

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

March 21, 2013 – 2:00 p.m.

March 22, 2013 – 8:30 a.m.

On March 21, 2013, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 2:00 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

Roel (“Roy”) Rodriguez, Vice-Chair

Jim Parrish

Frank Simpson

Absent: Ben Gorzell, Jr.

April Nixon

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, Director of Actuarial Services
Christine Sweeney, General Counsel
Debbie Munoz, Director of Member Services
Bill Wallace, Director of Communications
Dan Wattles, Director of Governmental Relations
Scott Willrich, Director of Information Resources
Holly Macki, Director of Real Estate
Kristin Qualls, Director of Equities
Dimitry Shishkoff, Director of Risk Management
Stacy White, Executive Assistant
Marcia Beard, R. V. Kuhns & Associates
Robert Klausner, Klausner Kaufman Jensen & Levinson
Nancy Williams, Hewitt EnnisKnupp

Also in attendance:

Sherry Chapman, Investment Accountant
David Crow, Arlington Fire Fighters
Debbie Farahmandi, Investment Operations Specialist
Howell Hollis, Investment Analyst
Chris Jones, Combined Law Enforcement Associations of Texas (CLEAT)
George Kauffman, City of Garland
Scott Kerr, Texas Association of Fire Fighters

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 Rodriguez, Regional Manager – City Services
Bob Scott, GFOA/City of Carrollton
Mel Thomas, Editor

Ms. Oakley called the meeting to order at 2:02 p.m. and Roy Rodriguez gave the invocation.

1. Consider and Act on Real Estate Manager Recommendations (taken out of order)

Ms. Macki and Mr. Schwartz presented this item. Ms. Macki reviewed the search process timeline which began in December 2012 when the Board approved the 2013 Real Estate Implementation Plan, which called for a commitment of up to \$600 million in Core, Value-Added and/or Opportunistic real estate investments and authorized staff to conduct manager searches as needed to fulfill the allocation. Ms. Macki provided details regarding the manager screening process which was used to identify the most attractive Core and Value-Add/Opportunistic investment opportunities suitable for TMRS' Real Estate Implementation Plan. Ms. Macki added that ORG evaluated its universe of over 700 managers and inquired with several managers considering new investment funds and included opportunities where TMRS could participate as a founding investor. She reported that six managers were identified for further review. Based on specific scoring criteria, the top three ranked managers were selected for further due diligence. The three managers selected for recommendation include two core strategies and one value-add/opportunistic strategy. Ms. Macki then went into further detail and reviewed the manager screen results, the due diligence ranking factors and provided the final rankings for each real estate strategy. The three recommended managers each have unique strategies and characteristics that ORG and TMRS believe will help achieve the Board's goal for the real estate asset class of maximizing risk-adjusted returns, providing diversification across property types and sectors, and capitalizing on unique investment opportunities.

Mr. Schwartz and Ms. Macki then reviewed and discussed the real estate finalist characteristics. Mr. Schwartz first highlighted the Invesco U.S. Income Fund "Core" strategy with a recommended investment of \$100 million. This strategy will focus on stable income return opportunities while emphasizing high relative income, growth of income, and preservation of capital. He then presented the firm overview and investment merits and risks. Mr. Schwartz next moved to AbaCore I. The fund strategy focuses on core multi-family opportunities in select markets across the United States. AbaCore I is a closed-end fund with an estimated fund term of ten years. He provided a firm overview, investment merits and risks. Mr. Schwartz then moved on to discuss Lubert-Adler Fund VII. Their investment strategy will be focused on building a diversified portfolio comprised mostly of middle market rental assets (retail, multi-family, hotel and industrial) by combining acquisitions with value add business plans. The fund will be closed-end with an estimated fund term of seven years. He provided a firm overview, investment merits and risks.

Mr. Jim Parrish moved that the Board allocate \$100 million to the Invesco U.S. Core Income Fund; \$75 million to AbaCore I; and \$75 million to Lubert-Adler Fund VII for a total investment of \$250 million. This approval is 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. Mr. Frank Simpson seconded the motion; which passed unanimously by the members of the Board present, 4-0.

2. Introduction to the Non-Core Fixed Income Allocation (taken out of order)

Mr. Gavia introduced Mr. Mitra, TMRS Director of Fixed Income. Mr. Mitra began his presentation by introducing Howell Hollis, who replaced Katie Reissman as the Fixed Income Investment Analyst. Mr. Mitra then provided a timeline for the recommendation to implement the Non Core Fixed Income allocation which began in the summer of 2012. The process began with an internal study to assess the suitability of various Non Core Fixed income sectors, in view of progressively declining interest rates and increasing interest rate risk in the core, fixed income portfolio. Mr. Mitra reported that TMRS Staff, in conjunction with RV Kuhns, proposed and the Board approved a target 10% allocation to Non-Core Fixed Income in the 2012 asset allocation study.

Mr. Mitra stated that in the U.S. Bond Market, real yields are running negative with 10-year bond yields at 2% and inflation at 2.5%. The goal is to increase the yield of the overall portfolio by taking on a little more credit risk while reducing the exposure to interest rate risk by lowering duration. With employment numbers trending upward, the unemployment rate may begin to decline, thereby triggering the Fed to gradually start raising interest rates.

Mr. Mitra then reviewed the expected structure of the Non-Core Fixed Income portfolio. The overall objective is to diversify assets from Core U.S. Fixed Income to Non-Core; increase yield in the fixed income portfolio; and reduce the overall exposure to interest rate risk in low interest rate environment. To attain these objectives, a blended 50:50 index between U.S. High Yield and Emerging Market Debt is being considered as the top-line Non Core Benchmark. Against the top-line benchmark, the eligible investment universe for the Non-Core Fixed Income allocation would include High Yield, Emerging Market Debt, Bank Loans including structured bank loans, and U.S. Mortgage Credit. Mr. Mitra stated that U.S. High Yield traditionally provides a higher income and less interest rate risk to compensate for greater credit risk, but at current market levels look relatively expensive for unsecured, non-investment grade credit exposure. On the other hand, 1st lien, senior secured U.S. Bank Loans featuring floating rate coupons currently offer better risk-reward.

Mr. Mitra then compared the economic indicators of emerging markets, such as Brazil, Russia, India, China, South Africa and South Korea to the Developed Markets, primarily U.S., Europe and Japan. The large emerging markets have higher growth and less leverage relative to the developed world, making them less risky from a traditional credit perspective. Combined with higher real interest rates and upward sloping yield curves, emerging market debt currently offers better risk-reward versus developed market debt on a go forward basis.

Mr. Mitra then discussed the U.S. Commercial Mortgage Backed Securities (CMBS) structure which is a securitization of commercial real estate loan pools. The ultimate risk with CMBS is the decrease in underlying commercial property values. Certain debt tranches in legacy CMBS securitizations are trading at a discount to fair value given borrower equity in the underlying properties and subordination levels in the securitization trusts. These securities offer appreciably higher income relative to core domestic investment grade bonds with marginally higher credit risk.

Mr. Mitra then discussed U.S. Non-Agency Residential Mortgage Backed Securities (RMBS), which are the securitization of home loans not guaranteed by U.S. GSE's (Fannie Mae/Freddie Mac). Mr. Mitra stated that these securitizations are attractive as their pricing reflects diminished property values, and trade at 58 to 87 cents of par value. These securities provide loss-adjusted yields which range from 5.5% to 6% and with home prices continuing to improve, could yield as much as 6.5% to 9%.

Mr. Mitra then moved to the efficient frontier modeling of this allocation with an expanded universe (bank loans, CMBS, RMBS in addition to High yield and EMD) versus the benchmark. This provides an opportunity for TMRS to improve risk/return opportunity relative to the Non Core Fixed Income benchmark based on a set of assumptions.

Mr. Mitra next discussed implementation issues regarding the investment structure which will need to be validated by legal counsel. These include (1) separately managed accounts for sectors where underlying holdings are deemed as "securities" from a statutory perspective; and (2) co-mingled or "Fund of One" structures for markets where underlying holdings are not "securities" (for example, bank loans). The next steps needed are to (1) develop an operational structure with the custodial bank, (2) develop an operating plan for financial controls, and (3) develop compliance and performance attribution processes with TMRS Risk Management.

Mr. Mitra concluded by reminding the Board that this 10% allocation (currently \$2 billion) is a reallocation, half each from Passive Equity (Capital Appreciation) and Core Fixed Income (Capital Preservation/Income). He added that this re-allocation to Non-Core Fixed Income, a sector whose returns are predicated on income and capital appreciation, will allow TMRS to boost yield and reduce interest rate exposure in the fixed income portfolio, without altering the risk characteristics of the overall TMRS portfolio.

3. Quarterly Real Estate Investment Report (taken out of order)

Mr. Schwartz presented the third quarter Real Estate Portfolio Summary. Mr. Schwartz reported that the Real Estate portfolio is now funded at 1.6% out of the total 10% allocation. The third quarter and since inception returns have underperformed the benchmark, both gross and net of fees, due primarily to the "J" Curve effect. Mr. Schwartz added that the expectation, beginning with the next quarter is that the real estate portfolio should outperform the benchmark.

Mr. Schwartz next discussed Policy Target Compliance. He added that although the portfolio is not yet within any of the target ranges, the Policy permits this concentration during the initial investment phase of the real estate program. He then reviewed additional

information regarding diversification of the real estate portfolio by strategy, manager, property type and geographic location.

In response to a question from Mr. Parrish, Mr. Schwartz indicated that while TMRS' portfolio may be "overweight" in multi-family and industrial property types at this time, it is still within TMRS' policy guidelines.

4. Consider and Act on Renewal of ORG Portfolio Management Contract

This item was not taken up as the contract for ORG has two, one year renewals remaining.

5. Quarterly Investment Report

Ms. Beard began her presentation by reviewing TMRS' allocation. TMRS is currently overweight in equities relative to its target allocation (42.6% versus 35%). Relative to its peers, the TMRS actual allocation has more exposure to fixed income, but the portfolio continues to move towards a well diversified structure as fixed income is reduced to fund new strategies.

Ms. Beard discussed total fund performance versus benchmarks and reported that the total fund composite returned 5.97% over the trailing five-year period ending December 31, 2012, meeting the Investment Policy Objective for performance relative to the Actual Allocation Benchmark, but lagging the Policy Index. The Total Fund outperformed the Actual Allocation Benchmark by 0.13% over the five-year period, partially due to manager outperformance. The Total Fund underperformed the Policy Index by 0.28% over the same period, primarily due to strong recent performance by the alternative asset classes the system is currently in the process of funding.

Ms. Beard reviewed the Total Fund Risk/Return profile vs. peers, reporting that for the past 5 years, TMRS has experienced higher returns with less risk than the median fund, although over the past 10 years, TMRS's underweight to equities led to lower returns with similar risk versus the median fund. She next reviewed the asset class composite performance noting that the Fixed Income, Real Return and Real Estate composites provided diversification benefits during 2012. She added that equities made broad gains during the quarter, adding to strong performance for the calendar year, but noted that the equity markets continue to be volatile.

Ms. Goerdel gave an update on the current market environment, noting that equities performed well in January. She reviewed January/YTD 2013 performance. After reviewing the portfolio manager structure, Ms. Goerdel also provided a portfolio diversification status update.

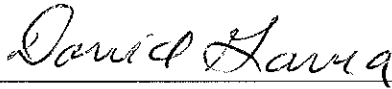
Ms. Goerdel noted that the risk report noted no risk concerns relative to compliance or market exposure for the fourth quarter 2012.

6. Executive Session

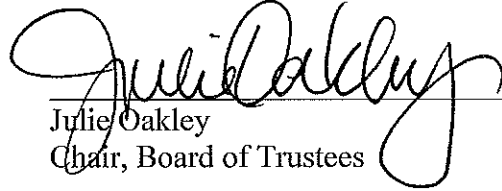
At 5:05 p.m., the Board entered into Executive Session, pursuant to Texas Government Code §§551.071 and 551.074 to consult with Legal Counsel to receive legal advice, and to discuss personnel matters. No action was taken during the Executive Session and the meeting was

opened to the public again at 6:30 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

At 6:30 p.m., the meeting recessed until 8:30 a.m. on Friday, March 22, 2013.



David Gavia
Executive Director



Julie Oakley
Chair, Board of Trustees