

State of Alaska
ALASKA RETIREMENT MANAGEMENT BOARD
INVESTMENT EDUCATION CONFERENCE

Location of Meeting
Grand Hyatt Hotel, Menzies Suite - 6th Floor
721 Pine Street
Seattle, Washington

MINUTES OF
Action Taken
October 29, 2007

A portion of the ARMB Investment Education Conference was recorded, beginning at 3:50 p.m. on October 29.

Eight ARMB trustees were present:

Gail Schubert, *Chair*
Sam Trivette, *Vice Chair*
Gayle Harbo, *Secretary*
Commissioner Annette Kreitzer
Martin Pihl
Tom Richards
Larry Semmens
Mike Williams

Commissioner Pat Galvin was absent.

Investment Advisory Council Members Present

Dr. William Jennings
George Wilson

Consultants Present

Robert Johnson, legal counsel
Michael O'Leary, Callan Associates, Inc.

Department of Revenue Staff Present

Brian Andrews, Deputy Commissioner
Gary M. Bader, Chief Investment Officer
Pam Green, State Comptroller

Scott Jones, Asst. Comptroller
Bob Mitchell, Senior Investment Officer
Zachary Hanna, State Investment Officer
Steve Sikes, State Investment Officer
Bree Simpson, Asst. State Investment Officer

Invited Participants and Others Present

Michael Burns, Executive Director, APFC
Rick Shafer, Chief Investment Officer, APFC

FARMLAND OPPORTUNITY

Chief Investment Officer GARY BADER reported that UBS Agrivest recently told staff about an investment opportunity in a farmland portfolio that will be coming to market. He said this asset class was attractive to the prior Alaska State Pension Investment Board (ASPIB) because farmland has a long history of positive returns. However, the farmland portfolio has not grown in size as quickly as staff had hoped it would since it began in June 2004.

MR. BADER related how the ASPIB had given staff the authority to pursue investment in a portfolio of 50 to 60 farmland properties that was held by three firms in a single entity, where one firm had indicated an interest in selling. It eventually turned out that no agreement was reached to acquire that portfolio.

MR. BADER said the portfolio of farmland investments that will be coming to market in the near future is estimated to be worth \$200 to \$250 million. The ARMB has \$106 million invested in its farmland portfolio at this point. So acquiring a large portfolio in one transaction would bring the farmland allocation up to its desired scale quickly.

MR. BADER explained that UBS Agrivest is the current investment manager for the portfolio of farmland investments, and it will be transferred to a third party around November 1. The third party will offer the portfolio for sale. This will allow UBS Agrivest to pursue buying this portfolio on behalf of its clients. The Board's other farmland manager, Hancock Agricultural Investment Group, is also aware that this portfolio is coming on the market, and they also will be bidding for the portfolio for some of their investors.

MR. BADER stated that the Board's farmland portfolio has target crop type weights of 90% row crops and 10% permanent crops. The Board heard in-depth presentations about the farmland portfolio from staff and its two farmland advisors at the September meeting in Fairbanks. The portfolio earns income from rental payments from farmers who plant the crops. History has shown that permanent crops are more risky than row crops, although they have a higher return over time.

MR. BADER indicated there was a memorandum in the meeting packet directed to Martin Pihl from

State Investment Officer Steve Sikes, because Mr. Pihl had asked a question at the September meeting about reviewing the target crop weights in the farmland portfolio. Row crops have not had a negative return since inception of the NCREIF Farmland Index in 1991. Row crop returns have low volatility because it is essentially resetting to the market every year. The annualized return for row crops since 1991 has been 10.2% with a standard deviation of 4.7%. Permanent crops have had an annual return of 10.8% over the same period but with a considerably higher standard deviation of 11.5%. The NCREIF Farmland Index has an allocation of roughly 50% permanent and 50% row crops.

MR. BADER stated that staff believes the ARMB tilt toward row crops is consistent with the Board's goal of being able to make pension payments rather than pressing for higher returns with higher risk. However, staff thinks the current target crop weights of 90% row, 10% permanent might be a bit too conservative. UBS Agrivest recently started a private REIT of farmland, and their asset allocation is basically 80% row crop and 20% permanent crop. Both of the ARMB Board's farmland advisors have suggested that this is a more reasonable way to balance the farmland portfolio. So staff was recommending changing the crop type target weights to 80% row/20% permanent and also changing the custom farmland benchmark to reflect that new mix.

Returning to the large farmland portfolio coming to market, MR. BADER said it represents a significant portion of the assets that UBS Agrivest currently manages. That is somewhat of a concern. However, UBS Agrivest has demonstrated themselves to have the highest standards as fiduciaries over time, and staff has confidence that they would not over pay for this portfolio. Also, there are certain underwriting characteristics that UBS Agrivest would be required to adhere to, in terms of pursuing this portfolio. UBS Agrivest knows this farmland portfolio better than anybody else because they have been managing it for over 15 years. Both of the ARMB's farmland advisors will probably be bidding for this portfolio. Staff believes that, if successfully acquired, it would be an outstanding opportunity to get the farmland asset allocation up to what was contemplated three years ago when the Board began pursuing this asset class. There is currently a 2.5% allocation for "Other" assets, including farmland.

MR. BADER proposed that the Board authorize UBS Agrivest to represent the ARMB in competing for this farmland portfolio. If UBS Agrivest is successful, staff recommended their allocation be increased to enough to cover the purchase price. The second recommendation would be to change the target crop type weights as described earlier. MR. BADER said that this is a time-sensitive issue, and the Board has been waiting a few years for this type of opportunity to come along.

MR. SEMMENS moved that the Alaska Retirement Management Board authorize UBS Agrivest to act on its behalf and serve as its advisor in the potential acquisition of the large portfolio of farmland assets coming to market; that if the portfolio is acquired, UBS Agrivest's allocation would increase by the purchase price; and that the Board change its target crop type weight from 90% row crop/10% permanent crop to 80% row/20% permanent with a band of +/-10%, and change the farmland benchmark to also reflect a 80% row/20% permanent mix effective December 31, 2007.

MR. TRIVETTE seconded.

MR. PIHL asked if the ARMB would own the farmland properties in the portfolio that is for sale or if it would be a lease situation. MR. BADER replied that if the ARMB is successful, the portfolio would be held by a single limited liability corporation. In prior discussions with the Board, staff has talked about increasing the number of its limited liability corporations in order to diversify the risk.

MR. O'LEARY stated that Callan's asset allocation optimizer model likes the farmland asset class a lot, even when it is highly constrained by a 5% premium to inflation target return.

MR. JOHNSON inquired about the mechanics of two ARMB farmland advisors bidding on the same portfolio. MR. BADER explained that there is a registration process in-house whereby an advisor interested in pursuing a property for the ARMB portfolio has to register it with Mr. Sikes. Once Mr. Sikes agrees to the registration, he advises the other manager that they cannot buy that property for the ARMB. So in this case, when Hancock tries to purchase the farmland portfolio that is for sale, they would be doing so on behalf of another client and not the ARMB.

MR. RICHARDS cited the language of staff's recommendation "The ARMB authorize UBS Agrivest to act on its behalf and serve as its advisor..." and asked if the Board was authorizing UBS to do their own work. MR. BADER clarified that the language means that UBS Agrivest would be acting on the ARMB's behalf.

MR. RICHARDS made the observation that the graph in Mr. Sikes's memo showed that the index returns on farmland investments have been declining since 2005. He asked if staff had an explanation.

MR. BADER stated that the returns for permanent cropland peaked at over 40% in 2005, while the ARMB's goal is to earn the inflation rate plus 5%. He said there has been a lot of land speculation, particularly in Florida, where land was being sold as farmland and developed for residential and commercial projects. The decline in 2006 may be a return to normalcy in the farmland market. MR. SIKES indicated he agreed, and added that the other thing that played a role is that farmland is eligible for tax benefits. Real estate investors were reportedly selling commercial property and buying farmland.

MR. O'LEARY made it clear that the graph in Mr. Sikes's memo did not suggest a decline in prices but was simply showing at various points in time the rate of annual increase. So the rate of annual increase in prices for permanent cropland went from over 40% to about 26% in 2006. The long-term target would be something on the order of 8.0% rate of annual increase -- 5% plus the inflation number.

MR. RICHARDS asked if staff had a sense of where the annual NCREIF Farmland Index total return would be heading in 2007. MR. BADER replied that staff expected that long term the annual

farmland rental fees would cover the real rate of return target of approximately 5% and that the increase in farmland value would match long-term inflation, getting somewhere close to the 8.0% rate that Mr. O'Leary mentioned. But staff would be unable to predict where the graph would be a year from now because they are taking a long-term view toward the investment. The annual returns have been positive for 15 years, and staff expects them to continue to be positive. But whether the return will be 10% next year or 30%, staff cannot say.

MR. SIKES said that there is a lot of optimism about the outlook for row crops because of alternative energy initiatives, which are a big new driver behind certain crops like corn and soybeans. The prices that farmers get for their crops will impact how much the ARMB can get for its leases. Another consideration is that many crops grown in the U.S. are exported to places like China. Lastly, there is a growing health consciousness in the world, and, although not a guarantee, things look very strong for fruits and vegetables.

MR. O'LEARY had a question about damaged crops in the recent California wildfires [*recording difficult to hear exactly what he said*]. An unidentified person stated that most of the areas that were burned were not really farmland but more dry brush terrain.

MR. TRIVETTE inquired about the farmland rate of return for fiscal year 2007. MR. SIKES replied that the aggregate farmland portfolio held by both UBS Agrivest and Hancock produced a net 12.3% return, net of fees. Since inception, the annualized return has been 9.16%, net of fees.

MR. SEMMENS said he could see why staff was recommending UBS Agrivest to act on the Board's behalf, but he wondered if that component had to be part of the ARMB trying to acquire the farmland portfolio that will be for sale.

MR. BADER stated that the Board had allocated \$125 million to UBS Agrivest to invest, and they have invested a good portion of that. The Board's direction to the chief investment officer is to not increase an asset allocation to a manager by more than 25% without returning to the Board. That is why staff was bringing its recommendation.

MR. WILLIAMS moved to divide the question. MS. HARBO seconded.

The motion passed without objection.

Roll call vote on large farmland portfolio acquisition opportunity:

Ayes: Harbo, Kreitzer, Pihl, Richards, Williams, Semmens, Trivette, Schubert

Nays: None

The motion carried unanimously, 8-0.

Roll call vote on crop type target weights:

Ayes: Harbo, Pihl, Semmens, Kreitzer, Trivette, Richards, Williams, Schubert
Nays: None

The motion passed unanimously, 8-0.

CONCLUSION

There was no other business for this special Board meeting session, and the Chair concluded the meeting at 4:30 p.m.

Chair of the Board of Trustees
Alaska Retirement Management Board

ATTEST:

Corporate Secretary

Note: The summary minutes are extracted from a tape recording of the meeting and are prepared by an outside contractor. For in-depth discussion and more presentation details, please refer to the tape of the meeting and presentation materials on file at the ARMB office.

Confidential Office Services
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