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

September 19, 2013 – 1:00 p.m.
September 20, 2013 – 8:00 a.m.

On September 19, 2013, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 1:00 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
Jim Parrish, Vice Chair
April Nixon
Bill Philibert
Julie Oakley

Present also were:
David Gavia, Executive Director
Ian Allan, Director of Internal Audit
Rhonda Covarrubias, Director of Finance
Eric Davis, Deputy Executive Director
Kristi O'Hara, Director of Human Resources
Nancy Goerdel, 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 Real Estate
Bonnie Mitra, Director of Fixed Income
Debbie Munoz, Director of Member Services
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
Todd Shupp, R. V. Kuhns & Associates
Amy Hsiang, R. V. Kuhns & Associates
Tracey Nykiel, R. V. Kuhns & Associates
Ed Schultz, ORG
Barbara McDowell, ORG
Nancy Williams, Hewitt EnnisKnupp

Also in attendance:

Sherry Chapman, Investment Accountant
Debbie Farahmandi, Investment Operations Specialist
Howell Hollis, Investment Analyst
Peter Jeske, Support Services Analyst
Chris Jones, Combined Law Enforcement Associations of Texas (CLEAT)
George Kauffman, City of Garland
Scott Kerr, Texas State Association of Firefighters (TSAFF)
Kevin Lawrence, Texas Municipal Police Association
Carol Leung, Investment Analyst
Randle Meadows, Arlington Police Association
Michelle Mellon-Werch, Associate General Counsel
Candace Nolte, Controller
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
Juan Garcia, Governor's Office
Meredyth Fowler, Speaker's Office
Greg Shipley, Combined Law Enforcement Associations of Texas (CLEAT)
Mel Thomas, Editor
Lorraine Moreno, Membership Development Specialist
Rene Nunez, Former Chairman, Texas Permanent Fund

Mr. Rodriguez called the meeting to order at 1:00 p.m. and gave the invocation.

1. **Consider and Act on U.S. All Cap Equity Manager Recommendation(s)**
   Mr. Gavia introduced Kristin Qualls and Tracey Nykiel of R.V. Kuhns to discuss the U.S. All Cap satellite/active Equity Manager recommendations. The focus of this search was on U.S. Equity All Cap managers and it is driven by the TMRS Strategic Plan incorporating value-add investment goals through asset class structure and active management decisions. Ms. Qualls gave a quick overview of the All Cap satellite strategies. The objective of the search was to select managers to implement an allocation to U.S. Equity All Cap with the focus on traditional and opportunistic strategies. Ms. Nykiel reviewed the specifics of the search process which began with 21 potential candidates that were narrowed down to the two recommended managers, Epoch U.S. Choice (traditional strategy) and Sasco Contrarian Value (opportunistic strategy). A short list of managers that met minimum requirements was developed for active U.S. Equity All Cap products that would complement TMRS' passive and rules-based equity strategies while adding value. Ms. Qualls reviewed the initial evaluation by both TMRS and R.V. Kuhns of questionnaire responses and the evaluation criteria utilized. Four finalists were selected for on-site due diligence visits. The final evaluation resulted in Epoch and Sasco ranking highest on a quantitative and qualitative basis. Board member questions about the manager rankings provided for further discussion about the quantitative and qualitative aspects of the evaluation that resulted in the rankings.

Ms. Qualls next highlighted the candidate characteristics of Epoch U.S. Choice including industry experience of the portfolio management and analyst teams, size of the firm, quantitative analysis, risk management attributes of the investment team, strategy characteristics, performance expectations, "takeaways" and other considerations regarding Epoch. Ms. Nykiel highlighted the characteristics of Sasco Contrarian Value. She discussed the industry experience of the portfolio management team and strategy characteristics as an opportunistic All Cap product. Ms. Nykiel discussed the Contrarian investment style and concluded that this strategy complements Epoch's strategy quite well.

Ms. Qualls discussed the risk budget analysis of the combination of both managers, which validated that Epoch and Saco are a solid combination that is expected to provide TMRS with additional excess return for an acceptable amount of additional risk.

Ms. Qualls concluded that TMRS Staff and R.V. Kuhns concurred with the recommendation that both Epoch and Sasco be selected for a $200 million mandate each for a total of $400 million, through separately managed accounts which allow for better control. R.V. Kuhns and TMRS staff will determine if a Transition Manager is required as part of the implementation process. The Board inquired about the size of the mandates and Ms. Qualls noted that the size of each rules-based strategy implemented in late 2012 and early 2013 were considered and that because these mandates provide broader exposure to the markets, in aggregate they will have a larger allocation. The Board further discussed the recommendation including fee proposals and it was noted that they are based in part on a manager's overhead relative to assets under management.

Mr. Parrish made a motion for Epoch Investment Partners, Inc., U.S. Choice and Sasco Capital, Inc. U.S. Contrarian Value strategy for $200 million mandate each as a separately managed account at fees not to exceed what was stated. Ms. Nixon seconded the motion; which passed unanimously by the members of the Board present, 5-0.

2. **Consider and Act on Non-Core Fixed Income Manager Recommendation(s)**

Mr. Gavia introduced Mr. Bonnie Mitra and Ms. Amy Hsiang from R.V. Kuhns to begin discussion on manager recommendations for the Non-Core Fixed Income Allocation. This is one part of the overall Non-Core allocation focusing on the U.S. Bank Loans/Collateralized Loan Obligations (CLOs) components which was approved by the Board at the June 2013 meeting.

Ms. Hsiang gave an overview of the Manager Search process stating that they began with a list of 19 "best ideas" Bank Loan/CLO managers that have deep experience in investing in both Bank Loans and CLO debt tranches and have posted strong returns in the Bank Loan space. Mr. Mitra noted there is no single CLO index and there are not many managers dedicated to the CLO space so experience investing in CLO debt was considered. Ms. Hsiang discussed the search process and initial scoring which cut the initial group from 19 down to four semi-finalists. On-site due diligence visits were conducted to the four semi-finalist managers, which included multiple presentations and interactions with candidate portfolio managers, research analysts, traders, risk management, operations, legal and compliance. Ms. Hsiang reviewed the screening criteria and then moved into the scoring which showed the managers that made it through each phase of the screening process resulting in three finalists.

Mr. Mitra discussed the characteristics of the three finalists: Credit Suisse, Highland Capital Management, L.P. and Guggenheim. He reviewed Credit Suisse's background and investment management style. Credit Suisse was founded in 1997 with origins dating back to 1935. They are one of the largest, most experienced managers of senior secured bank loans with a historically stable investment team. There were no issues regarding risk, execution, compliance and ethics. Performance and fees were also reviewed.

Highland Capital Management, L.P. was reviewed next. They were founded in 1993 and this is the firm that institutionalized the bank loan market; they are widely regarded as a pioneer in managing leveraged credit, having launched one of the first non-bank issued CLOs in 1996 and institutionalizing the bank loan sector as an investment asset class. There were no issues regarding risks, execution, compliance or ethics. Performance and fees were also reviewed. Mr. Parrish asked for an explanation of the performance fees. Mr. Mitra responded and noted that the incentive fee is relative to the benchmark but subject to a high water mark.

The third company, Guggenheim Partners Investment Management, LLC was reviewed by Mr. Mitra. Guggenheim was founded in 1999 with several senior managers and corporate credit/structured products. This is a top down macro-economic portfolio management strategy which funnels into a proprietary group model that incorporates fundamental bottom-up credit research; this process has delivered outperformance attributed to proactive relative value decisions. Again, he discussed that there were no issues on risk, execution, compliance or ethics. Performance and fees were also reviewed.

Mr. Mitra reviewed the performance summaries showing that the combination of these three managers gives you the best risk/reward dynamic. He reviewed the risk budgeting impact, stating that when combined with the All Cap Equity Strategy being recommended today, expected return increases by 0.17% and tracking error decreased by 0.1%.

Mr. Mitra discussed that because there is a legal uncertainty as to whether bank loans are "securities" under Texas law, the structure being recommended is a "fund of One" LP or LLC which adds a separate layer of expenses. Assets would be kept at State Street or the manager's lowest cost custodian.

Mr. Philibert made a motion to approve $250 million each to Credit Suisse Asset Management LLC, Highland Capital Management L.P. and Guggenheim Partners Investment Management L.P. for Bank Loan/CLO mandates as presented at fees no greater than proposed, and authorize the Executive Director to negotiate the contracts; except that funding of these mandates will not occur until IPS guidelines are presented and approved by the Board of Trustees. Ms. Nixon seconded the motion; which passed unanimously by the members of the Board present, 5-0.

3. **Quarterly Real Estate Investment Report**

Ed Schwartz and Barbara McDowell from ORG presented the first quarter 2013 Real Estate performance report. Through the first quarter, the portfolio total commitments level is at about 50% of the total allocation. At present, the portfolio is outperforming the ODCE Net of fees. The portfolio is fairly well diversified by manager, property type and geographically. Mr. Schwartz reviewed the portfolio summaries by manager.

Ms. McDowell discussed diversification and she reviewed the Policy Target Compliance. She stated that TMRS is well within the target range and likewise we are within range on property type, geographic and economic location diversification, manager diversification, vintage year, and leverage ratio.

4. **Consider and Act on Real Estate Manager Recommendation(s)**

Holly Macki began the discussion by reviewing the Real Estate Investment timeline and the search process. Six managers were identified through the manager screening, one Core open-end fund, and five Value-Add and Opportunistic closed-end funds. She reviewed the due diligence ranking factors and final manager rankings. Three managers were selected for further due diligence and on-site visits. The top two ranking managers were selected for recommendation to the Board. Additionally, the evaluation team recommended additional allocations to two existing TMRS managers.

Mr. Schwartz discussed the Real Estate finalist characteristics beginning with Greenfield Acquisition Partners VII. He reviewed the fund's investment strategy and its focus on suburban office and industrial properties, in properties with strong or improving supply and demand fundamentals and cyclically weak capital interest ("situational opportunities") and in public university student housing developments. Mr. Schwartz discussed the fund details, target returns and target leverage. A firm overview, investment merits, including conservative underwriting standards and use of leverage was discussed. Material risks were also covered. Within material risks, Mr. Schwartz highlighted the dependence on one key principal, Eugene Gorab. Questions were raised as to why projected fees were higher than Fund VI and those questions were addressed.

Mr. Schwartz then moved on to review the Stockbridge Value Fund II. This is a classic value-add fund focusing on multifamily, industrial, office and retail with target markets on the West Coast (including the Interior West), East Coast and Sunbelt. He reviewed fund details, returns and leverage. The management fees are lower than market, although higher than Fund I. A firm overview and investment merits were reviewed, including the merits of a seasoned investment team that has worked together over twelve years. Material risks were also covered, including the team's short history with Stockbridge, however this is mitigated by the team's experience together at another firm.

Ms. McDowell reviewed the characteristics of both Harrison Street Securities and Stockbridge Smart Markets Fund.

Ms. Macki presented the Staff's recommendations on the managers and allocating the $250 million as follows:

SECTOR	FUND	ALLOCATION
Core	Stockbridge Smart Markets*	$50 million
Core Real Estate Securities	Harrison Street Securities*	$50 million
Value-Add/Opportunistic	Stockbridge Value Fund II	$75 million
Value-Add/Opportunistic	Greenfield Fund VII	$75 million

Ms. Oakley asked if the Staff was still comfortable with the 20% maximum per manager within the Real Estate category. Ms. Goerdel answered that the limits remain appropriate.

Ms. Nixon made a motion to recommend that the Board of Trustees 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, registration under the Investment Advisor's Act of 1940 as amended, and successful negotiation of the contracts at management fees substantially comparable to those proposed: Stockbridge Smart Markets for an allocation of $50 million, Harrison Street Securities for an allocation of $50 million, Stockbridge Value Fund II for an allocation of $75 million and Greenfield Fund VII for an allocation of $75 million. Mr. Parrish seconded the motion; which passed unanimously by the members of the Board present, 5-0.

5. **<u>Consider and Act on Absolute Return Strategy and Authorize Manager Search</u>**
Mr. Mitra, Mr. Shishkoff and Mr.Shupp from R.V. Kuhns began the presentation on Absolute Return Strategies (ARS). This has been a four year process to assess the strategy, provide Board education and review all aspects of ARS.

Mr. Mitra began by reviewing the ARS philosophy which is to generate returns regardless of the directionality of market movements and target positive returns in every market environment. He highlighted four different types of performance drivers: 1) Manager skill in rotating (long/short trading); market factors based on valuation; 2) Manager skill in navigating less liquid, non-public and opaque markets; 3) Manager skill in navigating special situations; and 4) Manager skill in predicting and capturing market trends. The objectives of ARS include portfolio diversification, stable return stream/controlled volatility, and a positively skewed risk/reward profile.

Mr. Mitra discussed the ARS benchmark structure. The peer group will be the HFN Fund of Hedge Funds Multi-Strategy Index and strategic goal will be Cash (3-month LIBOR) plus 5%. He reviewed risk benchmarks, the strategic risk/reward benchmark as well as liquidity and fees, noting that the average fee of 2% Management plus 20% Performance for underlying managers is typical. Mr. Shupp acknowledged that fees in this space are high, but that R.V. Kuhns believes the results warrant it, and further noted that often in a Fund of Funds structure those fees can be negotiated lower. In the context of the overall portfolio, the addition of ARS makes the portfolio more efficient.

The two fundamental risk questions relate to understanding the manager's market risk exposure and whether they are adhering to the original investment thesis. Mr. Shishkoff discussed how risk analysis and evaluation of the fundamental risks is achieved by historical returns risk analysis system, holdings based risk analysis, and qualitative evaluation and dialogue with the manager. He indicated that risk analysis for ARS would require the purchase of a returns based analytics system, and an additional Risk Analyst with a strong statistics background.

Mr. Mitra discussed the two common ARS implementation approaches: a customized "Fund of One" approach and direct hedge fund investments with specialized consultant support. He added that many plans start with the Fund of One approach before evolving to a direct hedge fund investment model. There are various fees associated with each approach.

Mr. Mitra then outlined the Investment team's recommendation of starting the implementation through a customized Fund of One approach to get the assets invested expeditiously, and later researching the direct hedge fund approach to assess the feasibility of migrating to that structure in 3-4 years. Mr. Mitra also reviewed the resources needed for implementation through the Fund of One approach, noting that in addition to the resources described by Mr. Shishkoff for risk management, an additional Investment Analyst would be needed to support analysis and oversight. These resources will be incorporated into the 2014 Budget Proposal.

Mr. Parrish made a motion that the Board of Trustees approve the implementation of Absolute Return Strategies as presented and authorize Fund of One manager searches. Ms. Oakley seconded the motion; which passed unanimously by the members of the Board present, 5-0.

After the vote was taken, Ms. Oakley left the meeting at 4:20 p.m.

6. Quarterly Investment Report

Ms. Goerdel and Ms. Beard began this update by reviewing TMRS' allocation versus its peers. The TMRS actual allocation has more exposure to fixed income than its peers, but the portfolio continues to move towards a well-diversified structure as fixed income is reduced. Ms. Goerdel next reviewed TMRS fund performance versus benchmarks. We have exceeded the benchmarks at five years, but not the policy target of 7%. TMRS Fund performance versus peers was reviewed next. In the one to three year range, as expected, we have underperformed our peers, but at the five and seven year periods, we have outperformed.

Ms. Goerdel stated that this has been a very volatile year; it is difficult to forecast how the year will end. She reviewed the Rebalancing Policy, showing where funding will come from for new allocations for the remain\der of 2013 and through 2014.

7. **Executive Session**

At 4:42 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 5:46 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

At 5:46 p.m. the meeting was recessed until 8:00 a.m. on Friday, September 20, 2013.

David Gavia
Executive Director

Roel "Roy" Rodriguez
Chair, Board of Trustees