

MINUTES

SOUTH DAKOTA INVESTMENT COUNCIL Sioux Falls, South Dakota December 9, 2014

1) Roll Call

The Investment Council meeting was called to order at 9 a.m. on December 9, 2014 by Chair Jon Hunter. Council members in attendance were Lorin Brass, David Hillard, Jon Hunter, Steve Kirby, Vern Larson, Jim Means, Rich Sattgast and Rob Wylie.

Others attending all or part of the meeting included Matt Clark, Brett Fligge, Chris Nelson, Tammy Otten, Jarrod Edelen, Randy Spinar, Darci Haug, Brandy Eisma, Sami Kangas, Cindy Pickering, Krystal Seeley, and Laurie Riss from the Investment Office; S&PL Commissioner-Elect Ryan Brunner; Jane Roberts, Michelle Mikkelsen, and Susan Jahraus from the South Dakota Retirement System; Jon Gray and Allie Sweeney from Blackstone Real Estate Partners; and Bill Walton and Hank Midgley from Rockpoint Real Estate. The Blackstone presentation was attended by several of the Investment Office's portfolio managers.

AGENDA ITEMS:

- 1) Roll Call
- 2) Minutes
- 3) Blackstone Real Estate Presentation
- 4) Investment Update – FY 2015
- 5) Iran Divestiture – Update
- 6) SDIC FY2014 Annual Report
- 7) Audit Committee Update
- 8) Sarbanes Oxley – Compliance Checklist
- 9) Policy & Subcommittee Charter Reviews
- 10) Legislation – SDIC, SDCFF, SDRS
- 11) Succession Planning
- 12) Rockpoint Real Estate Presentation
- 13) Higher Education Savings Program
- 14) CD Program – Update
- 15) Technology & Data Security-BIT Meetings
- 16) New/Old Business
- 17) Future Meeting Dates
- 18) Adjournment

Chair Hunter noted that this is Vern Larson's final meeting with the Investment Council. Matt Clark thanked Vern for stepping in to serve out the remaining term of the School and Public Lands Commissioner and serving on the Council during that time. Ryan Brunner, the S&PL Commissioner-Elect and soon-to-be Council member, was introduced.

(Note: For sake of continuity, the following minutes are not necessarily in chronological order. Documents referenced are on file in the Investment Office, and public access is subject to the provisions of SDCL 1-27.)

2) Minutes

VERN LARSON MOVED, SECONDED BY DAVID HILLARD, TO APPROVE THE MINUTES OF THE SEPTEMBER 9, 2014 COUNCIL MEETING. MOTION PASSED UNANIMOUSLY.

3) Blackstone Real Estate Partners Presentation

Jon Gray, Global Head of Blackstone Real Estate, and Allie Sweeney, Principal of Blackstone Real Estate, joined the Council to discuss Blackstone's real estate funds and the current real estate environment.

Jon Gray began with an overview of Blackstone's global real estate platforms and performance since 1991, emphasizing their performance in BREP V during the market crisis. He discussed the returns that have been generated for SDIC investments for the last 20 years, as well as the amount of distributions to SDIC since 2012 and the projections of capital coming back by the end of 2014 and 2015.

Gray discussed BREP's foundation of success, which includes the same strategy, process and people since Fund I. BREP's strategy benefits from their size advantage and value creation at the asset level before selling. Their approach includes conducting extensive analysis to identify undervalued sectors, buying or building platforms to execute the strategy, and going all-in with scale, speed and certainty. Gray provided specifics on a few different real estate transactions as a review of their process.

He discussed BREP's views on the current real estate investment environment in the United States, Europe and Asia.

He discussed upcoming BREP VIII, including the target size of the fund, the investment period, the term, and management fees.

Gray discussed his views on a number of questions that were asked about the economies and real estate investment opportunities in different countries, as well as specific investments.

Hunter thanked Blackstone for their presentation. He noted that action on the investment opportunity in BREP VIII will be taken at the Council's next meeting.

4) Investment Update – FY 2015

Tammy Otten presented the Motions and Actions report from the September 9, 2014 Council meeting. She noted that since the last Council meeting no new co-investment was made in accordance with the Council's Co-Investment Policy. An outside managed portfolio in distressed mortgages was increased under the External Manager Policy. Estimated total asset values as of November 30, 2014 and estimated net total rate of returns as of December 9, 2014 were provided.

Otten gave an update of the current equity like risk of the various funds and Clark discussed current market valuations derived from the asset allocation modeling process.

5) Iran Divestiture - Update

Otten discussed the Iran Scrutinized Companies List memo dated November 21, 2014 that had been previously provided to the Council. Florida had updated their list as of 9/23/14 and removed one name from the list. Staff recommended that this name be removed from the South Dakota list. A report will be provided to the Executive Board of the Legislature in January as required by law.

RICH SATTGAST MOVED, SECONDED BY JIM MEANS, TO APPROVE THE UPDATED IRAN SCRUTINIZED COMPANIES LIST DATED DECEMBER 9, 2014 AS PRESENTED. MOTION PASSED UNANIMOUSLY.

6) SDIC FY 2014 Annual Report

Otten stated that the Investment Accountants compile and produce the annual report each year. The investment accountants were introduced, including Cindy Pickering, Sami Rains, Krystal Seeley and Brandy Eisma. Otten provided an overview of the FY 2014 Annual Report stating that there were minor changes in the format from last year. The major change was not having a section on the Cement Plant Retirement Fund which was consolidated with SDRS during the fiscal year. Clark reviewed the report's transmittal letter.

It was noted that the FY 2014 annual report and audit report are posted on the SDIC website. The Council members were provided a printed copy of the report.

7) Audit Committee Update

David Hillard, Chair of the Audit Committee, reported that the fiscal year 2014 audit was complete. He stated that he had talked with Ashlee Keyes in the Department of Legislative Audit (DLA). Hillard discussed the *Emphasis of Matter* section of the auditor's report. This section listed the percentage of financial position for which carrying values have been estimated by management in the absence of readily determinable market values. The auditors reported a clean opinion on the financial statements.

Discussion continued regarding DLA performance of quarterly agreed upon procedures audits. Hillard stated that the September quarter audit had been completed and provided the highlights of the report. He stated the audit went well, and the committee will be working with DLA regarding any improvements to the quarterly audit process.

Otten added that Eide Bailly had completed the SDRS audit for fiscal year 2014 and had provided their report to the SDRS Board of Trustees on December 4. The auditors reported a clean opinion. Follow-up work will be done to coordinate financial information between the Investment Office and SDRS to allow the audits to be completed on a timely basis and meet new deadline requirements for the statewide CAFR.

8) Sarbanes Oxley – Compliance Checklist – Annual Review

Otten reviewed the Sarbanes-Oxley compliance checklist. As a government agency, the Investment Council does not need to comply with Sarbanes Oxley, but the report outlines how we would compare if required. Much of the checklist deals with audit issues.

9) Policy & Subcommittee Charter Reviews

Several Investment Council/Office policies and charters were reviewed and presented to the Council with some recommended changes. Each change was reviewed, and the Council discussed the updated policies/charters in detail.

(a) The *Pre-authorized Co-investment Policy* was reviewed and the recommended changes were discussed. An additional change was recommended by the Council.

JIM MEANS MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE UPDATED PRE-AUTHORIZED CO-INVESTMENT POLICY AS PRESENTED AND SUBSEQUENTLY REVISED BY THE COUNCIL. MOTION PASSED UNANIMOUSLY.

(b) The *External Manager Hire, Rebalance and Terminate Authorization Policy* was reviewed and recommended changes were discussed.

JIM MEANS MOVED, SECONDED BY ROB WYLIE, TO APPROVE THE UPDATED EXTERNAL MANAGER HIRE, REBALANCE AND TERMINATE AUTHORIZATION POLICY AS PRESENTED. MOTION PASSED UNANIMOUSLY.

(c) The *Compensation Committee Charter* was reviewed and recommended changes were discussed.

DAVID HILLARD MOVED, SECONDED BY STEVE KIRBY, TO APPROVE THE UPDATED COMPENSATION COMMITTEE CHARTER AS PRESENTED. MOTION PASSED UNANIMOUSLY.

(d) The *Audit Committee Charter* was reviewed and recommended changes were discussed.

JIM MEANS MOVED, SECONDED BY DAVID HILLARD, TO APPROVE THE UPDATED AUDIT COMMITTEE CHARTER AS PRESENTED. MOTION PASSED UNANIMOUSLY.

(e) The *Shareholder Activism Policy related to Federal Divestiture Enactments* was reviewed and discussed. No changes were made.

10) Legislation – SDIC, SDCFF, SDRS

Otten reviewed proposed legislation for the Council's consideration. The three bills included changes to SDCL 4-5-26 legal list, SDCL 4-5-29 to add a section regarding procurement laws, and SDCL 4-5-30 to change how the Investment Council funds its yearly budget.

STEVE KIRBY MOVED, SECONDED BY VERN LARSON, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO FILE THE PROPOSED REVISIONS TO SDCL 4-5-26, 4-5-29 AND 4-5-30 IN THE UPCOMING LEGISLATIVE SESSION. MOTION PASSED UNANIMOUSLY.

Otten also indicated that the Bureau of Finance and Management had drafted legislation to repeal SDCL 4-5-30.1 on the timing of the proration to the General Fund. The office supports this change.

ROB WYLIE MOVED, SECONDED BY RICH SATTGAST, THAT THE INVESTMENT COUNCIL SUPPORT THE PROPOSED LEGISLATION TO REPEAL SDCL 4-5-30.1 RELATING TO THE PROCESS FOR CASH FLOW FUND PRORATION AND AUTHORIZE THE INVESTMENT OFFICER TO SPEAK ON BEHALF OF THE LEGISLATION. MOTION PASSED UNANIMOUSLY.

The Council will receive a weekly or more frequent legislation update once session begins in January.

11) Succession Planning

Clark reviewed the Investment Officer Succession Plan. The first part of the plan outlines the process to follow with the normal retirement of the Investment Officer. The second section outlines the process in the event of a need for an emergency search. He noted modest changes were made to update the plan to be non-gender specific.

JIM MEANS MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE UPDATED INVESTMENT OFFICER SUCCESSION PLAN AS PRESENTED. MOTION PASSED UNANIMOUSLY.

Clark also addressed an outline of future efforts to develop staff leadership capabilities relating to succession. This effort will include annual updates.

12) Rockpoint Real Estate Presentation

Bill Walton, Rockpoint Founding Managing Member, and Hank Midgley, Principal of Rockpoint Real Estate, provided an update of their current real estate funds and presented information on Rockpoint Real Estate Fund V for which they are currently fundraising.

Bill Walton began the presentation with an overview of Rockpoint's experienced team and strategic approach. He noted that their fundamental approach to real estate focuses on acquiring high-quality, well-located assets at attractive values relative to stabilized cash flow, comparable sales and replacement cost. They focus on adding value at the property level and engage in active

portfolio management to maximize risk-adjusted returns at the fund level. He discussed their investment discipline relating to their confidence and conviction that an investment must have the potential to generate strong risk-adjusted returns, which is consistent with its history of pulling back in uncertain markets. Walton noted that their main offices are in Boston, Dallas and San Francisco, and their primary target markets focus on major coastal cities.

Hank Midgley reviewed the track record for all of Rockpoint's funds since 1995. He reviewed Fund IV's committed level, the distributions to date, and the sector focus of the deals in the fund.

Walton discussed the real estate environment in the United States and Rockpoint's primary target markets and property types. He reviewed Fund IV's sector diversification and Fund V's estimated diversification. He discussed their decision-making process from the start of a deal through the final commitment of the management committee. Information was provided for the key terms for Fund V.

Hunter thanked Rockpoint for their presentation.

Following Rockpoint's presentation, discussion continued on a potential investment for Fund V. Chris Nelson updated the Council on the current total exposure to real estate, as well as the long-term projections for real estate and the projected distributions from Blackstone Real Estate in the coming months.

Clark discussed the recommendation of \$125 million for SDRS and proportionate amounts for the trust funds. He added that for three of the trust funds, adjustments would be made because of different distribution rates which affect the growth into the future. The adjustments are to use 96% of the proportionate amount for the Health Care Trust and Dakota Cement Trust and 102% for School and Public Lands. Council discussion continued.

ROB WYLIE MOVED, SECONDED BY JIM MEANS, TO AUTHORIZE THE STATE INVESTMENT OFFICER TO INVEST UP TO \$125 MILLION FOR THE SOUTH DAKOTA RETIREMENT SYSTEM AND UP TO AN ADJUSTED PROPORTIONATE AMOUNT FOR THE SCHOOL AND PUBLIC LANDS FUND, THE DAKOTA CEMENT TRUST, THE EDUCATION ENHANCEMENT TRUST, AND THE HEALTH CARE TRUST IN ROCKPOINT REAL ESTATE FUND V. MOTION PASSED UNANIMOUSLY.

13) Higher Education Saving Program

Sherry Nelson reviewed the Higher Education Savings Plan summary of accounts, the quarterly compliance schedule, and the minutes of the Allianz third quarter conference call that had previously been provided to the Council. She noted that the Program Management Agreement requires Council approval of the auditor selected by Allianz.

STEVE KIRBY MOVED, SECONDED BY ROB WYLIE, TO APPROVE PRICEWATERHOUSECOOPERS AS THE AUDITOR FOR COLLEGEACCESS 529 PLAN FOR THE YEAR ENDING DECEMBER 31, 2014. MOTION PASSED UNANIMOUSLY.

Nelson discussed the proposal by Allianz that included several asset allocation and underlying fund changes within the age-based and static portfolios that would further reduce the interest rate sensitivity of the portfolios. Allianz recommended adding the Dodge & Cox International Stocks Fund, already included as a stand-alone option, as an underlying fund in the age-based portfolios. They also suggested removal of AllianzGI NFJ Global Dividend Value Fund, AllianzGI Income & Growth Fund and Thornburg International Value Fund as part of an ongoing effort to maintain the same level of diversification while utilizing fewer funds.

JIM MEANS MOVED, SECONDED BY RICH SATTGAST, TO APPROVE THE CHANGES TO THE COLLEGEACCESS 529 PLAN PROPOSED BY ALLIANZ GLOBAL DISTRIBUTORS AND PRESENTED TO THE INVESTMENT COUNCIL ON THIS DAY AND TO AUTHORIZE THE STATE INVESTMENT OFFICER TO EXECUTE THE NECESSARY DOCUMENTS AND TAKE ANY OTHER ACTIONS DEEMED NECESSARY TO CARRY OUT THE PORTFOLIO CHANGES AS PRESENTED. MOTION PASSED UNANIMOUSLY.

14) CD Program - Update

Sherry Nelson reviewed her memo summarizing the results of the CD Program. Forty-nine banks, two savings associations and six credit unions participated this year, an increase of four institutions versus last year. The total accepted was \$35 million, an increase of \$11.343 million. The rate of .37% stayed the same as last year and was based on the one-year Treasury note yield of .12% on 9/26/14 plus a liquidity premium of .25%. A listing of the participating financial institutions and a report on program statistics were provided.

15) Technology & Data Security – BIT Meetings

Hunter discussed a meeting he and Matt Clark had with the head of the Bureau of Information and Technology (BIT) about the technology, data security needs and primary risks of the Investment Office. That meeting was followed up with several BIT staff visiting the Investment Office and meeting with several Investment Office staff.

Clark reviewed the primary issues that BIT and staff are in the process of addressing, including network drives and backups, remote access, and passwords. Investment Office staff members Jarrod Edelen and Randy Spinar reviewed in more detail the work that has been completed and is in progress in these areas. Darci Haug discussed the order management system. Clark added that annual meetings will be held with BIT to stay up-to-date on all technology related issues.

16) New/Old Business

Otten informed the Council that Form 13H for Large Trader Reporting and Form 13F on domestic equity holdings had been filed with the SEC for the quarter ended September 30, 2014.

17) Future Meeting Dates

The next Investment Council meeting will be held in Pierre in conjunction with the Appropriations budget hearing on February 5, 2015.

18) Adjournment

Chair Hunter declared the meeting adjourned at 3:30 p.m.