

**TEXAS MUNICIPAL RETIREMENT SYSTEM**

**REGULAR MEETING OF THE BOARD OF TRUSTEES**

**TMRS Headquarters**

**1200 North IH 35**

**Austin, Texas**

**December 3, 2010**

On December 3, 2010, the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a regular meeting at 8:30 a.m. at the Texas Municipal Retirement System Headquarters, 1200 North IH 35 in Austin, Texas, with the following members present:

**Board of Trustees**

Ben Gorzell, Jr., Chair

April Nixon, Vice Chair

Pat Hernandez

Julie Oakley

Frank Simpson

Absent: Roel ("Roy") Rodriguez

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, Staff Actuary

Holly Macki, Director of Real Estate

Michelle Mellon-Werch, Associate General Counsel

Cindy Morse, Executive Assistant

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

Robert Klausner, Klausner & Kaufman

Marcia Beard, R. V. Kuhns & Associates, Inc.

Pete Madsen, R. V. Kuhns & Associates, Inc.

Ed Schwartz, ORG Portfolio Management LLC

Nancy Williams, Hewitt EnnisKnupp, Inc.

Guests:

Jim Blagg, Guest  
Chelsea Buchholtz, Office of the Governor  
David Crow, Arlington Firefighters  
Debbie Farahmandi, Investment Operations Specialist  
Glenn Johnson, Garland Fire Fighters  
Scott Kerr, Texas State Association of Fire Fighters  
Kathy Klausner, Guest  
Anthony Mills, Regional Manager, City Services  
Jim Moore, City of Mesquite Firefighters  
Candace Nolte, Controller  
Dev Outlaw, Director of Fixed Income  
Jim Parrish, City of McKinney  
Kristin Qualls, Assistant Director of Equities  
Kate Reed, Investment Analyst, Equities  
David Rodriguez, Regional Manager, City Services  
Bob Scott, City of Carrollton  
Dimitry Shishkoff, Director of Risk Management

The meeting was called to order at 8:35 a.m., and the invocation was given by Pat Hernandez.

**1. Executive Session**

At 8:37 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 9:35 a.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 Consent Agenda, including Adoption of Minutes from the October 27, 2010 Special Meeting of the Board of Trustees**

Mr. Gavia introduced this item and explained the Consent Agenda includes the quarterly service retirements, disability retirements, death benefits, financial statements. He added that in December of each year, the Consent Agenda also includes the Seven Year Inactive Report/Transfer of Inactive Accounts, Seven Year Inactive Report/Transfer of Unclaimed Refunds and the Updated Service Credit and Annuity Increase Ordinances Adopted Report. Mr. Simpson moved that the Board adopt the Consent Agenda as presented. Ms. Nixon seconded the motion, which passed unanimously.

**3. Consider and Act on the Real Estate Investment Policy Amendment**

Ms. Goerdel introduced this item. She pointed out that the Real Estate Investment Policy is the same as that previously presented to the Board, with the addition of clarifying language that geographic diversification would be viewed by regions. Mr. Ed Schwartz began a high level review of the Real Estate Investment Guidelines Summary. He stated that the absolute return objective is a 5% real rate of return net of fees and commented that based on R. V. Kuhns' inflation assumption of 2.5%, that would be a nominal return of 7.5%. He then explained the difference between the absolute return and relative return objectives. Mr.

Schwartz indicated that we would seek to mitigate risks through both the Guidelines and manager selection, and he outlined the key risk considerations. He discussed the Investment Sectors under consideration, and briefly described these for the Board. He mentioned that the investment structures used will be commingled funds, public real estate securities and commercial mortgages. Next, he discussed diversification within this asset class that includes a minimum of 50% in core, and upper limits of 25% each in value-added and opportunistic, although it is likely that the Core percentage will be greater than 50%. Ms. Oakley asked why the upper limits were the same for value-added and opportunistic sectors, but carry different risk levels. Mr. Schwartz explained that the definition of each category is not precise, and although lowering the opportunistic level somewhat would be okay, the recommended level provides more flexibility. Mr. Schwartz then discussed property type diversification and pointed out that “office” has been specifically underweighted. He moved on to discuss geographic diversification. He mentioned limits on managers, such as no more than 20% of real estate allocation commitment per manager and a limit of 30% commitment in any one vintage year. He discussed the guidelines regarding Investment Structure, leverage and investment size. He also outlined the manager selection process. Mr. Gorzell asked for more discussion on why “office” was deliberately underweighted. Mr. Schwartz explained that, for various reasons, “office” is not a great core holding and typically has lower returns with higher volatility, so ORG has specifically underweighted this area.

Mr. Simpson discussed geographic diversification and indicated that he would like to express a preference for Texas. Mr. Gorzell stated that he is comfortable with the policy as drafted, but would like reporting expanded to show properties held in Texas and by state. Mr. Simpson stated he would like to see aggregate properties held by state rather than specific addresses.

Ms. Nixon moved that the Real Estate Investment Policy Guidelines be adopted as presented. Ms. Oakley seconded the motion. The motion passed 4 to 1, with Mr. Simpson voting no.

#### **4. Consider and Act on Authorization to Begin Real Estate Manager Search**

Ms. Goerdel stated that with the adoption of the Real Estate Guidelines, the next item to be discussed is the implementation plan. She said that staff is asking that this pacing plan, which was developed by ORG in conjunction with staff, replace the original 3% interim implementation target. Mr. Schwartz discussed the pacing plan and explained that the plan begins with the lower risk sector, Core, as a first step. He indicated that the current market has been volatile recently and that competition for the “trophy” properties has heated up. Ms. Goerdel reported that next year, staff is anticipating committing approximately \$500 million, with \$300 million in the beginning and 1 to 3 investment opportunities.

Mr. Schwartz discussed how managers get into ORG’s database of managers and said that there are close to 400 managers in the database at any point in time. Mr. Gorzell asked for a description of how capital calls are handled.

Ms. Goerdel concluded by stating that what is being requested is adoption of the pacing plan and authorization to conduct a search for potentially 1-3 Real Estate managers for a total initial core allocation of \$300 million.

Mr. Simpson moved that the Board adopt the pacing plan approach, replacing the interim implementation target of 3% formerly adopted by the Board, for the real estate asset class and that, in accordance with the pacing plan as presented, the Board authorize TMRS staff and ORG to conduct a search for real estate managers/investment offerings to fulfill an initial Core real estate allocation of \$300 million, with final selections to be made at the March 24-25, 2011 Board of Trustees meeting. Ms. Hernandez seconded the motion, which passed unanimously.

**5. Consider and Act on Renewal of R. V. Kuhns Contract**

Ms. Goerdel began this item by stating that R. V. Kuhns was selected as TMRS' first General Investment Consultant at its September 7, 2007 meeting. She highlighted R. V. Kuhns' contributions to TMRS, including assisting the Board in the adoption of the Investment Policy Statement, conducting asset allocation studies which resulted in the adoption of a fully diversified asset allocation strategy and conducting a number of investment-related educational sessions with the Board. She added that R. V. Kuhns has also assisted in manager searches which resulted in the selection of TMRS' current investment managers.

Ms. Goerdel reported that the current contract with R. V. Kuhns will expire on December 31, 2010. She indicated that R. V. Kuhns has met all expectations and responsibilities under the contract and that they have added value to the investment program. She said that Investment Department staff has a good, healthy working relationship with the staff at R. V. Kuhns, and emphasized that continuity is key for success of the ongoing diversification.

Ms. Oakley moved that the Board authorize the execution of amendments to the R. V. Kuhns contract to effect its renewal for a period of two (2) years, under the same terms and conditions, to expire on December 31, 2012. Ms. Nixon seconded the motion, which passed unanimously.

**6. Investment Report**

Ms. Goerdel took this opportunity to introduced two new TMRS staff members: Dev Outlaw (Director of Fixed Income), and Dimitry Shishkoff (Director of Risk Management). The Board welcomed them both to TMRS. Ms. Goerdel then introduced Marcia Beard and Pete Madsen from R. V. Kuhns to present the September quarterly performance report and the October monthly update report information. Mr. Madsen began by discussing recent trends in the Capital Markets and discussed the high correlations in the Market in the 3<sup>rd</sup> quarter. Mr. Madsen reviewed the peer group analysis and stated TMRS is right where it should be given the fact that it is diversifying. Mr. Madsen then discussed TMRS' comparative performance.

Mr. Madsen then moved on to October performance. He stated that strong returns in both September and October overcame the rest of the year's negative returns, to date. He reviewed the asset allocation by manager and versus target allocation. He discussed comparative performance versus the benchmarks and the value added by the managers.

Ms. Goerdel gave the Investment Department update. She updated the Board on the focus for 2011, including the Annual Investment Policy Review, the review of the commingled fund structure in the Securities Lending program, the upcoming asset-liability study, and other items of interest to the Board, such as acquisition of the risk management system.

*At this time, the Board took a short break from 11:00 a.m. to 11:10 a.m.*

**7. Consider and Act on Proposed 2011 Budget**

Ms. Covarrubias presented the updated operating budget document and reported that it contains only minor adjustments from the version presented to the Board at the October 27<sup>th</sup> Board meeting. She began her review by aligning the budget with the System's strategic plan and by highlighting 2010 accomplishments. She reviewed each goal in the strategic plan and highlighted portions of the budget that relate to each goal.

Ms. Covarrubias then reviewed the Executive Summary. She pointed out that the overall budget increase is 5.8%, but excluding new items the increase would be only about 1%. She reviewed the 5 major sections of the budget. Beginning with Personnel Services, she noted the inclusion of 2 new positions and a 2% merit increase for staff.

In Professional Services, she pointed out that consulting services includes a full year of ORG, the asset-liability study with R. V. Kuhns, an entity wide salary survey/review, and milestones for the FileNet upgrade. She pointed out the increases for actuarial services are due to the experience study, the asset-liability study and contingencies for legislative needs. Concerning legal fees, she discussed the need for assistance related to real estate investments.

Ms. Covarrubias reported that the Communication Section shows a decrease for various cost savings. The Rentals and Maintenance Section increased due to new software requests and the Miscellaneous Section also includes a slight decrease. Capital expenditures include funds for replacement of a service room UPS as well as minor construction. Mr. Gavia mentioned that the proposed expense for the network switch upgrade was removed from the 2011 budget.

Ms. Covarrubias indicated in the back of the budget document, the Board will find that Appendix A includes details concerning the two new requested positions; Appendix B provides information relating to IT consulting needs; and Appendix C is a comparison of 2009-2011 budgets, with an estimate for the remainder of 2010 and an explanation of differences. Also included are exhibits relating to merit increases, a 5-year Review of TMRS contribution rate for TMRS as an employer, and a justification for replacement of network switches.

Mr. Simpson commended staff on the volume and level of work done. However, with regard to merit increases, he wanted to be mindful of member cities' situations and as a result would recommend no change in salaries at this time for TMRS staff. Mr. Simpson did want to add the network switches back into the budget.

Mr. Willrich addressed a question from Mr. Gorzell regarding the justification for the network switches. Mr. Willrich pointed out the risks to be mitigated by the proposed switches and the safe guards they add. Ms. Oakley explained the reasons why she asked for more information on this item at the October Board meeting. Ms. Nixon requested that the salary survey that is going to be done include total compensation, not just salary. Mr. Gorzell followed up on the network switches. Mr. Willrich further discussed this proposal and explained what the ramifications could be if the switches are not replaced and a failure subsequently occurs. Ms. Oakley voiced her approval for adding the network switches back into the budget in order to level out capital costs over years.

Mr. Simpson moved that the Board approve the proposed 2011 operating budget without a 2% merit increase for staff, but with the requested network switch upgrade. This motion failed for lack of a second.

Ms. Hernandez moved that the Board approve the proposed 2011 operating budget as presented, and including the requested network switch upgrade. Ms. Nixon seconded the motion, which passed unanimously.

**8. Consider and Act on Resolution Transferring Monies from Interest Reserve Account to Expense Fund**

Mr. Simpson moved that \$12,856,000 be transferred from the Interest Reserve Account to the Expense Fund. This amount includes the addition of network switches that were added back into the budget. Ms. Hernandez seconded the motion, which passed unanimously.

**9. Discussion on Six Month Progress Report on Member Services Department's Benefit Payments Audit Report**

Mr. Allan presented his progress report based on the 2010 Benefit Payments audit. He mentioned that several of the recommendations have been completed. He highlighted items that were still outstanding and discussed progress made toward completion of these recommendations. These items are very complex and require more time to ensure proper compliance.

**10. Consider and Act on Adoption of 2011 Risk-Based Audit Plan**

Mr. Allan presented the 2011 Risk-Based Audit Plan, which was prepared in accordance with auditing standards. He suggested that the risk analysis be deferred to an every other year timetable and instead focus on an ISO-9000 type of approach to quality management. He proposed that this process be completed beginning in early 2011, and then follow that with an audit of contributions within the Member Services Department. Mr. Simpson asked what the time commitment for the quality management process would be.

Ms. Oakley moved that the Board adopt the 2011 Risk-Based Audit Plan as presented. Ms. Hernandez seconded the motion, which passed unanimously.

**11. Consider and Act on New Appointments and/or Reappointments to the Advisory Committee on Retirement Matters**

Mr. Gorzell indicated that this agenda item would be tabled to a later meeting in order to give the Board more time to review the applications.

**12. Consider and Act on Election of 2011 Board Officers**

Mr. Gorzell called this item and explained that a new Chair and Vice Chair is elected each December. Ms. Hernandez moved that April Nixon be elected Chair of the Board and that Frank Simpson be elected Vice Chair for 2011. Ms. Oakley seconded the motion, which passed unanimously.

**13. Executive Director and Staff Reports**

The Board did not have any questions or comments about the staff reports.

**14. Call for Future Agenda Items**

As there was no further business to come before the Board, Ms. Oakley moved that the meeting be adjourned. Ms. Hernandez seconded the motion, which passed unanimously. The meeting was adjourned at 12:15 p.m.



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David Gavia  
Executive Director



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April Nixon  
Chair, Board of Trustees