



June 30, 2017

Joint Legislative Commission
on Governmental Operations
North Carolina General Assembly
Raleigh, North Carolina 27601

Re: Use of new investment authority by the State Treasurer through the fiscal year ended June 30, 2016

Commission Members:

We are submitting this report under G.S. 147-69.8 on the use of new investment authority by the State Treasurer. The report covers new investment authority granted by the General Assembly since 2009 and includes performance and other investment information through June 30, 2016. We have interpreted "new investment authority" or "broadens the investment authority" in the statute to cover two types of situations: (1) changes in the percentage limits stated by G.S. 147-69.2(b) for particular classes of investments; and (2) changes that allowed the State Treasurer to invest in an investment asset type that was not previously allowed.

Please note that G.S. 147-69.8 was amended during the 2016 legislative session. Effective June 30, 2016, the reporting period changed from the calendar year to the fiscal year. Using the fiscal year as the reporting period is consistent with other statutory reporting requirements related to the North Carolina Retirement Systems. The previous "Report on New Investment Authority" submitted to the Joint Legislative Commission on Governmental Operations on June 30, 2016, covered from January 1, 2009 through December 31, 2015. Thus this report and the prior year's report are not completely comparable in that the time periods over which market values and performance are measured differ.

Opportunistic Fixed Income Portfolio

The Opportunistic Fixed Income (or Credit Strategies) asset class (G.S. 147-69.2(b)(6c)) was created by the General Assembly in June 2009. It included some investments that were previously authorized under other provisions of G.S. 147-69.2. **Table 1** reports the assets and investment performance for the Opportunistic Fixed Income Portfolio since fiscal year 2009.

Table 1: Opportunistic Fixed Income Assets and Investment Performance, Fiscal Years 2009-2016

Fiscal Year Ended June 30	Beginning Market Value	Additions	Redemptions / Distributions	Net Revenue	End Market Value	Rate of Return	% of Retirement Systems' Assets
2009	211,031	324,005	(36,081)	(67,866)	431,090	-19.86%	0.72%
2010	431,090	1,119,789	(876,773)	165,792	839,899	34.63%	1.29%
2011	839,899	3,627,992	(2,174,492)	210,865	2,504,264	15.79%	3.34%
2012	2,504,264	1,694,561	(1,113,561)	29,344	3,114,608	0.37%	4.18%
2013	3,114,608	683,386	(1,016,386)	516,192	3,297,800	17.45%	4.12%
2014	3,297,800	1,361,499	(390,708)	500,156	4,768,747	12.90%	5.29%
2015	4,768,747	998,733	(308,747)	(20,513)	5,438,220	-0.52%	6.07%
2016	5,438,220	573,355	(515,521)	(236,549)	5,259,505	-4.40%	6.01%

Note: Dollar amounts are in thousands. All data are as of June 30 of the applicable fiscal year. Returns of some funds may reflect higher costs and lower returns in earlier years.

The value of Opportunistic Fixed Income assets originally was limited to 5% of the total assets of the Retirement Systems, but the limit was raised to 7.5% in August 2013. The allocation to Opportunistic Fixed Income assets remained below the original 5% limit in fiscal year 2013 despite the increase in the limit to 7.5%; however, the allocation rose above 5% in



April 2014. Therefore, **Table 2** provides information on the Opportunistic Fixed Income funds added by the State Treasurer since fiscal year 2014.

Table 2: New and Additional Commitments to Opportunistic Fixed Income Funds, Fiscal Years 2014-2016

Fiscal Year Ended June 30	Fund	Beginning Commitment	Additional Commitment	Commitment Amount Funded	Redemptions / Distributions	End Market Value	Rate of Return
2014	Anchorage Capital Partners	300,000	50,000	350,000	0	476,290	6.18%
2014	Benefit Street Partners	0	150,000	147,153	9,335	140,241	1.27%
2014	Brigade LCS Fund	300,000	30,000	330,000	0	318,120	-0.71%
2014	Claren Road Credit Fund, Ltd.	100,000	160,000	260,000	190,340	48,622	-3.42%
2014	Claren Road Credit Opportunities Partners, L.P.	0	131,840	231,840	88,631	89,448	-12.13%
2014	GSO Capital Solutions Fund II, L.P.	0	84,667	27,392	3,144	27,089	1.84%
2014	Marathon Currituck Fund, LP	0	300,000	413,400	0	404,394	-1.09%
2014	Monarch Debt Recovery Fund	300,000	30,000	380,000	1,840	444,300	3.55%
2014	PAAMCO – Newport Burgundy	500,000	100,000	950,000	0	1,061,190	2.99%
2014	Providence Debt Fund III, L.P.	0	200,000	161,999	14,328	158,228	4.77%
2014	Silverback Arbitrage Fund	125,000	30,000	155,000	0	143,593	-1.99%
2015	AG Global Debt Strategy Partners, L.P.	179,915	100,000	279,915	5,399	445,215	10.59%
2015	Brightwood Capital Fund III, L.P.	0	100,000	75,000	9,277	69,095	2.23%
2015	Claren Road Credit Opportunities Partners, L.P.	131,840	100,000	231,840	88,631	89,448	-12.13%
2015	CVI Credit Value Fund III	0	100,000	35,000	0	38,200	12.59%
2015	Marathon Currituck Fund, LP	300,000	113,000	413,400	0	404,394	-1.09%
2015	MCP Private Capital Fund II	0	82,149	36,841	1,209	18,560	-14.42%
2015	Monarch Debt Recovery Fund	330,000	50,000	380,000	1,840	444,300	3.55%
2015	PAAMCO - Newport Burgundy	600,000	350,000	950,000	0	1,061,190	2.99%
2016	AG Pisgah, L.P.	0	400,000	305,000	0	309,096	1.82%
2016	Marathon Currituck Fund, LP	413,000	40,000	413,400	0	404,394	-1.09%

Note: Dollar amounts are in thousands. "Beginning Commitment" is the previously committed amount to the fund prior to the "Additional Commitment". All other data are as of June 30, 2016. New commitments include commitments to new funds and additional commitments to existing funds. Returns of some funds may reflect higher costs and lower returns in earlier years. For additional commitments, the "Redemptions/Distributions," "End Market Value," and "Rate of Return" are reported for the entire commitment, not just the additional commitment. Given the irregular distribution schedule of capital drawdown vehicles, IRR is shown for rate of return as opposed to a time-weighted return.

Inflation Sensitive Portfolio

The Inflation Sensitive asset class (G.S. 147-69.2(b)(9a)) was created by the General Assembly in June 2009. It included some investments that were previously authorized under other provisions of G.S. 147-69.2. **Table 3** reports the assets and investment performance in the Inflation Sensitive Portfolio from since fiscal year 2009.

Table 3: Inflation Sensitive Assets and Investment Performance, Fiscal Years 2009-2016

Fiscal Year Ended June 30	Beginning Market Value	Additions	Redemptions / Distributions	Net Revenue	End Market Value	Rate of Return	% of Retirement Systems' Assets
2009	893,775	1,139,739	(11,310)	(8,575)	914,369	-0.92%	1.52%
2010	914,369	776,291	(203,481)	(21,250)	952,705	-2.31%	1.46%
2011	952,705	3,924,478	(2,124,728)	(116,189)	2,636,266	-11.23%	3.52%
2012	2,252,254	3,033,825	(2,197,063)	(263,243)	2,825,772	-8.85%	3.79%
2013	2,825,772	2,115,198	(1,890,059)	(36,879)	3,014,032	-0.97%	3.77%
2014	3,014,032	1,194,653	(712,710)	203,950	3,699,925	6.34%	4.10%
2015	3,699,925	2,455,494	(1,042,386)	(349,257)	4,763,776	-8.01%	5.32%
2016	4,763,776	2,142,990	(1,423,428)	(290,882)	5,192,457	-5.75%	5.93%

Note: Dollar amounts are in thousands. All data are as of June 30 of the applicable fiscal year. Returns of some funds may reflect higher costs and lower returns in earlier years.



The value of Inflation Sensitive assets originally was limited to 5% of the total assets of the Retirements Systems, but the limit was raised to 7.5% in August 2013. The allocation to Inflation Sensitive assets remained below the original 5% limit in fiscal year 2014 despite the increase in the limit to 7.5%; however, the allocation rose above 5% in May 2015. Therefore, **Table 4** provides information on the Inflation Sensitive funds added by the State Treasurer since fiscal year 2015.

Table 4: New and Additional Commitments to Inflation Sensitive Funds, Fiscal Years 2015-2016

Fiscal Year Ended June 30	Fund	Beginning Commitment	Additional Commitment	Commitment Amount Funded	Redemptions / Distributions	End Market Value	Rate of Return
2015	Blackstone Energy Partners II, L.P.	0	100,000	2,455	0	1,357	-99.57%
2015	Blackstone Granite Fund – Class B – Commodity Pod	0	200,000	200,000	0	189,876	-2.79%
2015	Blackstone Granite Fund – Class C – Opportunistic Commodity	0	100,000	38,179	0	36,793	-7.38%
2015	Blackstone Granite Fund – Class D – Bayview	0	400,000	184,661	0	185,767	0.37%
2015	Blackstone SP NCRASMA	0	400,000	121,854	8,226	156,573	30.86%
2015	Blackstone SP NCRASMA (Overage)	0	100,000	44,017	27	48,088	11.48%
2015	EnCap Energy Capital Fund VIII Co-Investors, L.P.	19,815	10,000	28,616	2,376	9,205	-20.96%
2015	EnCap Energy Capital Fund X, L.P.	0	123,000	26,206	0	23,126	-22.71%
2015	Landmark Real Asset SMA, L.P.	0	250,000	33,516	2,096	30,169	-12.69%
2015	Landmark Real Estate Partners VII, L.P.	0	100,000	54,613	11,387	52,200	27.73%
2015	MTP Energy Fund LP	175,000	75,000	250,000	0	231,267	-2.30%
2015	MTP Energy Opportunities Fund II LLC	0	250,000	79,639	1,498	70,845	4.16%
2016	BlackRock TIPS Index	0	500,000	500,000	300,000	205,163	1.08%
2016	DL Blue Diamond Fund	0	300,000	300,000	0	300,307	0.10%

Note: Dollar amounts are in thousands. “Beginning Commitment” is the previously committed amount to the fund prior to the “Additional Commitment”. All other data are as of June 30, 2016. New commitments include commitments to new funds and additional commitments to existing funds. Returns of some funds may reflect higher costs and lower returns in earlier years. For additional commitments, the “Redemptions/Distributions,” “End Market Value,” and “Rate of Return” are reported for the entire commitment, not just the additional commitment. Given the irregular distribution schedule of capital drawdown vehicles, IRR is shown for rate of return as opposed to a time-weighted return.

Alternatives Portfolio

The State Treasurer makes investments in the Alternatives Portfolio, which includes the Private Equity and Multi-Strategy Portfolios, through G.S. 147-69.2(b)(9).

G.S. 147-69.2(b)(9)(ii), added by Session Law 2011-211 in June 2011, allows investments in limited liability entities if the their primary purpose is “to engage in any other strategies not expressly authorized by any other subdivision of this subsection.” The State Treasurer today administratively classifies the Multi-Strategy Portfolio under G.S. 147-69.2(b)(9)(ii). According to the Investment Policy Statement, the Multi-Strategy Portfolio includes “externally managed vehicles with the flexibility to invest across markets.” Of the six funds in the Multi-Strategy Portfolio, only one fund post-dates the 2011 session law, and this fund was also within the authority granted by G.S. 147-69.2(b)(8). **Table 5** reports the assets and investment performance of the Multi-Strategy Portfolio since fiscal year 2011.



Table 5: Multi-Strategy Portfolio, Fiscal Years 2011-2016

Fiscal Year Ended June 30	Beginning Market Value	Additions	Redemptions / Distributions	Net Revenue	End Market Value	Rate of Return	% of Retirement Systems' Assets
2011	621,945	3,084	(231,635)	38,210	431,604	6.84%	0.58%
2012	431,604	1,003,590	(145,793)	191,962	1,481,363	9.23%	1.99%
2013	1,481,363	190	(12,870)	236,304	1,704,988	16.01%	2.13%
2014	1,704,988	130	(324,882)	291,783	1,672,019	18.83%	1.85%
2015	1,672,019	112	(9,781)	24,465	1,686,815	1.48%	1.88%
2016	1,686,815	90,868	(134,187)	(26,173)	1,617,323	-1.46%	1.85%

Note: Dollar amounts are in thousands. All data are as of June 30 of the applicable fiscal year. Returns of some funds may reflect higher costs and lower returns in earlier years.

Amendments to G.S. 147-69.2(b)(9) in June 2011 increased the overall statutory allowed maximum percentages of alternatives; however the authority for investments in the private equity funds dates to 2001. **Table 6** reports the assets and investment performance of the Private Equity Portfolio since fiscal year 2011.

Table 6: Private Equity Portfolio, Fiscal Years 2011-2016

Fiscal Year Ended June 30	Beginning Market Value	Additions	Redemptions / Distributions	Net Revenue	End Market Value	Rate of Return	% of Retirement Systems' Assets
2011	2,737,956	2,658,474	(2,654,923)	438,929	3,180,436	15.24%	4.24%
2012	3,180,436	1,613,863	(1,446,659)	216,248	3,563,887	6.55%	4.79%
2013	3,563,887	1,423,609	(1,732,358)	194,683	3,449,821	5.76%	4.31%
2014	3,449,821	715,700	(778,085)	616,730	4,004,167	18.27%	4.44%
2015	4,004,167	855,630	(1,055,549)	370,012	4,174,260	9.58%	4.66%
2016	4,174,260	800,225	(781,317)	182,609	4,375,777	4.32%	5.00%

Note: Dollar amounts are in thousands. All data are as of June 30 of the applicable fiscal year. Returns of some funds may reflect higher costs and lower returns in earlier years.

The limit on the value of Alternatives assets as a percentage of the total assets of the Retirements Systems was raised from 5% to 7.5% in June 2011 (Session Law 2011-211) and to 8.75% in August 2013 (Session Law 2013-398). The allocation to the Alternatives Portfolio rose above 5% in September 2011, and has been above or below 5% at various times since 2011. However, the allocation has not exceeded 7.5%. **Table 7** provides information on the Alternatives funds added by the State Treasurer since fiscal year 2012.



Table 7: New and Additional Commitments to Alternatives Funds, Fiscal Years 2012-2016

Fiscal Year Ended June 30	Fund	Beginning Commitment	Commitment	Commitment Amount Funded	Redemptions / Distributions	End Market Value	Rate of Return
2012	Accel-KKR Capital Partners IV, LP	0	10,000	5,042	104	5,521	10.31%
2012	Gladius Aconcagua	0	1,000,000	1,000,000	(319,131)	1,398,615	13.62%
2012	Halifax Capital Partners III, L.P.	0	30,000	15,279	5,831	21,295	32.76%
2012	Harvest Partners VI, L.P.	0	100,000	92,859	54,459	94,927	22.32%
2012	Mount Kellett Capital Partners II, LP	0	75,000	73,259	46,208	25,118	-2.06%
2012	NEA 14, L.P.	0	35,000	42,300	2,445	56,058	17.11%
2012	Oaktree European Principal Fund III, L.P.	0	50,000	40,285	0	42,352	7.56%
2012	Tenaya Capital Fund VI	0	75,000	60,444	0	60,034	-0.92%
2012	Vista Equity Partners Fund IV, L.P.	0	50,000	42,587	17,329	62,213	21.59%
2012	WLR AGO Co-Inv, L.P.	20,000	1,300	7,162	9,466	-	5.15%
2013	Access Capital L.P. II D	29,328	4,925	28,589	32,224	113	4.46%
2013	Angeleno Investors II, L.P.	30,000	1,700	29,989	7,036	19,047	-3.43%
2013	Carousel Capital Partners IV, L.P.	0	25,000	13,742	1,690	21,348	23.90%
2013	Catterton Partners VII, L.P.	0	100,000	75,674	308	91,636	12.20%
2013	Hg Capital 7	0	98,230	72,957	3,637	64,348	-3.54%
2013	Levine Leichtman Capital Partners V	0	150,000	105,651	6,832	114,105	10.40%
2013	Marlin Equity IV	0	49,000	20,609	0	20,892	0.85%
2013	Milestone Partners IV, L.P.	0	50,000	43,314	697	47,526	6.84%
2013	NEA 14, L.P.	35,000	10,000	42,300	2,445	56,058	17.11%
2014	Apollo Investment Fund VIII, L.P.	0	220,000	93,570	3	96,065	2.73%
2014	Avista Capital Partners III, L.P.	0	150,000	135,051	552	160,931	8.37%
2014	Catterton Growth Partners II, L.P.	0	75,000	73,853	0	87,905	12.94%
2014	Crestview Capital Partners III, L.P.	0	150,000	33,779	0	32,722	-3.29%
2014	CVC Capital Partners VI, L.P.	0	97,489	44,102	13	27,434	-10.97%
2014	GCM Grosvenor - NC Innovation Fund 2013-1	0	15,000	13,114	1,793	12,789	7.21%
2014	Lexington Middle Market Investors III, L.P.	0	150,000	63,178	18,645	53,549	13.54%
2014	StepStone SYN	30,000	5,000	30,351	4,712	23,048	-1.84%
2014	TCV VIII, L.P.	0	150,000	97,547	7,090	97,415	6.03%
2014	Warburg Pincus Private Equity XI, L.P.	0	150,000	130,500	15,114	145,525	11.89%
2015	ARCH Venture Fund VIII, L.P.	0	80,000	57,600	0	61,111	68.80%
2015	Francisco Partners IV, L.P.	0	100,000	34,000	0	34,273	0.90%
2015	GCM Grosvenor - NC Innovation Fund II	0	247,500	23,551	0	24,541	-0.74%
2015	Landmark Equity Partners XV, L.P.	0	250,000	119,331	44,297	86,456	11.67%
2015	NEA 15 Opportunity Fund, L.P.	0	65,000	18,688	0	18,350	43.70%
2015	NEA 15, L.P.	0	67,500	24,975	0	25,152	0.87%
2015	Northbound NCRS Fund, L.P.	0	200,000	18,066	0	16,606	-16.43%
2015	Tenaya Capital Fund VII, L.P.	0	90,000	19,906	0	18,056	-12.09%
2016	AG Cataloochee, L.P.	0	200,000	90,000	0	95,281	8.93
2016	Arch Venture Fund IX	0	60,000	0	0	-	0.00%
2016	Charterhouse Capital Partners X, L.P.	0	168,735	2,093	0	-	0.00%
2016	Harvest Partners VII, L.P.	0	100,000	0	0	-	0.00%
2016	L Catterton Growth Partners III, L.P.	0	75,000	1,010	0	(8)	-100.00%
2016	MHR Institutional Partners IV, L.P.	0	150,000	22,500	229	20,723	-8.50%
2016	Thoma Bravo XII	0	150,000	8,297	0	7,431	-11.86%
2016	Warburg Pincus Private Equity XII, L.P.	0	175,000	12,250	0	9,238	-46.83%

Note: Dollar amounts are in thousands. "Beginning Commitment" is the previously committed amount to the fund prior to the "Additional Commitment". All other data are as of June 30, 2016. New commitments include commitments to new funds and additional commitments to existing funds. Returns of some funds may reflect higher costs and lower returns in earlier years. For 2011, only commitments closed on or after June 23, the effective date of Session Law 2011-211, are included. For additional commitments, the "Redemptions/Distributions," "End Market Value," and "Rate of Return" are reported for the entire commitment, not just the additional commitment. Given the irregular distribution schedule of capital drawdown vehicles, IRR is shown for rate of return as opposed to a time-weighted return.

Public Equity Portfolio

The State Treasurer makes investments in the Public Equity (or Global Equity) Portfolio through G.S. 147-69.2(b)(8).



Beginning in June 2011, investments were permitted in “limited partnerships, limited liability companies, and other limited liability investment vehicles that are not publicly traded and invest primarily in [public equities]” (G.S. 147-69.2(b)(8)(b.)). These investments include the Hedged Equity subcomponent of the Public Equity Portfolio identified in the State Treasurer’s Investment Policy Statement. **Table 8** reports the assets and performance of these funds from fiscal year 2011 through fiscal year 2016. Prior to the 2011 addition of G.S. 147-69.2(b)(8)(b.), the State Treasurer invested in hedge funds through the Alternatives and other Portfolios (*e.g.*, Opportunistic Fixed Income), depending on the assets in which the fund invested.

Table 8: Public Equity Limited Liability Vehicle Assets and Investment Performance, Fiscal Years 2011-2016

Fiscal Year Ended June 30	Beginning Market Value	Additions	Redemptions / Distributions	Net Revenue	End Market Value	Rate of Return	% of Retirement Systems’ Assets
2011	N/A	N/A	N/A	N/A	N/A	N/A	N/A
2012	-	140,000	-	(9,929)	130,071	-7.09%	0.17%
2013	130,071	-	-	12,072	142,142	9.28%	0.18%
2014	142,142	-	-	4,405	146,547	3.10%	0.16%
2015	146,547	1,515,702	(151,759)	(18,934)	1,491,557	8.99%	1.67%

Note: Dollar amounts are in thousands. All data are as of June 30 of the applicable fiscal year.

The limit on the value of public equity limited liability vehicle assets as a percentage of the total assets of the Retirement Systems was raised from 6.5% to 8.5% in August 2013, but the value of this portfolio has yet to exceed 6.5% of total Retirement Systems assets.

Thank you for your attention. Please feel free to contact the Department of State Treasurer if you have any questions.

Sincerely,

Dale R. Folwell, CPA



Appendix – Clarifications and Technical Corrections

Since 2009, the General Assembly has made several changes to G.S. 147-69.2 that could be viewed as broadening the Treasurer's investment authority but that the State Treasurer has interpreted as technical corrections or clarifications and not new investment authority.

Opportunistic Fixed Income Portfolio

In August 2013, the investments for the Opportunistic Fixed Income (or Credit Strategies) Portfolio (G.S. 147-69.2(b)(6c)) were changed from "obligations and other debt securities, including securities convertible into other securities" to "obligations, debt securities, and asset-backed securities, whether considered debt or equity, including obligations and securities convertible into other securities." Prior to the 2013 change, the State Treasurer invested in asset-backed securities as well as both debt and equity securities in the Opportunistic Fixed Income Portfolio under the pre-existing language.