

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

December 6, 2012 – 2:00 p.m.

December 7, 2012 – 8:30 a.m.

On December 6, 2012, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a regular 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

Frank Simpson, Chair (*arrived at 2:40 p.m.*)
Julie Oakley, Vice Chair (*left the meeting at 4 p.m.*)
April Nixon
Jim Parrish
Roel (“Roy”) Rodriguez

Absent: Ben Gorzell, Jr.

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
Ed Schwartz, ORG Portfolio Management
Lynn Kehoe, ORG Portfolio Management
Robert Klausner, Klausner Kaufman Jensen & Levinson
Nancy Williams, Hewitt EnnisKnupp

Also in attendance:

Caroline Davis, Investment Intern
Debbie Farahmandi, Investment Operations Specialist
Keith Hopkins, Mesquite Fire Fighters
George Kauffman, City of Garland
Scott Kerr, Texas Association of Fire Fighters

Michelle Mellon-Werch, Associate General Counsel
Anthony Mills, Regional Manager – City Services
Nick O’Keefe, Senior Staff Attorney
Jim Moore, Mesquite Fire Fighters
Cindy Morse, Investment Support Analyst
Kate Reed, Investment Risk Analyst
David Rodriquez, Regional Manager – City Services
Bob Scott, GFOA/City of Carrollton
Mel Thomas, Editor

Ms. Oakley called the meeting to order at 2:05 p.m. and Jim Parrish gave the invocation.

1. Consider and Act on Real Estate Manager Presentation/Selection

Mr. Gavia introduced Ms. Macki to present the Real Estate Manager Recommendation. Ms. Macki stated that this is the second real estate manager search to be conducted in accordance with the 2012 Real Estate Implementation Plan to commit up to \$600 million to Core, Value-Added and/or Opportunistic real estate investments.

Ms. Macki began her presentation by reviewing the timeline of real estate activities throughout 2012. She then reviewed the Real Estate Investment Search process. She noted that the search team included both ORG and TMRS staff. The search process discussed included market research; manager screening; manager questionnaire; evaluation and preliminary due diligence; in-depth due diligence and a Board recommendation. She then reviewed the manager screening criteria and results, the due diligence ranking factors and final rankings of candidates reviewed. In response to a question from Mr. Simpson, Ms. Macki stated that further review would be needed before the number two or three candidates could be considered should contract negotiations fail with the number one candidate.

Ms. Kehoe then presented an overview of Mesa West Capital and its core lending program. Mr. Schwartz pointed out that Mesa West is projecting a 7-8% return, but because it is a debt strategy, it could underperform core open-end funds in the event of rapid growth. Nonetheless, Mesa West’s investments present an attractive risk adjusted return. The Board discussed the specifics of this type of lending program. Ms. Kehoe noted that the principals of the firm have deep experience in this area and have a strong track record. Mr. Klausner pointed out that there would be key issues to discuss in protecting TMRS’ rights because this fund is an LLC domiciled in Delaware with different standards than those required in Texas.

Ms. Kehoe next discussed Harrison Street Securities and their long-only actively managed real estate securities strategy. There will be no leverage in the portfolio. This firm, though the investment team is small, is comprised of senior level staff and has a disciplined investment and risk management process. Harrison Street Securities invests in publicly traded real estate securities only. There was further discussion on the potential overlap between owning both the equity side and the debt side of investments. There was also discussion on manager diversification within the real estate portfolio.

Mr. Schwartz then discussed the supplemental \$50 million investment in Harrison Street Real Estate Capital. TMRS has previously committed \$100 million to this fund. TMRS fees are significantly less (35 bps) than the new investors that are committing to the fund.

He next reviewed the Stockbridge Capital Group’s “Smart Core Fund” \$50 million supplemental investment. Like Harrison Street Real Estate Capital, TMRS has previously committed \$100 million to this fund.

Ms. Macki concluded by reviewing the recommendation for managers and allocation amounts by sector. The Board also discussed background checks to be conducted for the supplemental investment.

Mr. Parrish moved that the TMRS Board of Trustees approve the following actions. Ms. Nixon seconded the motion; which carried unanimously by the members of the Board present, 5-0, contingent upon successful background checks.

- (1) That the Board of Trustees select the following managers (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 (including existing managers for additional commitments but not on Harrison Street Securities since it is a separately managed account), 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:

MANAGER	ALLOCATION	PRINCIPAL FOCUS
Mesa West Capital	\$100 million	Core Debt Fund
Harrison Street Securities	\$100 million	Core Real Estate Securities
Harrison Street Real Estate Capital	\$50 million	Core Fund
Core and Value Advisors (affiliate of Stockbridge Capital Group)	\$50 million	Core Fund

2a. Real Estate Portfolio: 2nd Quarter Real Estate Report (taken out of order)

Ms. Macki, Mr. Schwartz and Ms. Kehoe presented this quarterly report, reminding the Board that there is a two quarter reporting lag. Ms. Kehoe began by explaining the difference between approved (items approved by the Board), committed (all documentation has been signed); and invested (capital call made). Ms. Kehoe reported that TMRS has seen appreciation in the real estate investment to date. She provided graphs depicting diversification of the real estate portfolio by: strategy, manager, property type and geographic location. Mr. Schwartz reminded the Board that the portfolio may be out of compliance with

concentration policy guidelines during early stages of implementation of the real estate allocation, but is a consideration in manager searches and recommendations to the Board.

Mr. Schwartz began with an overall discussion of the real estate market. ORG's perspective remains cautious due to slow employment growth, weak consumer confidence, slow GDP growth and economic uncertainty. ORG believes that the best way to capitalize on current conditions is to focus on areas where higher rates of return are possible, that may require a larger initial investment. ORG's philosophy is to always look for opportunities where the initial capitalization rates are higher rather than getting caught in the investor trap of investing at low capitalization rates that require rapid growth.

Mr. Schwartz discussed ORG's review of the Policy Target Compliance.

2b. Real Estate Portfolio: Consider and Act on 2013 Real Estate Implementation Plan

Ms. Kehoe presented the 2013 Real Estate Implementation Plan Summary. She reminded the Board that the Real Estate asset class has an allocation of 10% of the overall fund with a multi-year implementation goal. She provided a status report on investments approved by the Board, indicating that approximately \$600 million had been committed. She reviewed the sector diversification as well as Board action on the Real Estate allocation to date. She next reviewed the pace of investing noting that \$427 million was projected to be invested by the year end 2012, but to date \$316 million has been invested.

Mr. Schwartz reported that ORG and TMRS staff recommend that TMRS commit during calendar year 2013 \$600 million to Core, Value-Add and/or Opportunistic real estate investments. He reviewed the Cash Flow Forecast, indicating that by the end of 2013, it is anticipated that over \$1 billion will be committed. He reviewed the policy limitation on the amounts that could be committed in any given year and added that the search process will result in the presentation of recommended managers to the TMRS Board for approval.

Mr. Schwartz concluded by reviewing the amounts committed to date, including the one withdrawal due to unsuccessful document negotiations with a manager. He then reviewed the 2013 implementation actions necessary to meet the implementation strategy, noting that existing and new managers may be considered, as appropriate, as well as co-investment opportunities. Mr. Schwartz also noted that ORG and Investment Staff will return to the Board with Investment Policy guidelines regarding co-investment opportunities.

Ms. Nixon moved that the Board approve the 2013 Real Estate Implementation Plan as presented and authorize TMRS staff and ORG to conduct manager searches as needed for real estate managers/investment offerings to fulfill the total 2013 real estate allocation of \$600 million. Mr. Parrish seconded the motion which passed unanimously by the members of the Board present, 5-0.

3. Consider and Act on Revisions to the Investment Policy Statement

Mr. Gavia reported that at the October 25-26, 2012 Board of Trustees meeting, staff presented for discussion a number of proposed revisions to the Investment Policy Statement (IPS) that stemmed from the annual IPS review. Mr. Gavia then introduced Ms. Goerdel who reviewed the changes to the Investment Policy Statement (IPS) broken down by:

clarification, documentation of current policy and new policy. She reviewed the new policy items beginning with changes made since the October meeting.

Concerning the additional new policy items, Ms. Goerdel highlighted the changes which expands authority by: adding a grandfather clause to provide for prudent transition of assets between strategies and/or managers; allows counterparty risk to be managed through the 25% counterparty limit coupled with the provision of borrower default indemnifications in the securities lending guidelines; and also within the securities lending guidelines, allows for margin of 102% for non-US securities issued in U.S. dollars vs. U.S. dollar-based collateral..

She noted that these new changes were identified in the early stages of TMRS transitioning its securities lending to the new program through Deutsche Bank

Ms. Goerdel advised the Board that R.V. Kuhns, TMRS' Investment Consultant, has reviewed the proposed revisions and is in agreement that they are appropriate.

Mr. Rodriguez moved that the Board adopt the revisions to the Investment Policy Statement as proposed. Ms. Nixon seconded the motion; which passed unanimously by the members of the Board present, 4-0.

4. **Investment Report (taken out of order)**

Mr. Gavia introduced Marcia Beard to present the quarterly investment report. Ms. Beard reviewed the September 30 returns and reported that this quarter was a reversal of the second quarter noting GDP growth in the U.S. improved as unemployment decreased and manufacturing reversed a trend of three consecutive months of contraction. During this quarter, the Feds announced new bond purchases over concern about the continued weakness in the labor market. Foreign markets outperformed domestic markets during the third quarter.

Ms. Beard then reviewed TMRS' asset allocation relative to its peers, noting that TMRS, although at its target allocation for equities, has a lower allocation in that asset class and has more exposure to fixed income, but stated that the portfolio continues to move towards a well diversified structure as fixed income is reduced. She next reviewed fund performance versus benchmarks. Despite not being fully diversified, TMRS, over the five year period, has outperformed the actual allocation and policy index benchmarks. Ms. Beard then reviewed the total fund performance versus peers noting that on a 5-year basis, TMRS has experienced less volatility and outperformed the median plan.

Ms. Goerdel then moved into the staff investment report. The "fiscal cliff" is the overriding issue that is impacting the markets. The trend now is "flight to quality", along with uneven global growth, has pushed yields down in the fixed income arena. Public equities have been impacted by a mix of uncertainty and signs of improvement in the U.S. economy, but provided a positive return for November following a negative October number. Global linkers have also outperformed benchmarks. Ms. Goerdel reported that the total market value through November was over \$20 billion.

Ms. Goerdel then updated the Board on the status of portfolio diversification efforts, reporting that TMRS is in the process of implementing the core/satellite strategy, previously

approved by the Board. Ms. Goerdel noted that staff will provide the Board an implementation plan for the Non-Core Fixed income allocation and Absolute Return Strategies at future meetings. Ms. Goerdel also reported that the Risk Report produced no significant changes from the previous report, and noted that there were no compliance test violations as of September 30, 2012.

5. Consider and Act on Board Resolution Regarding 2013 Legislative Session

Mr. Wattles and Ms. Williams began discussion of this item. Mr. Gavia reviewed the activities leading up to the Board's decision not to sponsor a bill in the next legislative session. The Board had directed staff to draft a resolution for the Board to consider which could be used in directing its actions regarding legislation potentially affecting TMRS.

Mr. Wattles began by discussing the bills that had been prefiled to date. He indicated that the number of bills filed is significantly less compared to last session at this time. He discussed the four bills filed that affect ERS and TRS. No bills to date affect TMRS directly.

Mr. Wattles then discussed the actions taken by TML's resolution committee. TML has three levels of action: highest – seek introduction; 2nd level – in support changing the participation level from 1,000 hours to a higher limit. The other two resolutions, which TML voted to endorse, related to flexible COLA options. All three were adopted by the full membership.

Mr. Wattles next discussed the Comptroller's report on the status of pension funds in Texas. TMRS staff briefed the Comptroller's Office on TMRS, and reviewed the report prior to publication. He noted that the report is fairly favorable with respect to TMRS.

Mr. Wattles then reviewed the comments by the Advisory Committee members and others regarding the Board resolution on potential legislation.

Action on this item was postponed until the meeting reconvenes on Friday, December 7th.

6. Executive Session

At 5:00 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 6:02 p.m. All members of the Board who had been present when the Board went into Executive Session were again present.

At 6:02 p.m., the meeting recessed until 8:30 a.m. on Friday, December 7, 2011.



David Gavia
Executive Director



Julie Oakley
Chair, Board of Trustees