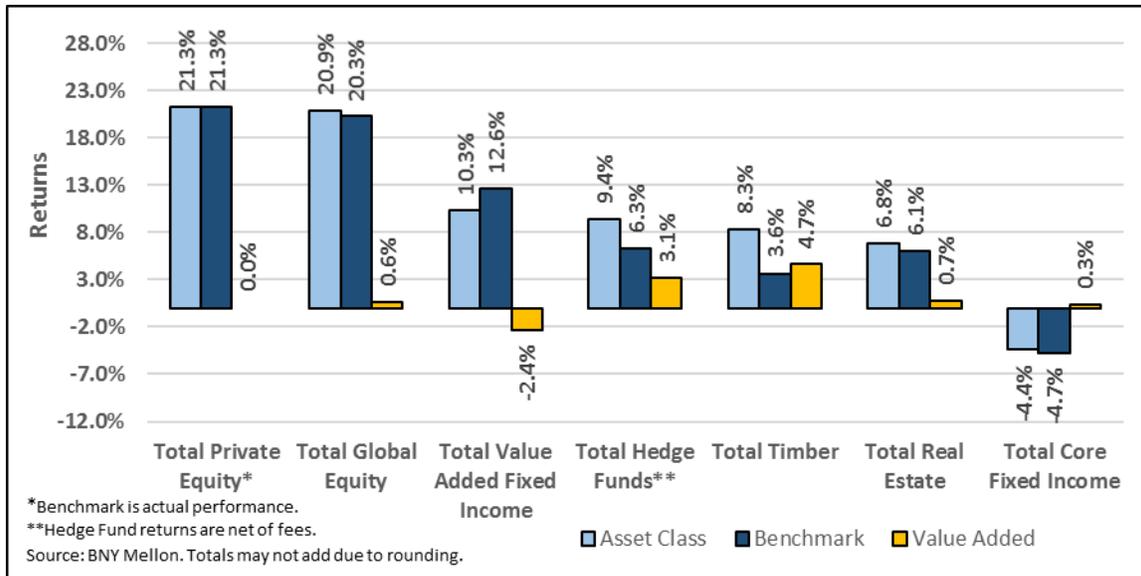
For the one-year ended June 30, 2017, the PRIT Fund was up 13.2% gross of fees, outperforming its benchmark of 12.0% by 127 basis points. On a net-of-fees basis, the PRIT Fund was up 12.8%, outperforming its benchmark by 79 basis points.

- 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
<b>Total PRIT Fund</b>	<b>13.2%</b>	<b>12.0%</b>	<b>127</b>	<b>66,850</b>	<b>100%</b>
<b>Total Global Equity</b>	<b>20.9%</b>	<b>20.3%</b>	<b>60</b>	<b>30,498</b>	<b>45.7%</b>
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%
<b>Private Equity</b>	<b>21.3%</b>	<b>21.3%</b>	<b>0</b>	<b>7,092</b>	<b>10.6%</b>
<b>Real Estate</b>	<b>6.8%</b>	<b>6.1%</b>	<b>70</b>	<b>6,048</b>	<b>9.1%</b>
<b>Total Timberland</b>	<b>8.3%</b>	<b>3.6%</b>	<b>467</b>	<b>2,483</b>	<b>3.7%</b>
<b>Hedge Funds</b>	<b>9.4%</b>	<b>6.3%</b>	<b>313</b>	<b>5,580</b>	<b>8.4%</b>
<b>Value Added Fixed Income</b>	<b>10.3%</b>	<b>12.6%</b>	<b>(235)</b>	<b>5,403</b>	<b>8.1%</b>
<b>Core Fixed Income</b>	<b>-4.4%</b>	<b>-4.7%</b>	<b>33</b>	<b>7,984</b>	<b>12.0%</b>

### 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%

Mr. Brousseau asked the status of the request for PRIM's travel expense records. Eric Convey, Director of Communications, updated the Committee on this request and noted that three boxes of documents had been delivered to the records requestor and Mr. Convey is awaiting any questions by the requestor.

### III. Executive Director's Fiscal Year 2018 Goals and Objectives (Voting Item)

Mr. Brousseau noted that the Administration and Audit Committee, pursuant to the PRIM Charters, is tasked with reviewing and potentially revising the Executive Director's proposed goals and objectives and to then recommend them to the PRIM Board for approval. Mr. Trotsky noted that his FY 2018 Goals

and Objectives are largely consistent with those of prior years. Mr. Trotsky highlighted a few of his new FY 2018 goals and objectives including coordinating the first Board education retreat, Project SAVE Phase II – identifying and implementing direct investment management and completing the announced reorganization of investment team members.

The Committee voted (unanimously) to recommend to the PRIM Board that the Board approve the Executive Director's FY 2018 Goals and Objectives, as contained in Appendix D of the Expanded Agenda, and further to authorize the Executive Director to take all actions necessary to effectuate this vote.

#### **IV. Proposed 2018 PRIM Board and Committee Meeting Schedule**

David Gurtz, CPA, CFA, Chief Operating Officer and Chief Financial Officer, referred Committee members to the proposed 2018 Calendar and Meeting Schedule, attached as Appendix F, and asked Committee members to inform Grace Mamo, Executive Assistant, of any potential schedule conflicts. PRIM staff's goal, Mr. Gurtz said, is to bring a finalized schedule to the Committee for a vote during the November Board cycle.

Treasurer Goldberg said some PRIM Board and/or Committee members have told her the quarterly Board cycle adopted this calendar year has left them feeling as if there is a lack of continuity from one meeting to the next. Mr. Naughton said whenever he has had questions between meetings, he has found PRIM staff to be "more than open" to discussing matters via telephone.

#### **V. Recommendations from 2016 PRIM Board Self-Evaluation**

Mr. Gurtz noted that based on the Board Self-Evaluation, administered by Cortex, and the discussions held regarding the results of the Board Self-Evaluation at the May 4, 2017, Administration and Audit Committee and the May 16, 2017, PRIM Board meetings, PRIM staff has four action items.

The first action is, as part of the review of PRIM's Governance Manual, PRIM staff will direct Cortex to provide best practice recommendations regarding committee composition and ways to encourage the Board to focus more on long-term, strategic issues and relatively less effort and attention on manager and vendor selections. Mr. Gurtz said Cortex, will present recommendations for updates to PRIM's Governance Manual at the November 2, 2017, Committee meeting.

The second action is to encourage any Board or Committee member to meet and discuss the Open Meeting Law with PRIM's General Counsel.

The third action is for PRIM staff to evaluate Board meeting materials to ensure they contain additional information based on discussions held at the Committee meetings and continue to explore the possibility of moving to paperless meeting packages.

Lastly, Mr. Gurtz provided the Committee with some details about the Board education retreat, which has been scheduled for September 26, 2017.

#### **VII. Other Matters**

The Committee members briefly discussed the following topics:

- a. June 2017 Operating PRIM Budget
- b. Travel
- c. Client Service

The PRIM Administration and Audit Committee meeting adjourned at 11:13 a.m.

List of documents and exhibits used during the meeting:

- *Minutes of the PRIM Administration and Audit Committee Meeting of May 4, 2017*
- *PRIT Fund Performance Report*
- *BNY Mellon Gross of Fees Performance Report*
- *Executive Director and Chief Investment Officer's Fiscal Year 2018 Proposed Goals & Objectives*
- *Executive Director and Chief Investment Officer's Fiscal Year 2017 Board-approved Goals & Objectives*
- *Proposed 2018 PRIM Board and Committee Meeting Schedule*
- *Recommendations from 2016 PRIM Board Self-Evaluation*
- *June 2017 PRIM Operating Budget*
- *Travel Report*