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

October 27, 2010

On October 27, 2010, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a special meeting at 12:00 p.m. at the Omni Corpus Christi Hotel – Bayfront, 900 North Shoreline Boulevard, Corpus Christi, Texas, with the following members present:

Board of Trustees
April Nixon, Vice Chair
Pat Hernandez
Julie Oakley
Frank Simpson
Roel ("Roy") Rodriguez

Absent: Ben Gorzell, Jr., Chair

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
Holly Macki, Director of Real Estate
Cindy Morse, Executive Assistant
Debbie Munoz, Director of Member Services
Christine Sweeney, General Counsel
Bill Wallace, Director of Communications
Scott Willrich, Director of Information Resources
Robert Klausner, Klausner & Kaufman, P. A.
Pete Madsen, R. V. Kuhns & Associates, Inc.
Ed Schwartz, ORG Portfolio Management LLC

Guests:
Bonita Hall, Texas Municipal Human Resources Association
Randle Meadows, Arlington Police Association
Jim Moore, City of Mesquite Firefighters
Greg Vick, Texas City Management Association
In Mr. Gorzell’s absence, the meeting was chaired by Ms. Nixon. She called the meeting to order at 12:00 p.m. and also gave the invocation.

1. **Executive Session**
   At 12:01 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 12:37 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

2. **Consider and Act on Adoption of Minutes from the September 24, 2010 Regular Meeting of the Board**
   Mr. Gavia presented the Minutes and asked if there were any questions or revisions. As there were none, Mr. Rodriguez moved that the Minutes be adopted as presented. Ms. Hernandez seconded the motion, which passed unanimously.

3. **Real Estate Educational Presentation**
   Mr. Gavia introduced Mr. Schwartz from ORG Portfolio Management, LLC. Mr. Schwartz gave an overview of the items that he planned to discuss during his presentation and he mentioned that this presentation was for informational purposes only. He said that real estate is added to portfolios because it is a good source of diversification for portfolios that are predominantly stocks & bonds. Real estate has been growing in diversified portfolios because it provides stable income streams and good returns, and the returns are of moderate volatility. He indicated that real estate provides low correlation to other asset classes. He pointed out that real estate returns are cyclical and we are coming out of the worst downturn in recent history. He said that historically, returns have averaged about 7% income with 1% appreciation. With regard to all real estate investment types, Mr. Schwartz highlighted common performance and risk factors.

Mr. Schwartz then discussed some of the different real estate property types, including Office, Retail, Industrial, Apartment, Hotel and others. Beginning with the Office property type, Mr. Schwartz said that historically, returns here are the lowest and are more volatile than other types. He said that ORG believes this section should be underweighted in the portfolio. The Retail property type has the best nominal returns over time, and returns are less volatile than Office properties. For the Industrial property type, returns are historically more stable and less volatile than Office properties, with the outlook being more balanced on the supply/demand characteristics. The Apartment property type returns are expected to be one of the least volatile, and returns are often counter cyclical. The Apartment property type has the best risk adjusted returns over time. The Hotel property type is characterized as opportunistic; it is very management intensive and very sensitive to the business cycle. Returns are more volatile than Core property types. Other sectors include student housing, senior housing, medical office and self-storage. Mr. Schwartz briefly discussed each of these sectors.
Mr. Schwartz then discussed the investment sectors: Core, Value-Added and Opportunistic. He said that the Core sector is made up of properties that are operating, stabilized and fully leased. They generally have institutional investment qualities such as size, physical attributes and locations. Returns in the Core sector should be 7.9% per year, with a high proportion of the return generated from income and less from appreciation. Leverage is typically moderate in the Core sector. The Value-Added sector is made up of typically Core type properties that have a deficiency that is identifiable and correctable. This sector has higher potential returns, but higher leverage than Core. The Opportunistic sector is made up of higher risk, higher leveraged properties relative to Core and Value-Added, such as development or international properties and so commingled fund vehicles are generally used for diversification. Targeted returns are higher to compensate for the higher risk.

Mr. Schwartz then discussed commingled funds. He said that these are investment vehicles where pension funds pool capital, diversify risk and gain access to additional investment types. There are two types of commingled funds: closed-end funds and open-end funds. The closed-end funds have low liquidity. The open-end funds are generally limited to Core strategies and provide liquidity on a quarterly basis.

Mr. Schwartz then discussed public real estate securities. He said that these are publicly traded companies that predominantly own and operate real estate assets. Investors have no control over assets or management and the performance of underlying real estate is masked by accounting nuances and a lack of transparency. Historically, these have higher returns and higher standard deviations than Core, and correlations to equities are higher than from private real estate investments. However, these can provide an efficient and diversified method to invest in property types that are difficult to access in the private markets and ORG prefers public real estate securities over private for non-US real estate.

Mr. Schwartz then discussed the Commercial Mortgages structure. He said that returns in this structure are sensitive to interest rate spreads and credit quality. They have bond-like risks and investment characteristics with real estate as collateral and can be purchased in various investment grades or below investment grade.

Mr. Schwartz then discussed the Separate Account investment structure, where specific properties are wholly owned and controlled by the investor. Diversification is limited for large properties and so this structure is more appropriate for large real estate portfolios. These structures provide reasonably good liquidity although dispositions would take approximately six months. Costs are generally lower than in commingled funds. A legal opinion would be required to determine the legality of this structure for the TMRS system.

Next, Mr. Schwartz briefly discussed real estate benchmarks. He proposed using the NCREIF Fund Index- Open End Diversified Core Equity (NFI-ODCE). This is the same index that R. V. Kuhns recommended and was adopted in the TMRS IPS. Mr. Schwarz showed the diversification of the NFI-ODCE by property type, and compared the index performance returns versus other indices.
In regards to expected returns over the life of an investment, Mr. Schwartz then explained the “J Curve” and illustrated the impact of the J Curve, stating that money may flow out for the first several years before returns are generated, with the majority of returns delivered on the back end. Mr. Schwartz also explained that implementation of the real estate allocation would start with the lower risk Core sector, which is not expected to have as pronounced a J Curve effect.

4. **Discussion on Draft of Real Estate Investment Policy**

Mr. Schwartz stated that the goal of the real estate allocation was to enhance total return and provide diversification while minimizing risk and preserving capital. Performance objectives are that the real return should be 5% net of fees and the relative return should exceed NFI-ODCE net of fees. Risks will be mitigated through diversification, risk management guidelines and a well-defined investment selection process. He mentioned the key risk considerations and discussed diversification guidelines including sector percentages, property type percentages, geographic diversification (minimum 80%, US market investments), manager diversification, vintage year diversification (year in which first capital call is made), investment structure diversification, leverage limits (maximum loan to value ratio 65% in aggregate) and investment size limits (maximum investment is 15% of the real estate allocation). Mr. Simpson asked if clients are focusing on a specific area like Texas. Mr. Schwartz explained that there will naturally be a significant exposure to Texas, but from a practical perspective, vehicles that target Texas-specific real estate investments do not really exist. Targeting a specific percentage of the portfolio is difficult particularly when investing in commingled funds. Mr. Klausner was concerned from a fiduciary perspective about putting a geographic restriction or preference in the policy and indicated that while geographic exposure is a legitimate question for the managers, it should not be included in the policy. Mr. Simpson stated that he would like to know if other clients have “in-state” preferences in their investment policies. The Board was reminded that the real estate policy guidelines would be presented to the Board for adoption at the December 3, 2010 meeting.

The Board took a break at 2:20 p.m. The meeting resumed at 2:33 p.m. All of the members of the Board who were present prior to the break were present when the meeting resumed.

5. **Consider and Act on Board Meeting Dates and Locations for 2011**

Mr. Gavia presented this item and reminded the Board that the February and March 2011 meeting dates were adopted at the September Board meeting. Mr. Gavia then presented the following proposed dates and explained the rationale for each recommendation:

- May 19-20 (Thurs/Fri) - Austin
- June 16-17 (Thurs/Fri) - Austin
- July 21-22 (Thurs/Fri) - Austin
- September 21-22 (Wed/Thurs) - Austin
- Oct 12 (Wed) – Houston (in conjunction with annual TML conference)
- December 1-2 (Thurs/Fri) - Austin

After some discussion, Mr. Rodriguez moved that these proposed dates and locations for the 2011 board meetings be adopted. Ms. Hernandez seconded the motion, which passed unanimously.
6. **Investment Report**
Mr. Madsen reviewed the investment report. He said that September was one of the top Septembers on record, but the primary reason was due to expectations for “quantitative easing” and the willingness of investors to take on risk. He reviewed the total fund composite. He reported that on comparative performance, the system has had strong returns on both the 3rd quarter and 1 year basis and that the managers met or out-performed their benchmarks. He said that it is shaping up to be an interesting year, but there is still a lot of uncertainty ahead.

Ms. Goerdel updated the Board on the Colchester implementation and reported that funding is still on target for December 1, 2010. Ms. Goerdel updated the Board on the hiring of Dev Outlaw as the Director of Fixed Income, and Dimitry Shishkoff as the Director of Risk Management.

Ms. Goerdel updated the Board on the customer service/client service issues with Northern Trust, which appear to have been resolved. Ms. Goerdel reported that the annual review with BlackRock is about to begin. The Securities Lending relationship with State Street is still being monitored due to personnel changes, but Ms. Goerdel said that she sees no reason for concern at this time. She said that she is working with Mr. Allan to complete the internal audit on the manager search due diligence process. In closing, Ms. Goerdel reported that the aggregate manager fees, as of the second quarter, have run 4.65 basis points or .0465% of the total portfolio annually.

*At about 2:50 p.m., Mr. Simpson and Ms. Hernandez departed the meeting which left the Board without a quorum. The meeting officially ended at this time.*

David Gavia
Executive Director

April Nixon
Vice Chair, Board of Trustees