

**MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Joint Meeting of the Board of Trustees
and the Advisory Committee on Retirement Matters**

May 7, 2010

On May 7, 2010, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a joint meeting with the Advisory Committee on Retirement Matters at 8:30 a.m. at the TMRS Headquarters, located at 1200 North IH 35 in Austin, Texas, with the following members present:

Board of Trustees

Ben Gorzell, Jr., Chair
April Nixon, Vice Chair
Carolyn Linér
Roel ("Roy") Rodriguez
H. Frank Simpson

Absent: Pat Hernandez

Advisory Committee on Retirement Matters

Allen Bogard, City of Sugar Land
David Crow, Arlington Professional Fire Fighters
Dean Frigo, Asst. City Manager for Financial Services, City of Amarillo
Scott Kerr, Texas State Association of Fire Fighters
Michelle Leftwich, Assistant City Manager, City of Mercedes
John Lewis, Councilman, City of North Richland Hills
Randle Meadows, Arlington Police Association
Jim Moore, City of Mesquite Fire Fighters
Mike Perez, Texas City Managers Association
Bob Scott, Director of Finance, City of Carrollton
Steven Segal, Councilman, City of West University Place

Present also were:

David Gavia, Acting 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, Acting CIO/Director of Public Investments and Asset Allocation
Leslee Hardy, Staff Actuary
Holly Macki, Director of Real Estate
Michelle Mellon-Werch, Associate General Counsel
Cindy Morse, Executive Assistant
Debbie Munoz, Director of Member Services
Eddie Solis, Director of Government Relations

Bill Wallace, Director of Communications
Scott Willrich, Director of Information Resources
Robert Klausner, Klausner & Kaufman
Russ Kuhns, R. V. Kuhns & Associates, Inc.
Peter Madsen, R. V. Kuhns & Associates, Inc.
Joe Newton, Gabriel, Roeder, Smith and Company
Mark Randall, Gabriel, Roeder, Smith and Company
Dr. Gary Shilling, A. Gary Shilling & Co., Inc.

Guests:

Anumeha, Pension Review Board
Debbie Farahmandi, Investment Operations Specialist
Christopher Hanson, Pension Review Board
George Kaufman, Director of Finance, City of Garland
Anthony Mills, Regional Manager, City Services
Dan Moore, Pension Review Board
Candace Nolte, Controller
Kristin Qualls, Assistant Investment Officer
Kate Reed, Investment Analyst - Equities
Katie Reissman, Investment Analyst – Fixed Income
David Rodriguez, Regional Manager, City Services
Sean Thompson, Regional Representative, City Services
Greg Vick, Texas City Managers Association
Jonathan Berns, Principal, ORG Portfolio Management LLC
Barbara McDowell, Director of Portfolio Analytics, ORG Portfolio Management LLC
Ed Schwartz, Principal, ORG Portfolio Management LLC

The meeting was called to order by Mr. Gorzell at 8:33 a.m., and Mr. Rodriguez gave the invocation.

1. Executive Session

At 8:34, a.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 9:27 a.m. All members of the Board who had been present when the Board went into Executive Session were again present.

Ben turned the floor over to Carolyn Linér, who announced her retirement from the City of San Marcos after twenty-five years of employment. Mr. Gavia mentioned that Ms. Linér will continue to serve as a trustee on the TMRS Board until her replacement is appointed by the Governor. Mr. Gavia congratulated Ms. Linér on her retirement and thanked her for her service over the years.

2. **Adoption of Minutes from the February 19, 2010 Regular Meeting, the March 5 and March 11, 2010 Special Meetings and the March 12, 2010 Regular Meeting**

Mr. Gavia introduced this item and asked if the Board members had any questions or revisions. As there were none, Mr. Simpson moved that all of the Minutes be adopted as presented. Ms. Nixon seconded the motion, which passed unanimously.

3. **Economic Advisor Presentation**

Dr. Shilling began his presentation by stating his belief that we have entered a decade of deleveraging across many sectors. Leveraging factors lead to extraordinary growth, but we are now in deleveraging which will likely result in slower growth and possibly deflation. He said that people had been saving less and borrowing more with personal consumption growing significantly. Dr. Shilling indicated that this trend now seems to be turning around, however, driven by the 2008 stock market decline. He said that people have moved from stocks and to bonds due to a lack of confidence. In the housing sector, Dr. Shilling expects further declining home prices through the run-off of excess inventory. He predicts slow global growth in future years for the following reasons: (1) consumers shift from spending to a savings spree; (2) financial deleveraging; (3) low commodity prices; (4) increased government regulation and involvement in major economies; (5) rising protectionism; (6) weak housing markets; and (7) deflation. Global deleveraging will likely have several years to run, but this is not a straight line process. We have already seen the U.S. housing collapse, global financial crisis, U.S. consumer retrenchment, worldwide recession and the Euro zone crisis. Beyond those factors already playing out that support slow global growth, Dr. Shilling indicated that he believes the potential also exists for a U.S. commercial real estate crisis, and economic difficulties in China and Japan. These are all things to be aware of and be prepared for in the future. Dr. Shilling emphasized that we must be prepared for slow growth.

Ms. Goerdel asked Dr. Shilling to comment on the recent experience of the stock market and the continued flight to quality. Dr. Shilling summarized his thoughts of what happened and mentioned that he thinks investors are more risk-conscious.

Mr. Simpson asked Dr. Shilling for further comment about his thoughts on commercial real estate, given the decisions TMRS has to make on implementing an allocation to real estate. Dr. Shilling responded that the System will have to do its homework ahead of time for specific opportunities and be mindful of timing as the market in general has further downside. Ms. Goerdel stated that this is why the System is looking to hire a specialty consultant.

4. **Consider and Act on Results of 2009 Actuarial Valuation and Approval of 2011 Retirement Contribution Rates and Supplemental Death Benefit Contribution Rates**

Mr. Gavia introduced Mr. Randall and Mr. Newton and discussed the Board's statutory and fiduciary duties in connection with the Valuation and the setting of the rates.

Mr. Randall began the presentation and stated that the results of the Valuation were what GRS expected. He first began by looking at a summary of the system-wide results. Liabilities went up overall as did assets. The Unfunded Actuarial Liability (UAL) remained about the same, causing the funded ratio to improve. He showed that the system-wide funded ratio has improved for the last two years following the actuarial assumption and method changes. He

stated that TMRS' ratio is on a market value basis, and that the funded ratio compared to other plans is very good. He compared the actuarial value of assets to actuarial accrued liability. He also compared the number of active members and retired members.

Mr. Randall compared the yields on actuarial (book) value and market value of assets. He pointed out that the 6.5% average compound return over the last 10 years is tremendous compared to many other plans that are half that value.

Mr. Randall compared the market and actuarial value of assets, as well as contributions versus benefits and refunds. A graph on projected contributions versus benefits and refunds showed that over time, investment earnings will pay for more and more of the benefits. In a typical fund, 60% of plan benefits are paid from investment earnings versus 27% from employer contributions and 13% from employee contributions.

Mr. Simpson asked how much of the total annuities paid are from Current Service Annuity Reserve Fund (CSARF) and how much are from Municipality Accumulation Fund (MAF) on a system-wide basis. Ms. Covarrubias responded that approximately 80% of annuities are paid out of CSARF and 20% out of MAF. Mr. Randall discussed the CSARF valuation, the CSARF as a percent of the total fund, and the expected growth rate of the CSARF.

Mr. Newton moved into a discussion of the valuation at the city level. He first showed the aggregate MAF valuation, reconciling the Unfunded Actuarial Accrued Liability (UAAL). He stated that a big reason for the increase in liability is due to significantly lower than expected turnover. The actual-to-expected ratio for rate of termination was significantly lower than normal. Retirement experience was a little less than expected. Salary increase experience was right on target, contrary to what would have been expected given the economy.

Mr. Newton reviewed statistics regarding benefit changes. He then reviewed aggregate reconciliations, valuation-to-valuation, for the six different stratification groups. He discussed that the unanticipated changes for Group 6 cities added on average, an additional average of -0.10% to rates.

Mr. Newton showed the distribution of cities under the different areas of change. In summary, he indicated that the system-wide funded ratio did improve with overall results being close to expectations, with the only exception being turn-over. He said that phase-in adjustments continue and that several cities decreased benefits last year. He indicated that the CSARF will continue to grow, which increases the need for a robust reserve. He mentioned that GRS and TMRS staff will continue to look at the restructuring of TMRS' Retirement Trust Fund.

Mr. Simpson asked if there was anything the actuaries could sign off on that would provide rate relief for cities in 2011. Mr. Randall answered that he would not advise the Board to move off of its current phase-in structure. He acknowledged that the eight year phase-in period was a long time, and he stated that he is reticent to recommend any further extension of the phase-in period. Ms. Nixon moved that the Board accept the December 31, 2009 actuarial valuation and certify contribution rates for municipalities for 2011. Mr. Simpson seconded the motion, which passed unanimously.

5. **Consider and Act on Recommendation for Real Estate Consultant**

Ms. Goerdel walked the Board through the process used in the Real Estate Consultant search leading up to this decision, with rankings updated along the way while narrowing the list of candidates: the development and issuance of a questionnaire, telephone interviews, in-person interviews, and on-site visits. The process began with 11 firms identified before the narrowing process began. Ms. Goerdel indicated that the two finalists were Ennis Knupp and ORG Portfolio Management LLC (ORG). With Ennis Knupp, the key determinants were their limitations; with ORG, the key determinants were their strengths, including depth of knowledge, risk control, and their experience in building the investment class for clients from the ground up. Ms. Goerdel then introduced the individuals from ORG in attendance: Jonathan Berns, Ed Schwartz and Barbara McDowell. Mr. Berns gave a brief history of ORG's growth and outlined the unique benefits of ORG, including real estate professionals with field experience and actual experience in owning real estate. Mr. Berns said that these staff members are solely focused on real estate consulting and are able to identify market trends ahead of the curve.

Mr. Schwartz discussed ORG's investment philosophy for real estate, which is based on generating attractive risk adjusted returns through active management that exploits market inefficiencies. ORG favors funds sponsored by top-tier managers whose interests are aligned with the investors. They recognize that the real estate asset class provides diversification benefits, a hedge against inflation, and offers unique opportunities due to dislocations in markets that occur from time to time.

Ms. McDowell discussed ORG's implementations steps. Mr. Simpson asked about the Board's role in this process. Ms. Goerdel stated that this has not been fully defined but that the key, high level discussions, especially with regard to policy, would be brought to the Board. Mr. Simpson further asked whether managers could be directed to favor investments in Texas provided expected returns are competitive. Mr. Schwartz explained how these funds are developed, and that the mandates typically focus on property types rather than geographic location. The structure expected to be proposed is a limited partnership or commingled fund where an individual investor could not direct a manager towards a specific focus as suggested. Mr. Klausner pointed out that a focus on the geographic areas requires a different structure where TMRS would be investing directly in properties and that would require a different level of legal and fiduciary review

Mr. Schwartz then highlighted that in their review and analysis, the mid-size funds (a universe of about 350 firms) are the best performing funds. He also discussed the customization of the client's investment portfolio. ORG's view on the U. S. market was discussed next, leading to their current investment themes: consider investment funds that capitalize on pending commercial mortgage maturities, continue pursuing secondary fund transactions in high quality funds from motivated sellers, pursue opportunistic and value-added strategies globally that capitalize on market distress, and review potential fund recapitalizations where high returns can be achieved with moderate to low risk.

Mr. Berns concluded ORG's presentation by stating that ORG is honored to be considered for TMRS' Real Estate Consultant.

Ms. Goerdel mentioned that the real estate target is 10% of the total portfolio and that it will likely take three to five years to reach that target. The goal is to bring a policy to the Board, possibly in September, for the Board's consideration. Mr. Gorzell noted that TMRS would be the largest client based on the dollars allocated to real estate and asked for further discussion by ORG on their current investment themes. Mr. Klausner asked if ORG assists in negotiation of the fees in an LP arrangement and Mr. Schwartz responded that ORG often helps coordinate the process and will assist in negotiating all aspects and terms of the LP agreements with TMRS Staff and Counsel.

Mr. Simpson moved that the Board accept staff's recommendation to select ORG Portfolio Management LLC as the TMRS Real Estate Consultant and authorize the Executive Director to negotiate a three-year contract, with an option to extend for up to two years, satisfactory to the System at a fee of \$310,000 per year increased annually by the increase in CPI subject to a 5% ceiling per year. Ms. Linér seconded the motion, which passed unanimously.

6. Investment Report

Mr. Madsen presented the quarterly investment performance analysis. He said that risk assets dominated the returns for the quarter with equities outperforming fixed income. He reviewed and discussed the economic indicators noting that the major contributors to positive equity returns were improving GDP, unemployment figures, and housing data. Mr. Madsen illustrated the total fund composite make up and pointed out that TMRS is still primarily in fixed income. He discussed a new measure developed by R. V. Kuhns to reflect the fund's liquidity. Ranges within the scoring matrix identify an asset class as liquid, less liquid, and illiquid. With the portfolio currently fully invested in publicly traded securities, the overall liquidity score reflects it as "liquid." As less liquid or illiquid asset classes are implemented, over time this may segment down from liquid to less liquid although the majority of the portfolio will remain liquid.

7. 2009 Review of Securities Lending and Custody

Ms. Goerdel introduced Jonathan Kowolik to review TMRS' securities lending program. Mr. Kowolik presented a very high level overview of what securities lending is, why it is important to review this program, and the securities lending process itself. He discussed both direct and indirect exposure, through certain equity commingled funds, to securities lending. He discussed the key factors that need to be monitored in the process: utilization, collateralization, counter party exposure; earnings and earnings attribution, and investment exposure within the cash collateral. He indicated that both State Street and Northern Trust are very capable providers and that State Street has been very consistent. The total on loan balance was proactively capped by TMRS at 58.8% of lendable assets. He reported that collateral levels are appropriate as is borrower diversification. The program has maintained relatively strong liquidity. Mr. Kowolik indicated that there are no current concerns regarding State Street's management of the portfolio. He reported that risk in the cash collateral pool has come down resulting in lower yields; the program has generated strong earnings over time; and the fee split is reasonable. He also stated that the indirect securities lending exposure through Northern Trust has continued to come down as investments have been moved to non-lending index funds. TMRS has participated in the lending funds' redemption program to the extent allowed.

In conclusion, Mr. Kowolik stated that he believes the securities lending program is providing value to the System and staff is prudently and actively reviewing the program. Mr. Kowolik also believes that should TMRS move from a pooled account to a segregated cash collateral reinvestment account, the revised investment policy should adequately address cash collateral investment requirements.

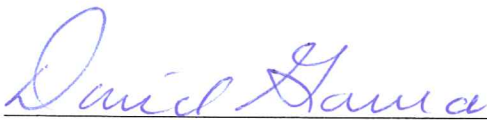
8. **Update on Advisory Committee and Non-TMRS Organizations' Discussions of Potential TMRS Related Legislation**

Mr. Solis updated the Board on the preceding days' Advisory Committee meeting, including the letter from the Texas Municipal Human Resources Association (TMHRA), and GRS' discussion on fund restructuring. He stated that GRS will continue discussing fund restructuring with the Advisory Committee. He mentioned that the Texas Municipal League's (TML) Committee on TMRS approved supporting TMRS' fund restructuring, and they also support an additional flexible COLA. Mr. Solis mentioned that the tiered plans proposal had been forwarded to the TML General Government Committee for consideration without a recommendation. With regard to the Advisory Committee's timeline, Mr. Solis said that the goal is for the Advisory Committee to bring their recommendations to the Board in August, about a month earlier than last session.

Ms. Nixon thanked the Advisory Committee members for their diligent participation. Mr. Rodriguez concurred and suggested voting on some of the items before the Advisory Committee so that the System can continue to make progress on developing the legislative package.

9. **Call for Future Agenda Items**

As there was no further business, Mr. Rodriguez moved that the meeting be adjourned. Ms. Linér seconded the motion, which passed unanimously. The meeting was adjourned approximately 1:00 p.m.



David Gavia
Executive Director



Ben Gorzell
Chair, Board of Trustees