MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Meeting of the Board of Trustees

September 18, 2014 – 1:30 p.m.

On September 18, 2014 the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 1:30 p.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees
Roel "Roy" Rodriguez, Chair
Jule Oakley, Vice Chair
Jim Parrish
Bill Philibert

Absent: David Landis
Jim Jeffers

Present also were:
David Gavia, Executive Director
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Kristie O'Hara, Director of Human Resources
TJ Carlson, Chief Investment Officer
Leslee Hardy, Director of Actuarial Services
Debbie Munoz, Director of Member Services
Christine Sweeney, General Counsel
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Holly Macki, Director of Real Estate
Kristin Qualls, Director of Equities
Dimitry Shishkoff, Director of Risk Management
Jesse Pittman, Project Manager
Karen Jackson, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Marcia Beard, R. V. Kuhns & Associates
Sean Ealy, R. V. Kuhns & Associates
Ed Schwartz, ORG
Barbara McDowell, ORG
Nancy Williams, Hewitt EnnisKnupp

Also in attendance:
Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist
Melissa Jerkins, Quantitative Analyst

Di Fu, Investment Data Analyst
Peter Jeske, Project Specialist
Michelle Mellon-Werch, Associate General Counsel
Nick O'Keefe, Senior Staff Attorney
Cindy Morse, Investment Support Analyst
Kate Reed, Investment Risk Analyst
David Rodriquez, Regional Manager – City Services
Eddie Schultz, Real Estate Analyst
Mel Thomas, Editor
David Crow, Arlington Professional Fire Fighters
Alex Kramer, Arlington Professional Fire Fighters
Bob Scott, Government Finance Officers Association of Texas
Chris Jones, Combined Law Enforcement Associations of Texas
George Kauffman, City of Garland
Scott Kerr, Texas State Association of Firefighters
Keith Hopkins, Mesquite Fire Department
Melinda Griffith, Combined Law Enforcement Associations of Texas
Greg Shipley, Combined Law Enforcement Associations of Texas
Chris Hanson, Pension Review Board
Jim Baker, Unite Here

Mr. Rodriguez called the meeting to order at 1:32 p.m. and Ms. Oakley gave the invocation. David Landis and Jim Jeffers were absent from the Board meeting.

1. **Consider and Act on Real Estate Manager Recommendation(s)** ***(originally appeared as item #3 on the Thursday, September 18, 2014 agenda)***
   Ms. Macki introduced Mr. Schwartz and Ms. McDowell from ORG Portfolio Management, LLC. Ms. Macki reviewed the timeline for the Real Estate manager search. She outlined the steps of the manager search process and the preliminary manager screening criteria. Seven managers were selected, two Core Open-End funds and five Value-Add/Opportunistic Closed-End Funds. Ms. Macki reviewed the due diligence ranking factors and the scoring criteria. The final rankings were reviewed with the top three managers selected and follow-on investments will be recommended.

   Mr. Schwartz reviewed the Real Estate manager characteristics. The top ranking managers were selected from recommendations by the evaluation team after completing a rigorous search process. The team looks for managers with a unique investment strategy to maximize risk adjusted returns and provide diversification across property types and sectors. The three managers selected were Abacus Multi-Family Partners III, Moorfield Real Estate Fund III and Westbrook Real Estate Fund X.

   Mr. Schwartz discussed Abacus Multi-Family Partners III and their investment strategy, fund details and target returns. Abacus is 100% owned by the principals and their sole business is real estate investment funds with a focus on U.S. multi-family investments. Abacus has a research-based approach, and he discussed their primary market characteristics, target fundamentals and up-and-coming market characteristics.

Mr. Schwartz next reviewed Moorfield Real Estate Fund III. This is a United Kingdom only fund. An issue is the pending Scottish independence vote and Staff's recommendation may be amended to take into account the outcome to the Scottish election. Should Scotland vote in favor of independence it would materially change the investment and thus require additional due diligence. If Scotland remains in the United Kingdom the investment recommendation in Moorfield would stand as presented. The reason for looking at Europe is they are lagging behind in the recovery so opportunities for value-add/opportunistic investments are greater. Although there is added risk, it is consistent or even lower with the value-add/opportunistic investments in the U.S.

Mr. Schwartz then discussed Westbrook Real Estate Fund X. The fund is opportunistic in nature and will be 50/50 in selected U.S. coastal markets and in the global markets. Westbrook utilizes lower leverage as compared to a generally accepted maximum leverage ratio for opportunistic funds. They are currently not a registered vendor, but they have agreed to register prior to investment.

Ms. McDowell discussed the follow-on allocations. Two existing managers, Greenfield Acquisition Partners VII and Lubert-Adler Real Estate Fund VII, provided better opportunities than many new current offerings in the marketplace. With Greenfield, the additional $25 million will bring TMRS' combined investment in this fund to $100 million. TMRS will benefit from exposure to industrial properties. The Lubert-Adler fund is a value-add fund and the $25 million add-on will bring TMRS' combined investment in this fund to $100 million. An area of risk is the heavy reliance on the capabilities of one principal. The risk can be mitigated by the "key man" provision that will cut off new investment activities in the event the principal is no longer involved.

Mr. Parrish made a motion that the Board select the following managers (and also known as fund sponsors) for investment in real estate fund structures of the managers or their affiliates, 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 substantially comparable to those proposed.

SECTOR	FUND	ALLOCATION
Value-Add/Opportunistic	Abacus Multi-Family Fund III LP	$75 million
Value-Add/Opportunistic	Greenfield Acquisition Partners VII, L.P.	$25 million additional allocation
Value-Add/Opportunistic	Lubert-Adler Real Estate Fund VII, L.P.	$25 million additional allocation

Value-Add/Opportunistic	Moorfield Real Estate Fund III A and B, Limited Partnership	£50 million (Approx. $83 million based on $1.65 exchange rate)**
Value-Add/Opportunistic	Westbrook Real Estate Fund X, L.P.	$100 million
TOTAL		**$308 million****

**Final allocation in $US subject to exchange rate at time of funding for Moorfield Real Estate III.

Authorization for new and existing managers or their affiliates may include the option to participate in the funds' distribution reinvestment programs and exceed the authorized commitments by the value of the distribution reinvestments, when TMRS Staff and its real estate consultant determine that it is economically advantageous to do so and in accordance with the TMRS IPS Real Estate Guidelines. Management fees are not included in the capital commitment and may be paid through cash flow of the investment, capital calls, or via invoice. Moorfield's commitment will be contingent upon the Scottish independence referendum vote; if the vote does not pass, the Moorfield commitment will remain in effect, but if the vote does pass, the commitment would need to be re-evaluated by TMRS staff and the Board. Westbrook's commitment will be contingent upon becoming a registered investment advisor. Ms. Oakley seconded the motion, which passed 4-0.

2. **Consider and Act on Non-U.S. Emerging Markets Equity Manager Selection(s)** ***(originally appeared as item #4 on the Thursday, September 18, 2014 agenda)***
Ms. Qualls reviewed the timeline and recommendations regarding Phase II non-US Emerging Markets manager search which started at the beginning of May 2014. The objectives regarding non-U.S. Equity are to add alpha, provide further diversification with complementary equity strategies that have low correlations while remaining within TMRS' risk tolerance.

Mr. Ealy discussed the minimum qualifications and the search process. The screening process initially identified 10 candidates to receive the RFI questionnaire of which nine managers chose to respond. The initial scoring reduced the number of candidates to six which was then reduced to four finalist candidates. Ms. Qualls added that the funding source will be the NTAM Russell 3000. The scoring process was done with both TMRS and RVK staff scoring each candidate independently. The finalist scoring focused on "portfolio fit" which included qualitative and quantitative aspects to determine the "best fit" for TMRS. Based on the scoring, two managers were selected for Board recommendation: Acadian Asset Management and William Blair and Company.

Mr. Ealy discussed the top candidate's characteristics. Acadian's investment strategy is a research based quantitative model approach. The strategy is closing at the end of the 2014 and TMRS will be one of the last investors in this product which has a diversified portfolio with 300 – 450 holdings.

Ms. Qualls discussed the characteristics of William Blair and Company. The strategy team is led by two co-Portfolio Managers with good tenure and stability. The William Blair product will be a more concentrated portfolio with 50 – 80 holdings. Compliance for both managers is very strong. Ms. Qualls reviewed the risk budgeting impact. The two manager recommendations should provide additional excess returns with only a slight increase in overall risk.

Ms. Qualls reviewed the Staff's recommendation for Acadian Asset Management and William Blair. The portfolio structure of the mandates will either be a separately-managed account or a commingled fund. The NTAM Russell 3000 core/passive fund will be the funding source for both strategies. TMRS and RVK will also determine if a Transition Manager will be required as part of the implementation process. Ms. Oakley asked if there were material risks associated with the recommended manager. Staff discussed certain risks associated with emerging markets and the underlying country risk as well as geopolitical risks within those emerging market countries.

Ms. Oakley made a motion to approve the selection of the following managers or their affiliates for investment in the specified equity strategies in accordance with the fee structures presented. The Executive Director is authorized to decide on the final legal structures (including, without limitation, commingled fund and separately managed account structures) for investment in non-US emerging markets strategies of the managers or their affiliates and to negotiate and execute contracts satisfactory to the System for such investments.

1. Acadian Asset Management - Emerging Markets Equity strategy for a $175 million mandate
2. William Blair & Company - Emerging Markets Leaders strategy for a $175 million mandate

Mr. Philibert seconded the motion, which passed 4-0.

3. **Chief Investment Officer Management Update, Including Governance, Personnel, Manager Update and Other Investment Related News or Matters *(originally appeared as item #1 on the Thursday, September 18, 2014 agenda)***
Mr. Carlson updated the Board on upcoming interviews for the Director of Absolute Return. There are several strong candidates and hopefully a selection will be made soon.

4. **Discussion of Proposed Amendment of Rebalancing Policy Section of Investment Policy Statement *(originally appeared as item #2 on the Thursday, September 18, 2014 agenda)***
Mr. Carlson discussed the Investment Policy Statement (IPS) Rebalancing policy based on the Board's request at the previous Board meeting. The current rebalancing policy is

governed by minimum and maximum allocation ranges, but the issue is Staff cannot rebalance if a boundary is not breached. This can have a negative impact on the portfolio. The proposal allows Staff additional flexibility to rebalance the portfolio between managers and asset classes within the Board approved ranges to adjust for market movements and consider current market conditions. The IPS does include consultation with the Executive Director. The results of rebalancing will be reported back to the Executive Director and the Board.

Ms. Sweeney did ask for clarification on language presented and for a clarification between the difference of a "rebalance" and an "initial investment". Mr. Parrish asked if this allows the Chief Investment Officer to place the money wherever he wants. Mr. Carlson responded to the affirmative, but only within the ranges pre-approved by the Board of Trustees.

The addition of the Executive Director's signature to the Portfolio Rebalance Transaction Report was requested to provide evidence of the Executive Director's inclusion in the process.

5. **Executive Session** ***(originally appeared as item #7 on the Thursday, September 18, 2014 agenda)***
At 3:42, 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 4:19 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

At 4:19 p.m. the meeting was recessed until 8:30 a.m. on Friday, September 19, 2014.

David Gavia
Executive Director

Roel "Roy Rodriguez
Chair, Board of Trustees

MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Meeting of the Board of Trustees

September 19, 2014 – 8:30 a.m.

On September 19, 2014, the Board of Trustees of the Texas Municipal Retirement System (TMRS) reconvened for a meeting at 8:30 a.m. at TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees
Roel "Roy" Rodriguez, Chair
Jule Oakley, Vice Chair
Jim Parrish
Bill Philibert

Absent: David Landis
Jim Jeffers

Present also were:
David Gavia, Executive Director
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Kristie O'Hara, Director of Human Resources
TJ Carlson, Chief Investment Officer
Leslee Hardy, Director of Actuarial Services
Debbie Munoz, Director of Member Services
Christine Sweeney, General Counsel
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Kristin Qualls, Director of Equities
Dimitry Shishkoff, Director of Risk Management
Jesse Pittman, Project Manager
Karen Jackson, Executive Assistant
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Marcia Beard, R. V. Kuhns & Associates
Nancy Williams, Hewitt EnnisKnupp
Joe Newton, Gabriel, Roeder, Smith & Company

Also in attendance:
Debbie Farahmandi, Investment Operations Specialist
Melissa Jerkins, Quantitative Analyst
Di Fu, Investment Data Analyst
Peter Jeske, Project Specialist
Michelle Mellon-Werch, Associate General Counsel
Nick O'Keefe, Senior Staff Attorney

Cindy Morse, Investment Support Analyst
Kate Reed, Investment Risk Analyst
David Rodriquez, Regional Manager – City Services
Eddie Schultz, Real Estate Analyst
Mel Thomas, Editor
David Crow, Arlington Professional Fire Fighters
Alex Kramer, Arlington Professional Fire Fighters
Bob Scott, Government Finance Officers Association of Texas/City of Carrolton
Chris Jones, Combined Law Enforcement Associations of Texas
George Kauffman, City of Garland
Scott Kerr, Texas State Association of Firefighters
Melinda Griffith, Combined Law Enforcement Associations of Texas
Greg Shipley, Combined Law Enforcement Associations of Texas
Dan Moore, Pension Review Board

Mr. Rodriguez called the meeting to order at 8:30 a.m. and requested a moment of silence.

6. **Consider and Act on Consent Agenda** ***(originally appeared as #8 on the Friday, September 19, 2014 agenda)***
   Mr. Gavia presented the items contained in the consent agenda. He asked if there were any questions or revisions to the minutes and there were none.
   Mr. Parrish made a motion that the Board adopt the Consent Agenda as presented. Mr. Philibert seconded the motion, which passed 4-0.

7. **Update on GASB 68 including Status Reports, Criteria for Substantively Automatic Benefits and a Draft Funding Policy** ***(originally appeared as #9 on the Friday, September 19, 2014 agenda)***
   Mr. Newton updated the Board on the changes to GASB. TMRS is currently in the GASB 67 reporting period and it will be reflected in the December 31, 2014 financial statements. The basic financial statement presentation will not be significantly different; however, the notes and required supplementary information will require more detail. Under GASB 68, there could be a liability on the employers' statements that is larger than ever seen before or it could be an asset. This liability/asset will change from year to year and can be quite volatile. There also could be an expense on the employers' books that is a larger expense than ever seen before. It could be shown as income, and the shorter amortization periods will accelerate recognition of pension cost. Mr. Newton reviewed the major "before and after" changes to the new accounting standards. He discussed the items that will be immediately recognized in pension expense as well as deferred in-flows and out-flows. An example was presented highlighting the differences between GASB 25/27 and GASB 67/68. The new Net Pension Liability will be more volatile than the funding Unfunded Actuarial Accrued Liability. Mr. Newton also presented an example showing the sensitivity to Market Returns and discussed the Discount Rate. If a system passes the projection test, that system will be able to use its long term investment return assumption. If a system fails the test, a blended rate must be utilized. The test is connected more to the funding policy than the current funded position.

Ms. Hardy discussed the funding policy which is the current procedures used by the Board condensed into a single document. Under the new accounting standards, funding policy disclosures and actual funding patterns will be taken into account which will make a written funding policy more important in ensuring secure retirement benefits. A funding policy is a systematic set of procedures used to determine the contributions which will be made in a specific year and series of years. It is much broader in scope than most people realize. The key elements include: a description of the actuarial cost method, asset smoothing method, amortization methods and actuarial assumptions. Each of these items is included in the TMRS funding policy. There is nothing new in the policy; it simply consolidates all policies in a single document. The Board will be asked to adopt the policy during the October Board meeting. Mr. Newton indicated that the funding policy should allow all cities to pass the test allowing cities not to be required to use the blended discount rate for reporting. Since TMRS is both well-funded and has a strong funding policy, each city should pass. There is one scenario where a city might fail – a lower funded city that adopts ad hoc COLAs. An idea for future consideration is to set the amortization period for ad hoc COLAs to be the lesser of the current 15 year policy or the average remaining life expectancy of the retirees receiving the ad hoc COLA.

Mr. Newton reviewed substantively automatic benefits and ad hoc USC and COLAs. GASB does not provide a definition of "substantively automatic". He discussed other definitions to clarify this phrase. In TMRS' case, due to the catch-up provision, the liability is virtually the same if you do it every year or every third year. The recommended default test is an ad hoc adoption one of the last two years and two out of the last five years, beginning with a "fresh start". This means we start looking back five years beginning with the first ad hoc adoption on or after January 1, 2015. If a city is determined to have substantively automatic USCs or COLAs, the city will have to disclose the liability as if the city had adopted repeating benefits instead of ad hoc benefits.

Ms. Covarrubias updated the Board on the GASB implementation status. The American Institute for Certified Public Accountant and State and Local Government Expert Panel whitepaper for agent multiple-employer plans suggest two best practices: 1) plan engages its auditor to issue a service organization controls (SOC1) Type 2 report on controls over census data maintained by the plan and fiduciary net asset additions and deductions and 2) plan actuary issues a separate actuarial valuation report specific to each employer, which includes an actuarial certification letter addressed to employer management. TMRS is currently performing the SOC audit and Ms. Covarrubias updated the Board on the current status of this audit. TMRS has been reminding cities about the user-entity controls that each city is responsible for. The employer GASB reporting package was discussed next. The rate letter and GASB information will be separated.

8. **Staff Quarterly Report/Asset Class Updates *(originally appeared as item #6 on the Thursday, September 18, 2014 agenda)***
Mr. Carlson reviewed the July 31st performance and pointed out that we are 37 basis points above benchmark. For the last twelve months and for a five-year basis, we were also outperforming the benchmark. From an asset allocation perspective, good progress has been

made. We have funded Absolute Return Strategy and should be funding the Non-Core Fixed Income by the end of the year.

Ms. Qualls gave an update on progress in funding the satellite structure of the Equity portfolio. She also showed the distribution of strategy/manager/portfolio benchmark.

Ms. Mackie reviewed the Real Estate performance. Overall performance is very strong, even including the "J" curve effect with some managers. She reviewed Real Estate portfolio diversification. The Board asked for a list of managers with strategy types to be included in the next presentation. She next discussed the Real Return performance which is out performing the benchmark.

Mr. Carlson Reviewed Absolute Return Strategy which was just funded, but is already positive. Private Equity education will be on-going and we will have staffing requests in the budget.

Ms. Reed provided an update on investment guideline compliance. 129 separate compliance tests were run on TMRS portfolios as of July 31. All funds were found to be in compliance with TMRS guidelines.

Mr. Shishkoff reviewed risk management. There are two categories of investment risk: risk for active management and risk from strategic target allocation. The key questions regarding active management risk: 1) are we within our Risk Budget? and 2) are we getting paid for the risk we take? In regards to strategic target allocation, this risk relates to long term asset class risk assumptions. He discussed the difference between our assumed return and policy benchmark. A shift should begin in tracking error from "allocation contribution" to "selection contribution" which means risk will shift from the fact that we are not fully diversified to the active management where it should be.

9. Discussion of Possible 2015 Legislative Agenda and Related Matters *(originally appeared as item #10 on the Friday, September 19, 2014 agenda)*

Mr. Wattles reviewed discussion from previous meetings that there was not a consensus on legislative changes from the Advisory Committee and suggested no changes be made. The Advisory Committee did recommend adoption of a resolution outlining the Board's position regarding legislative change. A red-line version of the resolution was reviewed and discussed. Mr. Wattles pointed out the significant modification would be the inclusion of an additional statement that describes the issues studied during this legislative interim period and the Board's pending decision not to propose any changes to the current plan design. Mr. Gavia reviewed the interaction between Staff and the Board during the previous legislative session that included frequent updates regarding bills filed and action.

Mr. Rodriguez suggested additional changes to the resolution. The two changes suggested were: 1) remove the phrase, "over no more than a 30 year period", in the third paragraph and 2) remove the phrase, "regarding cost of living adjustments, the employee eligibility threshold and tiered plan options" in the sixth paragraph.

This item will be brought back to the Board for adoption.

10. **<u>Executive Director and Staff Reports, including Reports from Administration, Communications, Staff Actuary, Finance, Governmental Relations, Human Resources, Information Resources, Internal Audit, Legal and Member Services</u>**
Mr. Gavia presented these reports and updated the Board on the latest release of "MyTMRS".

11. **<u>Call for Future Agenda Items *(originally appeared as item #13 on the Friday, September 19, 2014 agenda)*</u>**
Ms. Oakley suggested a review of the Charter of the Advisory Committee and the terms of the group class members.

12. **<u>Consider and Act on Meeting Dates and Location for 2015 Board of Trustees Meetings *(originally appeared as item #11 on the Friday, September 19, 2014 agenda)*</u>**
Due to two Board members being absent, the item was tabled until the October 2014 Board meeting.

    Ms. Oakley moved to table the agenda item for the October Board meeting. Mr. Philibert seconded the motion, which passed 4-0.

13. **<u>Fixed Income/Non-Core Fixed Income/Security Lending Annual Asset Class Review *(originally appeared as item #11 on the Friday, September 19, 2014 agenda)*</u>**
Mr. Carlson indicated that all of the Fixed Income managers are performing as expected. They have and continue to meet expectations and requirements. The Staff's quantitative and qualitative reviews have been positive.

    Blackrock's scores across all categories are better than satisfactory and it is recommended they continue to be retained. PIMCO, in the Core-Plus Fixed Income space, has also scored in the excellent category across all assessment areas and they are recommended for retention. The Securities Lending program has been in place for a number of years, but changed in 2013. The purpose is to generate incremental income from overnight and certain term loans of securities held, subject to guidelines described in the Investment Policy Statement. The new program is fully indemnified so that TMRS does not experience any losses. We do give up a little return for the full indemnification, but this is worth not having to deal with losses. Mr. Carlson reviewed the specifics of Deutsche Bank including credit review of Deutsche Bank AG. He discussed the primary borrowers, the cash collateral holdings, and the collateralization and period earnings. The key take-away items are: performing within expectations, generated meaningful earnings during the last twelve months, maintained compliance within policy. There are no recommendations for change at this time.

The meeting was adjourned at 10:58 a.m.

David Gavia

David Gavia
Executive Director

Roel "Roy" Rodriguez
Chair, Board of Trustees