

TEXAS MUNICIPAL RETIREMENT SYSTEM

REGULAR MEETING OF THE BOARD OF TRUSTEES

TMRS Headquarters

1200 North IH 35

Austin, Texas

March 24, 2011

On March 24, 2011, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a special meeting at 1:30 p.m. at the Texas Municipal Retirement System Headquarters, 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees

April Nixon, Chair

Frank Simpson, Vice Chair

Julie Oakley

Jim Parrish

Roel ("Roy") Rodriguez

Absent: Ben Gorzell, Jr.

Present also were:

David Gavia, Executive Director

Ian Allan, Director of Internal Audit

Rhonda Covarrubias, Director of Finance

Eric Davis, Deputy Executive Director

Bernie Eldridge, Director of Human Resources

Nancy Goerdel, Chief Investment Officer

Leslee Hardy, Staff Actuary

Holly Macki, Director of Real Estate

Cindy Morse, Executive Assistant

Dev Outlaw, Director of Fixed Income

Christine Sweeney, General Counsel

Bill Wallace, Director of Communications

Dan Wattles, Director of Governmental Relations

Scott Willrich, Director of Information Resources

Robert Klausner, Klausner & Kaufman, P.A.

Ed Schwartz, ORG Portfolio Management, LLC

Marcia Beard, R. V. Kuhns & Associates, Inc.

Jeremy Miller, R. V. Kuhns & Associates, Inc.

Christopher Merrill, Harrison Street

Dean Egarter, Harrison Street

Tuba Malinowski, Stockbridge

Sol Raso, Stockbridge

Steve Steppe, Stockbridge

Guests:

Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist
George Kaufman, City of Garland
Randle Meadows, Arlington Police Association
Jim Moore, City of Mesquite Firefighters
Candace Nolte, Controller
Kristin Qualls, Assistant Director of Equities
Kate Reed, Investment Analyst, Equities
Katie Reissman, Investment Analyst, Fixed Income
David Rodriguez, Regional Manager, City Services
Sean Thompson, Regional Representative, City Services

The meeting was called to order at 1:35 p.m., and the invocation was given by April Nixon.

1. Consider and Act on Real Estate Manager Recommendation

Mr. Gavia introduced Ms. Goerdel to present the Real Estate Manager Recommendation. Ms. Goerdel said this agenda item concerns the first Real Estate manager selection in TMRS' history. Ms. Goerdel stated that the search team included both ORG and TMRS staff. Ms. Goerdel introduced Ed Schwartz from ORG and Holly Macki, TMRS' Director of Real Estate Investments to discuss the search process and highlight the firms being recommended, to be followed by presentations by each of the firms.

Ms. Macki began her presentation by discussing the Real Estate Investment Search process. She described the Core Real Estate Investment search timeline, breaking the process down into six steps: (1) Market Research; (2) Manager Screening; (3) Manager Questionnaire; (4) Evaluation and Preliminary Due Diligence; (5) In-Depth Due Diligence; and (6) Recommendation. Ms. Macki then discussed the Manager Screening Criteria. She reported that ORG evaluated its universe of over 600 managers and reduced it to twelve (12) candidates. She briefly described the attributes of the 12 candidates, noting that these included six existing core open-ended funds, two core debt funds, three new core-open-end funds created by traditional value-added managers with unique pipelines of core properties, and one core fund targeting non-traditional properties with core attributes. Ms. Macki then reviewed the due diligence ranking factors and their weightings, describing each factor. There were several questions at this point on geographic diversification and how that fit into the process. Ms. Macki reviewed the scoring matrix and the scores of the top three candidates. She briefly reviewed the high points of two of the candidates and mentioned that the third top candidate was not currently being recommended due to their incentive-based fee structure which was reflected in their score. She added that they may be reconsidered at a later date following further discussions with the Board on various real estate investment fee structures.

Mr. Schwartz then described the finalists' characteristics, stating that each finalist has unique investment strategies and characteristics that will help achieve the Board's goal for the Real Estate asset class, including maximizing risk-adjusted returns, providing diversification across property types and sectors, and capitalizing on unique investment opportunities.

Mr. Schwartz then presented an overview of the two finalists, beginning with Harrison Street. He indicated that Harrison's strategy will focus exclusively on stabilized assets in the "defensive," "need based," and "demand driven" segment of the Real Estate market, which includes medical office, senior housing, student housing and self storage. The structure will be a newly formed open-end fund, with low leverage, and gross returns in our target range. There were questions concerning the fee difference between Harrison Street and Stockbridge and ORG responded that Stockbridge's fee proposal was aggressive; he further stated that acquisition and financing fees had already been negotiated away from the original Harrison Street proposal because TMRS is expected to be the lead investor, and that because their process is more resource-driven, one would expect their fees to be higher. He suggested re-visiting the fee proposal with Harrison in an attempt to narrow the gap between the two fee proposals. Mr. Schwartz also reviewed Harrison's investment merits and he discussed the material risks with Harrison including "key man risk" and limited track record on realized returns.

Mr. Schwartz then presented an overview of Stockbridge, indicating that Stockbridge's strategy is to create a "Smart Core Fund" which will target investments in "smart" employment centers in areas that are home to major universities and highly educated workforces. This structure will be a newly formed open-end fund, with expected returns and leverage within target, as well as low fees. Mr. Schwartz indicated that Stockbridge's merits include well-seasoned professionals and fees below market and discounted for TMRS as a founding investor. The material risks with Stockbridge as a firm include a short history in this area of the market, which is mitigated by the knowledge of successful performance in this area by the team while with their predecessor firm, RREEF. Additionally, Stockbridge's opportunity fund business has not performed well; however, Mr. Schwartz emphasized that the opportunity fund business, including investment strategy and process, are completely separate with the exception of some shared operational resources.

The presentation by Harrison Street was made by Christopher Merrill, President and CEO; and Dean Egerter, Director of Capital Markets. Mr. Merrill reviewed the concept of "needs based" segments, specifically Education, Healthcare and Self-Storage, as well as the Six Sigma based business structure. Mr. Merrill indicated that Harrison does not manage the properties, but instead works with a network of property managers. He reported that the segments they invest in provide consistent out-performance when compared to assets typically included in "Core" Real Estate properties. He indicated that there are opportunities to benefit in an inflationary environment due to shorter term leases typical for the student housing, senior housing and storage segments. Mr. Merrill and Mr. Egerter discussed the beneficial characteristics of the different segments of Harrison's strategy, and mentioned that they have a large network of real estate operating partners who focus on the development, management and leasing of Education, Healthcare and Storage related assets.

The presentation by Stockbridge was made by Tuba Malinowski, Managing Director; Sol Raso, Managing Director; and Steve Steppe, Executive Managing Director. Mr. Raso reported that Stockbridge is a fully independent, 100% employee-owned firm and registered investment advisor. Mr. Raso outlined what Stockbridge believes are the organization's strengths. Mr. Raso listed several public retirement system clients of the firm. Ms. Malinowski discussed the "Smart" core investment strategy and stated that it is an open-end fund that maintains a low risk

profile by adhering to specific disciplines such as diversification by property type and geographic region, moderate leverage limits, and a strict hold/sell discipline. She explained that the “Smart Core” strategy seeks to outperform the core benchmark by focusing on “smart” markets best positioned to capture long-term job growth, investing in specific submarkets with barriers to entry, targeting smaller assets, and underweighting office investments. She highlighted the target markets, and showed forecast growth by category. She then compared returns in general to those of the “smart” markets.

Mr. Steppe discussed acquisitions and the portfolio management process, as well as the composition of the Investment Committee and the process the Committee goes through in making its decisions. Mr. Raso summarized and highlighted the key elements of the proposed fund structure which included the limited partnership structure; an open-end, commingled vehicle; low fees to TMRS; governance structure that includes an Investment Advisory Committee; and direct access by TMRS to the portfolio managers.

Mr. Simpson moved that that the Board of Trustees select and allocate \$100 million to each of the following managers for core real estate open-end commingled fund strategies as proposed and in accordance with the IPS Real Estate Guidelines, individually contingent on favorable background checks and successful negotiation of the contracts at management fees not to exceed the following:

Harrison Street Real Estate Capitol LLC:	.80% (80 basis points) on NAV
Stockbridge Capitol Group, LLC:	.60% (60 basis points) on NAV

Mr. Rodriguez seconded the motion, which passed unanimously.

2. **Presentation and Authorization to Initiate Search for Remainder of 2011 Real Estate Pacing Plan**

Ms. Goerdel presented the next step in the 2011 Real Estate implementation plan. She indicated that during this second step, an additional \$100 million will go to Core (in addition to the initial \$200 million just approved for Core, subject to favorable background checks and successful contract negotiations), with the remaining \$200 million available for additional Core, Value Added or Opportunistic segments that represent attractive risk adjusted returns consistent with the TMRS Investment Policy.

Staff and ORG will evaluate market conditions and available opportunities as part of the search process, and will bring recommendations for managers and strategy solutions to the Board during the second half of 2011.

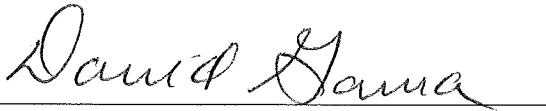
Mr. Rodriguez moved that the Board of Trustees authorize TMRS Staff and ORG Portfolio Management LLC to conduct a search(es) for real estate managers/investment offerings to fulfill the remaining 2011 Real Estate Implementation Plan allocation with a minimum of \$100 million to Core, and the balance to Core, Value-Added, and/or Opportunistic strategies. Ms. Oakley seconded the motion which passed unanimously.

3. **Executive Session**

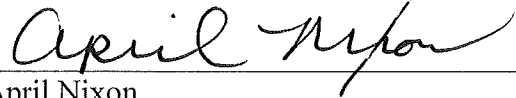
At 3:34 p.m., the Board entered into Executive Session, pursuant to Texas Government Code, §551.071 and §551.074 to consult with Legal Counsel to receive legal advice, and to discuss personnel matters. No action was taken during the Executive Session and the meeting was opened to the public again at 5:52 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

4. **Other Business**

As there was no further business to come before the Board, Mr. Rodriguez moved that the meeting adjourn until 9:00 a.m. on Friday, March 25, 2011. Mr. Parrish seconded the motion, which passed unanimously. The meeting was adjourned at 5:53 p.m.



David Gavia
Executive Director



April Nixon
Chair, Board of Trustees