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

Wednesday, October 25, 2017 – 9:00 a.m.

On October 25, 2017, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 9:00 a.m. at the Gaylord Texan, located at 1501 Gaylord Trail, Grapevine, Texas, with the following members present:

Board of Trustees
Jim Parrish, Chair
Bill Philibert, Vice Chair
Julie Oakley
Jim Jeffers
David Landis

Absent: Roel "Roy" Rodriguez

Present also were:

David Gavia, Executive Director
Eric Davis, Deputy Executive Director
TJ Carlson, Chief Investment Officer
Christine Sweeney, General Counsel
Dan Wattles, Director of Governmental Relations
Leslee Hardy, Director of Actuarial Services
Rhonda Covarrubias, Director of Finance
Scott Willrich, Director of Information Resources
Leslie Ritter, Director of Human Resources
Jesse Pittman, Senior Project Manager
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Chris Schelling, Director of Private Equity
Tom Masthay, Director of Real Assets
Sandra Vice, Director of Internal Audit
Karen Jackson, Executive Assistant
Marcia Beard, RVK
Amy McDuffee, Mosaic Governance Advisors
Mike Murphy, Courtland Partners, Ltd.
Mark White, Albourne America

Also in attendance:

David Rodriquez, Regional Manager – City Services
Eddie Schultz, Assistant Director of Real Assets
Colin Davidson, Regional Representative – City Services
Rachel Cleak, Alternative Analyst
Greg Shipley, Combined Law Enforcement Associations of Texas
Casey Srader, Government Finance Officers Association of Texas

George Kaufman, City of Garland
Devon Waters, City of Arlington
Cynthia Lujan, City of Presidio
Glorissel Munoz, City of Presidio

Mr. Parrish called the meeting to order at 9:00 a.m. and Mr. Landis gave the invocation.

1. **Consider and Act on Adoption of the Minutes from the September 21-22, 2017 Meeting of the Board of Trustees**
   Mr. Gavia stated that Staff had nothing to add to the minutes as presented.

   Ms. Oakley moved that the Board adopt the minutes from the September 21-22, 2017 meeting of the Board of Trustees. Mr. Philibert seconded the motion, which passed 5-0.

2. **Consider and Act on Meeting Dates and Locations for 2018 Board of Trustees Meetings**
   Mr. Gavia noted he requested and received feedback from the Trustees regarding conflicts with the 2018 Board meeting dates proposed at the September Board meeting. The following were selected as dates for 2018 meetings:

   February 15-16
   March 22-23
   May 24-25
   June 28-29
   August 23-24
   September 27-28
   October 25-26
   December 6-7

   Mr. Landis made a motion the Board set the meeting dates and locations for 2018 as suggested. Mr. Philibert seconded, which passed 5-0.

3. **Consider and Act on Proposed Amendments to the Strategic Plan**
   Mr. Gavia introduced Ms. McDuffee to continue the discussion of the proposed amendments to the Strategic Plan. Ms. McDuffee reviewed the process timeline and activities that have brought the Board to this point. The Strategic Plan needs to be a collaborative effort between Board and Staff. She highlighted the work completed by Staff with regard to creating work plans for every goal within the plan.

   The Mission Statement alternatives were reviewed and Ms. McDuffee listed the preferences. She also reviewed the refined statement alternatives. Discussion focused on the first alternative, "Providing secure, reliable retirement benefits." Options two and four were also reviewed for consideration.

   Mr. Jeffers moved that the Board approve the first alternative for the Mission Statement, "Providing secure, reliable retirement benefits". Ms. Oakley seconded the motion, which passed 5-0.

The discussion next turned to the Vision Statement. Ms. McDuffee reviewed the alternatives discussed at the August Board meeting. The goal is to find that balanced set of words that means something to the Board and to Staff.

Mr. Jeffers began the discussion stating a preference for alternative three and he noted the reasons why. Ms. Oakley preferred alternative two or three, however she did request for an explanation of the term “gold standard.” Mr. Landis and Mr. Philibert preferred option three, but Mr. Philibert also wanted clarification in regard to “gold standard.” Mr. Gavia gave his thoughts and Mr. Parrish made the suggestion, “The gold standard in delivering and empowering retirement benefits.” Ms. McDuffee suggested, “The leading model for empowering retirement.” Discussion included the meaning behind “leading”, “model”, and “delivering”.

Mr. Jeffers moved that the Board approve for the Vision statement, “To be the model for empowering retirement”. Mr. Landis seconded the motion, which passed 5-0.

The discussion next moved to the Core Values, currently referred to as A.C.T.I.V.E Principles. Ms. McDuffee reviewed the process and in what manner Staff arrived at the modified set of values. The Engagement Committee was created with representative from all departments within the organization. Mr. Schultz reviewed the process the Engagement Committee went through to develop their suggested Core Values and the rationale for splitting the Core Values between employees and leadership. Discussion centered on the word “reward” and its intended meaning. Ms. Oakley suggested that since the set of values introduced is so vastly different from the current Core Values, she felt the Board needed more time to review the changes.

Ms. McDuffee concluded with discussing the performance measures and implementation/reporting schedule. She reviewed the areas where changes were made since the August meeting. Discussion centered on how specific or how broad the performance measures should be. The goal should be to have a mixture of things that are quantifiable and things that are more process oriented. More review is needed to clarify how and when the goals will be reached.

Ms. McDuffee reviewed the preliminary 2018 Board and Committee work-plan and she highlighted the Board’s and Staff’s involvement over this time frame. The Board liked seeing the plan since it gave them an agency wide view of this implementation.

4. <u>Review and Discussion of 2018 Preliminary Operating Budget</u>

Ms. Covarrubias, Ms. Ritter and Mr. Willrich presented the 2018 preliminary operating budget. Ms. Covarrubias explained the internal process in obtaining requests from each functional department, which resulted in the proposed budget.

Ms. Covarrubias began by reviewing the 2017 accomplishments to-date and indicated that she would point out initiatives that align the budget with the strategic plan.

Ms. Covarrubias began by discussing the goals in the draft Strategic Plan. Goal 1 refers to the financial stability of the Plan and includes the proposed actuarial expenditures. GASB planning and implementation as well as the actuarial dashboard were discussed.
Goal 2 relates to customer service and communication. New funds were requested in the 2018 budget to focus on the buy option for the Employer Payroll Reporting project which includes funds for software and consulting; projected costs for the next five years were also provided in the Appendix.

Goal 4 refers to the culture within TMRS and includes objectives to address employee development. The 2018 proposed budget includes funds for eight new positions and funds for succession planning, leadership development/training and employee engagement.

Ms. Covarrubias then compared the 2017 budget with the proposed 2018 budget. Proposed 2018 administrative and capital expenditures are \$34 million, of which \$5 million is for "new" items/projects.

Ms. Covarrubias then walked through the main categories of the budget. Personnel services continues to be the largest category at 51% of the budget; new positions for 2018 were briefly discussed. It was noted that the same benefit package is being proposed.

Professional Services is 30% of the proposed budget, with approximately 40% of that category in the consulting line-item. The two significant new projects were mentioned: Employer Payroll Reporting and Electronic Records Program. Appendices with costs were included in the budget document; in addition, Business Cases were provided under separate cover.

Rentals and Equipment Maintenance is 9% of the proposed budget with \$1.65 million in the "new" data processing line item relating to software and maintenance costs for the Employer Payroll Reporting project.

Miscellaneous is 5% of the proposed budget and is stable from year-to-year. This includes such items as association dues, subscriptions, utilities, building and grounds, and Board expenses.

Capital expenditures were reviewed for new network switches, replacement of the UPS, boiler replacement and furniture purchases.

Appendix A was reviewed which outlines the new positions being requested. Appendix D shows anticipated needs for personnel in future years

Appendix E shows anticipated new major items, classified into five main categories. Highlights were included for the professional services category, which include consulting funds for projects and ongoing compensation studies; in addition, funds for actuarial services include an experience study and asset/liability or asset allocation studies. Capital expenditures includes future phone system replacement and SAN and physical server replacements.

The new positions requested in the 2017 budget were reviewed and the progress made in filling those positions was also discussed. Ms. Ritter reviewed the new positons requested and the associated costs for 2018. Mr. Gavia asked Ms. Ritter to explain the process in place in order to include a position request. Ms. Ritter highlighted the discussions which included vetting the business need driving the request and whether the need was permanent or temporary.

The Employer Payroll Reporting project was discussed and the cost for the total project. Mr. Willrich reviewed the build versus buy analysis as well as the risks and rewards. Mr. Parrish asked about the potential need to replace NextGen in future years. Mr. Willrich discussed this potential need and the reasons why this may be needed. Discussion continued regarding planning for future needs and how the payroll reporting module plays into these long range plans. It was also noted that the existing system contains software components that are no longer supported. There was a lengthy discussion regarding the concept of making changes now or waiting until a decision is made regarding whether or not to replace NextGen. The ability for Staff to work on other TMRS Direct features while purchasing this "off the shelf product" was also discussed.

The Electronic Records Project was discussed and Mr. Willrich highlighted the gap analysis performed by Contoural. The gap analysis resulted in several projects staff wants to undertake. The schedule is based on Contoural's recommendations and it is a bit aggressive. The schedule could be stretched out as staff continues to review the recommendations.

The last topic of discussion was the IT switch replacement due to the age of existing hardware.

5. <u>Consider and Act on Real Return Manager Search Recommendation(s)</u>

Mr. Masthay and Mr. Schultz presented the Real Return manager search recommendations with Mr. White from Albourne America. Three managers are recommended: MTP Energy Opportunities Fund III LLC (Magnetar), Stonepeak Infrastructure Fund III LP (Stonepeak) and Chickasaw Capital Management (Chickasaw). Mr. Masthay discussed the annual pacing model and multi-year pacing model. Annual pacing plans are developed in the context of multiple year investment horizons. This is necessary because private capital investments deploy and return capital over time rather than all at once.

The Real Return portfolio statistics were discussed as well as portfolio exposure by manager asset type and geography as well as private versus public. The approach continues a path of portfolio level conservatism.

Mr. Masthay reviewed the characteristics of Magnetar. The strategy is run by a team of dedicated energy professionals. The team leverages their presence in the market to find privately negotiated transactions in which to deploy capital where capital markets don't operate efficiently and also in special situations. The Investment case and the issues to consider regarding the investment were discussed.

Mr. Schultz reviewed the characteristics of Stonepeak. Stonepeak is a North American infrastructure manager investing in the telecom, water, midstream, transport and power/renewable/utilities sectors. They take a control or structured approach to investing as well as a countercyclical investment approach. The Investment case and the issues to consider regarding the investment were discussed.

The final manager recommendation, Chickasaw, is a Master Limited Partnership (MLP). This fund combines the liquidity of public securities but is effectuated as a pass-through entity, not subject to corporate taxation. This structure of security is commonly employed among mid-stream energy firms involved in the transport of petroleum and other related hydrocarbons. Mr. Masthay noted that Chickasaw is one of the longest standing firms in this space. The Investment case and the issues to consider regarding the investment were discussed.

Mr. White reviewed Albourne's comment with regard to Magnetar due to changes in the market place. He discussed Stonepeak's vision of not "chasing investments," but rather finding investments that are going to be valuable in the future.

Mr. Masthay informed the Board of a co-investment with Orion Mine Finance Co-Fund III of $25 million.

Ms. Oakley moved that the Board approve the following:

1) Authorize the following allocation(s), each as proposed and in accordance with the TMRS Investment Policy Statement, with an initial investment allocation up to the amount set out below, and at fees no greater than presented in the Summary of Recommendations chart in the TMRS Staff memo, each individually contingent on favorable background checks, if required below, and successful negotiation of the investment agreements:

Name of Investment Manager, Investment Fund or Fund Strategy	Asset Class Strategy	Initial Investment Allocation	Background Check Required (Yes or No)
MTP Energy Opportunities Fund III LLC (Magnetar)	Private Real Return	$125 Million	Yes
Stonepeak Infrastructure Fund III LP (Stonepeak)	Private Real Return	$150 Million	Yes
Chickasaw Capital Management (Chickasaw)	Public Real Return	$250 Million	No

2) Approve and incorporate by reference for all purposes the Board Standard Investment Authorizations for each such investment allocation.

Ms. Oakley also moved that the Board ratify the $25 million co-investment with Orion Mine Finance Co-Fund II. Mr. Landis seconded the motion, which passed 5-0.

6. **<u>Consider and Act on Real Estate Manager Search Recommendation(s)</u>**
Mr. Masthay and Ms. Cleak presented the Real Estate manager search recommendation with Mr. Murphy, Courtland Partners, Ltd. Mr. Masthay reviewed the pacing plan and how it relates to the multi-year plan and explained the portfolio shortfalls and actions taken to correct these shortfalls. Two managers are being recommended: TPG Real Estate Partners III, LP (TPG) and Madison Realty Capital Debt Fund IV, LP (Madison). TPG is the first "re-up" in the Real Estate area and Madison is a new manager.

The Real Estate portfolio construction was discussed as well as geographic and property type diversification.

TPG is a Fund III and is focused on opportunistic platform real estate investments in the United States and Europe. The Investment case and the issues to consider regarding the investment were discussed. Mr. Murphy concurred with this recommendation.

Mr. Masthay reviewed Madison. Madison is a vertically integrated real estate debt investment firm with in-house property management, leasing and design, development and construction expertise. The focus is the tri-state New York City area. The Investment case and the issues to consider regarding the investment were discussed. Mr. Murphy indicated that Courland felt this is an attractive opportunity.

Mr. Landis moved that the Board approve the following:

1) Authorize the following allocation(s), each as proposed and in accordance with the TMRS Investment Policy Statement, with an initial investment allocation up to the amount set out below, and at fees no greater than presented in the Summary of Recommendations chart in the TMRS Staff memo, each individually contingent on favorable background checks, if required below, and successful negotiation of the investment agreements:

Name of Investment Manager, Investment Fund or Fund Strategy	Asset Class Strategy	Initial Investment Allocation	Background Check Required (Yes or No)
TPG Real Estate Partners III, LP (TPG)	Opportunistic Real Estate	$100 Million	Yes
Madison Realty Capital Debt Fund IV, LP (Madison)	Value Add Real Estate	$100 Million	Yes

2) Approve and incorporate by reference for all purposes the Board Standard Investment Authorizations for each such investment allocation.

Mr. Philibert seconded the motion, which passed 5-0.

7. **<u>Review and Discussion of Annual Proposed Investment Policy Statement Revisions</u>** ***<u>(formerly #9 on the Wednesday, October 25, 2017 agenda)</u>***
Mr. Carlson presented the annual proposed changes to the Investment Policy Statement (IPS) and he noted that most of these items have been discussed previously with the Board.

The changes on page 10 of the red-line version of the IPS relate to the benchmarks. The static benchmarks have become less useful. Currently, we are doing a benchmark based on roll-up. This is a custom benchmark based on the percentage of the different types of managers within the asset class to create the benchmark. In some cases, we will measure against benchmark in the short term and in the long term, we will measure against the asset class goal. All institutions are struggling with this issue. A document from the Institutional Limited Partners Association was provided as support regarding this topic of setting policy benchmarks.

The second set of changes removes the traditional risk budget from the IPS and replaces it with the "three lines of defense methodology," as discussed with the Board at its February meeting. Ms. Oakley stated she felt that removing the risk budget from the IPS is almost like removing the Board from part of controlling the setting up of the risk tolerance. Ms. Oakley also asked if the Board is setting its risk tolerance somewhere else in the IPS. Mr. Carlson stated that the Board's role in setting risk tolerance is outlined on page 8 of the IPS. Ms. Oakley asked for clarification on the third line of defense to which Mr. Carlson responded. It was recommended to keep some of the deleted language in from Section XIII (A) and to provide clarification under Asset Allocation section.

Mr. Carlson discussed making the language consistent regarding policy benchmarks and asset class goals as seen on page 23. The benchmark mismatch and the recommendation of new benchmarks was discussed on page 24. Mr. Carlson also discussed various changes by adding clarification to the language.

Ms. Oakley suggested adding the term "asset class goals" to the glossary.

8. **<u>Executive Session</u>** ***<u>(formerly #12 on the Thursday, September 21, 2017 agenda)</u>***
At 2:30 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. The meeting was opened to the public again at 3:02 p.m. No action was taken during the Executive Session and all members of the Board that were present before the Executive Session were still present.

9. **<u>Call for Future Agenda Items</u>** ***<u>(formerly #13 on the Friday, September 22, 2017 agenda)</u>***
No items were discussed.

Due to time constraints, the following agenda items were not discussed and may be placed on the agenda for the December 7-8, 2017 Board meeting: Item 7, Private Equity Annual Asset Class Review, Item 8 Investment Staff Quarterly Report/Asset Class Updates, Item 10 Chief Investment Officer Management Update, and Item 11 Executive Director Update.

At 3:02 p.m. the meeting was adjourned.

David Gavia
Executive Director

Jim Parrish
Chair, Board of Trustees