

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

May 21, 2015 – 1:30 p.m.

On May 21, 2015 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

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

Absent: Roel “Roy” Rodriguez

Present also were:

David Gavia, Executive Director
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
Scott Willrich, Director of Information Resources
Holly Macki, Director of Fixed Income
Kristin Qualls, Director of Equities
Jesse Pittman, Project Manager
Robert Klausner, Klausner, Kaufman, Jensen & Levinson
Dimitry Shishkoff, Director of Risk Management
Marc Leavitt, Director of Absolute Return
Chris Schelling, Director of Private Equity
Tom Masthay, Director of Real Estate
Karen Jackson, Executive Assistant
Marcia Beard, RVK
Amy Hsiang, RVK
Joe Newton, Gabriel, Roeder, Smith and Company
Alyssa Martin, Weaver Tidwell
Dan Graves, Weaver Tidwell

Also in attendance:

Sherry Chapman, Investment Accountant
Candace Nolte, Assistant Finance Director
Adrienne Strong, Human Resources Generalist
Debbie Farahmandi, Investment Operations Specialist
Melissa Jerkins, Quantitative Analyst
Peter Jeske, Project Specialist
Michelle Mellon-Werch, Assistant General Counsel
Madison Jechow, Assistant General Counsel
Di Fu, Investment Data Analyst
Nick O'Keefe, Assistant General Counsel
Cindy Morse, Investment Support Analyst
Kate Reed, Investment Risk Analyst
Paula Nguyen, Investments Accountant
David Rodriquez, Regional Manager – City Services
Eddie Schultz, Real Estate Analyst
Carol Leung, Investment Analyst
Ariel Chou, Actuarial Analyst
Mel Thomas, Editor
Greg Shipley, Combined Law Enforcement Associations of Texas
Alex Cramer, Arlington Professional Fire Fighters
Bob Scott, City of Carrollton
George Kauffman, City of Garland
David Riggs, Texas State Association of Fire Fighters
Keith Dagen, Government Finance Officers Association of Texas
Anthony Chambliss, Sixthriver Architects
Perwez A. Moheet, City of Kyle

Ms. Oakley called the meeting to order at 1:30 p.m. and gave the invocation.

1. Consider and Act on Adoption of Minutes from the March 26-27, 2015 Regular Meeting of the Board of Trustees

Mr. Gavia stated that Staff had nothing to add to the minutes as presented. There were no changes suggested by the Board.

Mr. Parrish made a motion that the Board adopt the minutes from the March 26-27, 2015 Meeting of the Board of Trustees. Mr. Landis seconded the motion, which passed 5-0.

2. Chief Investment Officer Management Update, Including Governance, Personnel, Manager Updates and Other Investment Related News or Matters

Mr. Carlson began with a staffing update. Two additional analysts, one each for Fixed Income and Absolute Return have accepted positions with start dates in June. The next search will be for the Private Equity Analyst. Mr. Carlson also reported a fee adjustment by one of the equity managers resulting in an approximately \$54,000 annual savings.

3. Discussion on Draft Asset Allocation Study

Mr. Carlson discussed the objectives regarding the asset allocation study and that this discussion is educational, leading to an action item for the June Board meeting.

Ms. Beard reviewed the asset allocation background from 2008 to the present, highlighting major actions taken by the Board. The asset allocation process is reviewed with the Board every one, three and five years, for potential changes. She discussed TMRS' asset management decision flow process indicating the frequency of decisions for both the short and long-term. Mr. Carlson reviewed the investment beliefs of the Board which are included in the Investment Policy Statement. The philosophy and framework for Board actions were reviewed which are designed to provide the highest probability of meeting or exceeding the Board's objectives at a controlled level of risk with adequate liquidity. He discussed the asset allocation inputs highlighting the risk and return premia of various asset classes. The trend of decreasing investment return and flat to increasing risk level was discussed along with the fact that achieving adequate portfolio returns will be more difficult going forward.

Ms. Beard reviewed RVK's capital market assumptions for returns and standard deviation. She discussed the drivers in each of the general asset classes. Mr. Carlson reviewed the comparison of RVK, banks and other investment consultants return assumptions indicating that all assumptions we are using are within the normal range. The difference between arithmetic and geometric returns was discussed. Geometric returns take into account the volatility of returns while arithmetic returns are a simple average of returns.

Ms. Beard explained mean variance optimization which is the mathematical process and a quantitative tool to identify various optimal asset allocation target portfolios that have the best risk/return tradeoffs. She reviewed the benefits and shortcomings of using this type of quantitative modeling as well as two key inputs, passive investments and inflation assumptions. The current strategic allocation targets and ranges were discussed with regard to the achievement of long-term investment objectives and acceptable risk parameters. The asset allocation study is intended to capture the expected return, risk and correlation with other asset classes over the long-term. Mr. Carlson reviewed different portfolios on the "efficient frontier" beginning with an unconstrained model and then applied constraints to the different asset classes. The general impact of the review is to move further away from core fixed income because 30% of the portfolio is earning 2.15% which is forcing the rest of the portfolio to work that much harder. The discussion reviewed various allocations to different asset classes and the potential expected impacts on risk and returns. Mr. Carlson asked the Board for feedback on what they would like to see before the June meeting. Mr. Parrish asked for return constraints to range from 6.50% to 7.00%. Mr. Philibert requested to constrain the standard deviation at the current level.

Mr. Carlson discussed the role of active management. Some important factors of active management are: 1) qualified staff, which we have, 2) efficient and timely opportunity identification, 3) effective due diligence and selection process and 4) timely retention of

managers. Characteristics to improve the odds of success include: 1) proper benchmarks, 2) active management risk budgeting, 3) sufficient asset class allocation ranges and 4) timely review of investment opportunity set and timely execution of investment decisions.

4. Consider and Act on Non-Core Fixed Income Manager Recommendation(s) for Emerging Debt Strategy

Ms. Macki reviewed the Non-Core Fixed Income timeline leading to today's recommendations regarding the Emerging Market Debt mandate. Ms. Hsiang discussed the manager search process. After an initial screen, thirty managers were selected to receive a Request for Information. Only twenty candidates responded. An additional screening was performed based on strategies offered and historical performance. Ten managers were selected to move forward. Two managers were selected after further due diligence, including on-site visits with the managers. Ms. Hsiang discussed the minimum qualifications used in the search. Mr. Klausner highlighted the minimum qualification that a manager must certify in writing a willingness to act as a fiduciary and be bound by the Prudent Expert Rule.

Ms. Macki reviewed the firm and team characteristics of the finalists, Alliance Bernstein L.P. (AB) and BlueBay Asset Management LLP. She discussed the strategy characteristics, performance expectations and distinguishing features of each finalist. She discussed the risk budgeting impact on both excess return and total return. Ms. Macki concluded by reviewing the recommendation of allocating \$240 million to each manager for a total of \$480 million or 2% of the total fund.

Mr. Parrish made a motion to the Board to approve allocations to Alliance Bernstein L.P. and BlueBay Asset Management LLP as investment managers for the Emerging Market Debt mandate as presented and in accordance with the IPS Guidelines, at fees no greater than proposed, each contingent on successful negotiation of the contracts; and, authorize the Executive Director to decide on the final legal structures (including, without limitation, fund of one limited partnership structures and separately managed account structures) for investment in non-core fixed income structures of the managers or their affiliates and to negotiate, execute, and deliver contracts satisfactory to the System for such investments. Mr. Jeffers seconded the motion, which passed 5-0.

5. Receive Report on Real Estate Investment Audit

Mr. Gavia introduced Alyssa Martin and Dan Graves of Weaver Tidwell to present the results of the audit of the Real Estate Investment process. Ms. Martin discussed the scope of the audit beginning with an overview of the Real Estate Investment program. Until 2009, the TMRS investment objective was income-focused. The passage of HB 360 in May 2009 enabled TMRS to pursue a total return investment strategy.

The scope of the audit focused on the real estate investments processes as they pertain to public and private real estate investments of TMRS. The five objectives of the audit were listed and discussed. Ms. Martin reviewed the fieldwork procedures and identified twenty-two internal controls in place which were grouped into four general areas. They identified several opportunities for improving the effectiveness of controls over the real estate

investment process. The controls were rated overall as satisfactory, with four satisfactory ratings and one strong rating for the five audit objectives.

Mr. Graves presented the eleven different findings within the five objectives. Ms. Martin discussed the nine recommendations to assist management in improving the program. The results were presented to the Internal Audit committee at the conclusion of the audit.

Mr. Parrish discussed the conference call with the Internal Audit committee. Clarification of the recommendation regarding an investment advisory committee was requested. Ms. Martin explained the structure of various Investment Advisory committees.

6. Consider and Act on Approving Building Remodel Budget Limits and Authorizing Executive Director to Select and Negotiate Contract with Contractor within Budget Limit

Mr. Davis gave a brief overview of the project to date and reviewed the space use planning project leading to the preliminary design work. The second phase of the project included the Request for Proposal, competitive proposals received, the clarification process, bid review and contractor interviews. Mr. Davis discussed the original funds budgeted for the project and reviewed the current projected cost estimates. The Board asked several questions regarding the Request for Proposal process. Mr. Davis concluded with Staff's recommendation that Rand Construction be hired as the general contractor for the project and Staff be given permission to proceed with the budget not to exceed \$1.9 million.

Mr. Landis moved that the Board authorize the Executive Director to negotiate a contract with Rand Construction as general contractor and other contractors as necessary with the project not to exceed \$1.9 million. Mr. Jeffers seconded the motion, which passed 5-0.

7. Executive Session

At 4:20 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 5:14 p.m.

At 5:16 p.m. the meeting was adjourned.

David Gavia
Executive Director

Julie Oakley
Chair, Board of Trustees