

**MINUTES
ARKANSAS TEACHER RETIREMENT SYSTEM
BOARD OF TRUSTEES – CALLED TELEPHONE MEETING**

**Friday, September 8, 2017
9:00 a.m.
1400 West Third Street
Little Rock, AR 72201**

ATTENDEES

Board Members Present

Jeff Stubblefield, Chair*
Danny Knight, Vice Chair*
Dr. Richard Abernathy*
Anita Bell*
Lloyd Black*
Kelly Davis*
Hon. Andrea Lea*
Bobby Lester*
John Brady, designee for Dennis Milligan*
Susannah Marshall, designee for Candace Franks*
Robin Nichols*
Deborah Thompson*

Board Members Absent

Kathy Clayton
Johnny Key
Janet Watson

**via teleconference*

ATRS Staff Present

George Hopkins, Executive Director*
Gail Bolden, Deputy Director
Rod Graves, Assoc. Dir. of Operations
Rett Hatcher, Deputy Director
Mike Lauro, Information System Manager
Manju, Dir. Data Processing
Kevin Odum, Attorney Specialist
Tammy Porter, Executive Assistant
Clint Rhoden, Director of Operations
Leslie Ward, Manager, Private Equity

Guest Present

Sean Barron, Simmons

- I. **Call to Order/Roll Call.** Mr. Stubblefield, Chair, called the Board of Trustees meeting to order at 9:07 a.m. Voice roll call was taken. Ms. Kathy Clayton, Mr. Johnny Key and Ms. Janet Watson were absent.
- II. **Adoption of Agenda.**

Ms. Nichols moved for adoption of the Agenda. Mr. Brady seconded the motion and the Board unanimously approved the motion.
- III. **Executive Summary.** The Executive Summary was provided for reference with no questions or expansions on the written summary.

IV. Recommendation to Commit up to \$26 Million Dollars for a Debt Investment in Highland, LLC, a Wood Pellet Manufacturing Facility Located in the Pine Bluff Industrial Complex Adjacent to White Hall, Arkansas, with Imminent Need

The ATRS Board approved a commitment of up to \$25 million dollars for 31% equity ownership of Highland at the July 19, 2016 meeting. Construction and operations of the facility are nearing completion. As the facility nears full completion and production increases, Highland is reviewing opportunities to refinance some of its existing debt.

The existing debt expected to be refinanced is with the manufacturer of Highland's wood pellet production equipment, Astec. The Astec loan was intended only for construction financing and now construction is winding down. The Highland plant is in the final stages of being completed and all but one line of the manufacturing equipment are in production. Highland is expected to maintain its existing long term financing until sometime in 2018. The refinancing of the shorter term debt with Astec presents investment opportunities for ATRS.

The proposed investment of up to \$26 million dollars in a debt investment of Highland would have a beginning interest rate of 9% for a term of approximately three years. Based on certain criteria such as the favorable refinancing of the existing long term financing at an interest rate of 6% or less, the ATRS interest rate would be lowered to 8.5% from the time of the refinancing of the long term debt until maturity of the ATRS loan. The refinancing of the Highland long term debt to a 6% interest rate or lower would be a significant decrease in the current interest rate of the long term debt and would increase Highland's cash flow and available funds. The lower interest rate applied to the ATRS debt investment would be appropriate at that time based on the strength of Highland's projected production along with increased cash flow and available funds due to the lower interest rate of the long term debt.

ATRS staff has worked over the past several months to analyze this potential debt investment in Highland. Simmons Bank (Simmons) was also hired to perform due diligence on Highland. The recommendation of Simmons and ATRS staff is a commitment of up to \$26 million dollars in a debt investment of Highland, LLC, the parent company of the wood pellet manufacturing plant located in the Pine Bluff Industrial Complex adjacent to White Hall, Arkansas.

Overview on Biomass and Wood Pellets as a Renewable Energy Source

Biomass is a term for organic matter such as plant material and trees that are used for fuel. A newer and material use is for fuel, especially in power generation facilities for the generation of electricity. Wood pellets are the most common type of biomass pellet fuel and are generally made from compacted wood. The raw

material used in the pellet making process may be sawdust, wood chips, and full trees. The use of this renewable material is increasing globally as more countries strive to reduce carbon emissions and become more environmentally friendly by replacing coal with wood pellets as a means of producing heat and electricity. For example, the United Kingdom plans to use renewable resources such as wood pellets to produce 15% of their energy demand by 2020. Electricity generation using biomass (including wood pellets) in the United Kingdom increased 47% from 2013 to 2014 primarily driven by the ongoing conversion of power plants from coal to biomass.

The Drax Group is an innovative energy company that owns the United Kingdom's largest power plant and typically provides 8% or more of the United Kingdom's electricity. Drax has plans to convert three of its six power generating units to burn biomass instead of coal. The first of these units was successfully converted in 2013, the second in 2014, and plans to convert the third are underway. Conversion of the first unit resulted in 1.8 million tons of wood pellets used for fuel supply that year. The conversion of the second unit increased wood pellet demand 150% to 4.5 million tons of fuel. The U.S. is the largest supplier of wood pellets to the United Kingdom, and in 2014, imports of U.S. wood pellets only met 58% of Drax's need. The current wood pellet supply will continue to face pressure as demand for wood pellets increases both for Drax and globally.

Highland, LLC, the operating entity of the Highland Pellet Plant, located in the Pine Bluff Industrial Complex adjacent to White Hall at the Sheridan exit on I-530, has a ten-year agreement to supply Drax with over 600,000 tons of wood pellets per year. The agreement between Highland and Drax provides a ten-year rate that may increase annually based on the consumer price index (a means of measuring inflation) or local wood prices. This means the Highland contract with Drax provides for a base price that can increase based on any rising costs of the plant's manufacturing. The ability to increase the price of the wood pellets sold to Drax will help maintain the profitability of the plant through varying economic conditions.

Supply of Wood Fiber

One of the biggest risks faced by wood pellet producers is the ability to secure a sufficient long term supply of sustainable wood fiber intake needed for processing wood pellets. Highland has mitigated this risk by securing a ten year agreement with Plum Creek (now merged with Weyerhaeuser). Plum Creek will provide 100% of the wood fiber intake needed by Highland with targets and guarantees of quality and pricing. The contract is structured for Highland to pay a fixed price on a portion of the wood fiber and has incentives in place to encourage Plum Creek to source the rest of the needed wood fiber at a favorable cost to Highland.

For a daily view of the supply needs of Highland, the plant will look to receive 175 loads of tree length pulp wood per day. In addition to the Plum Creek supply

guarantee, ATRS has ample supply of timber in the area. ATRS timber holdings in Jefferson, Grant, Dallas, Cleveland, and Calhoun counties may benefit from the increased demand for pulp wood in the area to fulfill the needs of Highland.

Quality Location

Due diligence conducted by Simmons has shown that Pine Bluff, Arkansas, has the needed supply of energy, transportation, and infrastructure to meet and exceed the requirements of this project.

Union Pacific has a quality rail line near the facility and Highland has secured a long term agreement with Union Pacific to run unit trains twice a week using the mainline rail. Union Pacific is currently operating a rail service for Drax to their facility in Port Allen, Louisiana, and is familiar with the product and customers. Should shipping by rail be unexpectedly disrupted for a prolonged period, Highland is able to truck and barge the wood pellets to the Drax facility so a rail disruption should not have a major effect on Highland's ability to ship the wood pellets to Drax. The point of sale from Highland to Drax is Delivered at Place (DAP) meaning Drax takes possession of and pays for the wood pellets at their facility in Port Allen. Once the wood pellets reach the Drax facility in Louisiana, Drax is responsible for shipping the wood pellets overseas to their power plant. This should eliminate any foreign currency exchange risk for Highland as their product will be sold in the U.S. with payment in U.S. dollars. DAP in Port Allen also saves Highland any large scale storage or sea vessel loading costs.

Capacity and Capabilities of this Plant

Highland has taken an innovative "modular" approach in the construction of the plant. The modular approach used by Highland means the plant will have four separate lines used to produce the wood pellets. The plant is designed so three lines will produce the supply needed to exceed the requirements of the Drax contract and the fourth line is available for use if one of the other lines needs to be shut down for maintenance or repair. The ability to operate the lines independently of each other should help reduce any needed downtime for maintenance or repair. The equipment needed for the production of the wood pellets is built by Astec, Inc. Astec is renowned for excellent customer service and nationwide parts and service teams. Astec is based in Chattanooga, Tennessee, and has a long history in asphalt and paving equipment. Highland has agreements in place with Astec to guarantee the quality and volume of the wood pellets produced at the facility. Astec has the financial resources and strength to fully back those guarantees.

Construction Time

Construction is almost complete and plant commissioning is underway with production ramping up.

Conclusion

The long term contracts secured by Highland have minimized several of the risks associated with this type of project. Highland's executed contracts with Plum

Creek, Drax, and Astec mitigate several risks associated with this industry by securing supply, product demand, pricing, shipping, and manufacturing equipment guarantees. Plant construction is almost complete, all environmental permits are in place, and the plant is ramping up production. ATRS staff and Simmons recommend a commitment of up to \$26 million dollars for a debt investment in Highland, LLC. Other investments of this type allow for distributions from the investment to be reinvested or recalled by the investment. The draft Resolution for Highland allows recallable distributions for payments made on the debt investment. Since the only close for this investment opportunity is expected to take place before the next scheduled meeting of the ALC, Imminent Need is being requested. Previously the Legislative Council has not reviewed this type of investment

Mr. Hopkins confirmed that staff concurs with the recommendation.

A. Resolution 2017-23

Ms. Nichols *moved to adopt* Resolution 2017-23, to Commit up to \$26 Million Dollars for a Debt Investment in Highland, LLC, a Wood Pellet Manufacturing Facility Located in the Pine Bluff Industrial Complex Adjacent to White Hall, Arkansas, with Imminent Need, and the Board *unanimously approved the motion.*

VI. **Other Business.** None

VI. **Adjourn.**

Mr. Lester *moved to adjourn* the Board of Trustees Meeting. Mr. Knight *seconded the motion*, and the Board *unanimously approved the motion.*

Meeting adjourned at 9:13 a.m.

George Hopkins,
Executive Director

Jeff Stubblefield, Chair
Board of Trustees

Tammy Porter, Recorder

Date